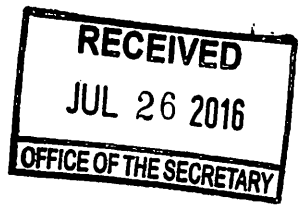
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



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

MEMORANDUM OF LAW IN SUPPORT OF RESPONDENTS' EXPEDITED PETITION TO THE COMMISSION FOR (A) AN ORDER EXTENDING THE 300-DAY RULE IN THIS PROCEEDING AND SETTING A DECEMBER 2016 HEARING DATE, (B) INTERLOCUTORY REVIEW OF HEARING OFFICER DETERMINATIONS, AND (C) AN ORDER APPLYING THE SEC'S AMENDED RULES OF PRACTICE TO THIS PROCEEDING

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July 25, 2016

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Respondents Lynn Tilton, Patriarch Partners, LLC, Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC, and Patriarch Partners XV, LLC (collectively, "Patriarch" or "Respondents"), respectfully petition directly to the Commission, pursuant to Rules 100(c), 161(a), 300 & 360(a) of the Commission's Rules of Practice, 17 C.F.R. § 201.100 *et seq.* (the "Rules"), for an order setting a December 2016 hearing date, as originally jointly requested by the parties but rejected by Administrative Law Judge Carol Foelak (the "ALJ"), and for an extension of the 300-day deadline in this proceeding of such length as the Commission deems appropriate for a December 2016 hearing schedule, in order to afford Respondents and their new counsel a full and fair opportunity to prepare their defense as a matter of due process. In the alternative, Respondents petition the Commission, pursuant to Rule 400, to grant interlocutory review of the ALJ's July 15, 2016 and July 20, 2016 Orders (the "Orders"), denying, *inter alia*, Respondents' request for a December 2016 hearing and for the ALJ to seek an extension of the 300-day deadline from the Commission to permit that hearing schedule.[1] Finally, Respondents request that the Commission direct the application of the newly-amended SEC Rules of Practice to these proceedings because doing so would "serve the interests of justice," pursuant to Rule 100(c). Respondents respectfully request these rulings from the Commission within one week, given the time exigencies and the parties' need to know the trial schedule and the rules governing discovery as a matter of fundamental fairness and due process.

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[1] Respondents moved for leave to seek interlocutory review after the ALJ initially ordered the parties to agree upon a September 2016 hearing date—which would have forced Respondents' new counsel to go to trial barely eight weeks after they had first noticed their appearance in this case earlier this month and lose the testimony of multiple key witnesses due to unavailability. The ALJ then unilaterally reset the hearing date for October 2016, but she otherwise denied the motion and threatened Respondents' new counsel, on the case for less than two weeks, with "sanctions" if they "fil[ed] further frivolous motions."

PRELIMINARY STATEMENT

Respondents petition the Commission for an order setting a December 2016 hearing date for this matter, as the parties originally jointly requested, and extending the 300-day deadline in this proceeding to accomodate that hearing schedule and thereby afford Respondents and their new counsel a full and fair opportunity to prepare a meaningful defense in this extraordinarily complex, high-stakes, and procedurally unusual matter, in which the undersigned took over as trial counsel only two weeks ago. Without an extension, the 300-day deadline will expire on November 12, 2016, excluding the 10-month stay imposed by the Second Circuit during the pendency of Respondents' challenge to the constitutionality of SEC ALJ appointments under the Appointments Clause. As a result, the ALJ apparently considered herself constrained to reject the parties' jointly-requested December 2016 hearing date—which itself will take a Herculean effort by Respondents and their new counsel to be ready for—and, instead, ordered the hearing to commence on October 24, 2016. Forcing Respondents and their new counsel to trial in October 2016—90 days from now—is fundamentally unfair, will substantially prejudice Respondents' ability to mount a meaningful defense, and violates Respondents' due process rights. For these and all of the other reasons explained here, it is surely the case that "additional time is necessary [and] appropriate in the public interest," Rule 360(a)(3), and denial of the parties' joint request for a December 2016 hearing date will "substantially prejudice" Respondents' case, Rule 161(b). The requested extension should therefore be granted and the hearing ordered to commence in December 2016.

The undersigned counsel entered their appearance in this proceeding barely two weeks ago and should be given "a reasonable opportunity to become familiar with the issues before the hearing starts." *In re Harrison Sec., Inc.*, Administrative Proceedings Release No. 611 (Oct. 7, 2003), at 4 (postponing hearing when new attorneys took over). Respondents are accused of

fraud, the Division seeks a penalty of over $200 million dollars, and the Division seeks a permanent bar from the industry—each a severe sanction that triggers due process protections and requires the assistance of well-prepared counsel to mount a vigorous defense. The requested extension would therefore be necessary, reasonable, and appropriate, even if the issues presented were relatively straightforward and the evidence was modest in scope. But this matter is far from straightforward and surely not modest in scope. The case involves millions of pages of documents, and new counsel understand that the prospective trial evidence includes nearly 1,000 trial exhibits, at least 24 proposed trial witnesses, and 11 expert reports totaling over 400 pages that cover an array of complex, technical issues. The ALJ has permitted the parties to revise and supplement their exhibit and witness lists following the lifting of the Second Circuit stay, but new counsel cannot do so before they complete the significant task of understanding the record and the universe of potential witnesses.[2]

Moreover, the SEC has thus far failed to produce significant information and documents material to the preparation of Respondents' defense. It has not yet produced *any* interview transcript or interview notes for six of its witnesses. And it has produced only largely illegible handwritten notes, and no interview transcripts, for three other witnesses; as a result, Respondents do not have critical, basic information, including the length of the interviews, any documents relied on by the witnesses, or even the questions asked that purportedly elicited the "answers" that appear in the notes. And the SEC's designated witness list includes three

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[2] The trial materials have been culled from an enormous investigative record produced to Respondents. And even that does not include over 2.5 million pages of documents produced by Respondents in response to Division requests and subpoenas. All of these materials relate to a range of extraordinarily complex financial issues, as well as a significant amount of complex accounting and financial reporting information for numerous entities that is critical to Respondents' defense.

unnamed "alternative representatives" from important institutional entities. These witnesses account for nearly half of the SEC's list of experts and witnesses to call.

New counsel have now identified these troubling omissions in discovery and need sufficient time to pursue their clients' rights and marshal additional witnesses and experts to respond to whatever points these witnesses seek to make. Respondents also intend to file a number of pre-trial motions that will need to be decided before the hearing, the resolution of which could materially limit the scope and nature of the evidence admissible at trial and the witnesses permitted to testify at trial. And they may now be denied the testimony of key participants—including several of Respondents' expert witnesses—due to availability issues in October 2016, which is not at all surprising, given that the Second Circuit's stay of these proceedings extended for nearly a year and was abruptly lifted earlier this month. Just as importantly, the parties jointly requested a December 2016 hearing date, in joint recognition that the interests of justice weigh strongly in favor of that date.

Accordingly, Respondents have made an overwhelmingly strong showing that additional time is "necessary or appropriate in the public interest" in this case, Rule 360(a)(3), not least because an October 2016 hearing will "substantially prejudice" Respondents' case, Rule 161(b). The Commission should therefore "issue an order extending the time period for filing the initial decision" in order to provide sufficient time to hold a hearing in December 2016 expected to last several weeks. Rule 360(a)(3); *see also* Rule 100(c) (extensions of time granted where they "serve the interests of justice and [do] not result in prejudice to the parties to the proceeding"). Respondents implore the Commission not to let fealty to the mechanical operation of the 300-day

deadline override the profound fundamental fairness and due process concerns raised by the circumstances presented here.[3]

The consequences to Respondents of any loss at trial are catastrophic and dwarf those of other recent SEC administrative proceedings, individually and cumulatively: the Division seeks disgorgement from Respondents in the amount of at least $208 million, nearly seven times more than the $32 million collected in disgorgement and penalties from all litigated administrative proceedings in fiscal year 2015. *See Office of Admin. Law Judges, U.S. Sec. Exch. Comm'n,* https://www.sec.gov/alj. The Division also seeks the severe sanction of a permanent bar from the industry. The dozens of distressed companies in which Respondents have invested, and their tens of thousands of employees, will also be severely impacted by these proceedings as well; indeed, no less than the welfare of these companies and their employees is at stake. By contrast, there is no exigency demanding the immediate trial of this case. Ms. Tilton is not a registered investment adviser, the Patriarch entities are no longer registered investment advisers, and no Patriarch entity serves as a collateral manager to any of the relevant funds, having resigned those positions in February 2016. As a result, there is no risk of any alleged ongoing or future harm to fund investors.

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[3] In reality, it will not "be possible [for the hearing officer] to issue the initial decision" before the Commission's 300-day deadline expires (*see* Rule 360), because the SEC's counsel expects the hearing to last at least three weeks—in other words, if the trial commences on the current hearing date it will conclude just one day before the 300-day deadline expires. *See* Decl. of Lisa H. Rubin, dated July 25, 2016 and filed herewith ("Rubin Decl."), Ex. 13 (July 18, 2016 SEC Letter to the ALJ). As a result, the ALJ will necessarily need to seek an extension of the deadline from this Commission at that point anyway. Respondents respectfully submit that the better course, and the only one that comports with fundamental fairness and due process, is to grant the extension now in order to permit a December 2016 hearing, as the parties originally jointly requested.

Only an extension of the 300-day deadline to accommodate a December 2016 hearing will provide Respondents and their new counsel the time necessary and sufficient to prepare a defense, and avoid the inherent and substantial unfairness imposed by the truncated schedule ordered here, as well as reversal and potential retrial on grounds that the current schedule violates Respondents' due process rights. Not surprisingly, the Commission frequently grants extension requests by the Chief ALJ where an ALJ is unable to issue a decision within the 300-day period required by Rule 360. It has done so based on the length and complexity of proceedings and where conflicts arose with other pending matters, *see, e.g.*, *In re Donald J. Anthony, Jr., et al.*, Investment Advisers Act Release No. 3890 (Aug. 7, 2014) & Investment Advisers Act Release No. 4007 (Jan. 26, 2015) (granting motion pursuant to Rule 360(a)(3) to extend the 300-day initial decision deadline by an additional 150 days due to complexity of case and excessive workload, and granting second extension of 30 days due to conflicts with other pending matters); to allow the ALJ additional time to review exhibits and conduct research, *see, e.g.*, *In re Lawrence M. Labine*, Exchange Act Release No. 74883 (May 6, 2015) & Investment Advisors Act Release No. 4318 (Jan. 19, 2016) (granting motion pursuant to Rule 360(a)(3) to extend the 300-day initial decision deadline an additional 300 days because the proceeding had been stayed for five months for settlement negotiations and was "start[ing] essentially anew"); "because of the size of th[e] particular record and the Office workload," *see, e.g.*, *In re John P. Flannery & James D. Hopkins*, Investment Advisers Act Release No. 3242 (July 18, 2011) at 1 (granting motion pursuant to Rule 360(a)(3) to extend the 300-day initial decision deadline by an additional 91 days); and even because the law clerk assigned to assist the ALJ in the preparation of the initial decision broke his elbow, *see, e.g.*, *In re Michael R. Pelosi*, Investment Advisers Act Release No. 3307 (Oct. 24, 2011) (granting motion, pursuant to Rule 360(a)(3) to extend the

300-day deadline for an initial decision by an additional 45 days). Surely, if those circumstances warranted extensions of the 300-day deadline, the circumstances presented here should compel one.

As an alternative to herself moving the trial date to December 2016, Respondents asked the ALJ to certify for interlocutory review her orders setting a hearing date prior to December and declining to seek an extension of the 300-day deadline from the Commission. She denied Respondents' application, finding it "patently fail[ed]" to meet the standards for certification for interlocutory review under Rule 400(c).[4] That rule permits a hearing officer to certify a ruling for interlocutory review where the ruling (i) "involves a controlling question of law as to which there is a substantial ground for difference of opinion; and (ii) an immediate review of the order may materially advance the completion of the proceeding." The ALJ's Orders satisfy both requirements. Whether the trial schedule that the ALJ ordered affords Respondents the due process rights to which they are entitled under the U.S. Constitution presents a "controlling question of law." And certifying for interlocutory review an order setting a trial date that denies Respondents adequate time to pursue and prepare their defense, and thereby deprives them of due process, would "materially advance the completion of the proceeding," because this deprivation of due process, if left to stand, would require reversal of any resulting decision and a rehearing of the case.

Respondents also sought interlocutory review on the ground that the circumstances outlined here qualify as "extraordinary" and, thus, that the orders declining to adopt the parties'

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[4] After the parties jointly submitted requests for a December 2016 hearing date, the ALJ ordered the hearing to begin in September 2016. On July 19, 2016, Respondents moved for reconsideration or certification for interlocutory appeal. On July 20, 2016, the ALJ ordered the hearing to begin on October 24, 2016, and denied Respondents' request for certification.

jointly-requested hearing date are "appropriate for interlocutory review," even if the Commission determines that they "do not involve issues that meet the standards of Rule 400(c)." *In re Gary L. McDuff*, Exchange Act Release No. 78066 (June 14, 2016), at 5.[5] The ALJ did not address this alternate basis for interlocutory review in her order. Accordingly, Respondents petition, in the alternative, for interlocutory review of the ALJ's orders declining to adopt a December hearing date.

Finally, Respondents petition the Commission, under Rule 100, to apply the new Rules of Practice to Respondents' case. Only a week ago and for the first time in decades, the Commission unanimously adopted numerous amendments to the rules governing its administrative proceedings, including amendments designed to permit reasonable pre-hearing schedules and provide much-needed discovery. While those amendments do not go far enough to rectify the inherent and fundamental unfairness of proceedings like this one, they at least add some meaningful protections for respondents such as our clients. Unfortunately, these new discovery and scheduling-related rules do not automatically apply to Respondents in this case—indeed, they seem to have been implemented at a time and in a manner that would deny our clients their benefit—and thus, Respondents request that the Commission specifically extend their application to these proceedings as a matter of fundamental fairness and due process. And

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[5] The ALJ also warned Respondents that "filing further frivolous motions may subject counsel to sanctions or limits on the number of permissible filings"—a surprising caution, given that Respondents' new counsel have filed only two, related motions thus far—both regarding the ALJ's refusal to enter the December 2016 hearing schedule jointly proposed by the parties as a matter of due process in order to afford Respondents a full and fair opportunity to prepare their defense. Indeed, it is particularly troubling that the ALJ would make such a sanctions threat against brand new counsel over potential future motion practice, given the intense debate that continues in the court over the constitutionality of these administrative proceedings and the chilling effect that such a threat could have on Respondents in the exercise of their due process rights in this proceeding going forward.

this should be no issue for the Division, which continues to seek discovery, having submitted several such subpoenas for the ALJ's endorsement since the stay was lifted in this proceeding.

For all of these reasons, Respondents respectfully request that the Commission: (a) extend the 300-day deadline in this proceeding and direct that the hearing be set for the parties' jointly-requested December 2016 hearing date; (b) in the alternative, grant interlocutory review of the hearing officer's denial of Respondents' request to reset the hearing for December 2016 and seek an extension of the 300-day deadline to permit a December 2016 hearing date; and (c) order that the just-amended Rules of Practice apply to these proceedings in their entirety. And Respondents further respectfully request that the Commission rule on this application within one week from today, given the time exigencies and due process concerns present here.

FACTUAL BACKGROUND

I. The Enforcement Division's Five-Year-Long Investigation Led To Administrative Proceedings That Imposed Extreme Time Pressure Upon Respondents.

The Enforcement Division investigated Respondents for more than five and a half years before these proceedings commenced. In December 2009, the Enforcement Division served a document request on Respondents seeking broad historical financial information. Respondents eventually received dozens more voluntary document requests and subpoenas from 2010 to 2014, seeking materials dating to 2000. On October 4, 2014, the Enforcement Division issued a Wells Notice, setting forth a theory of potential violations of the Investment Advisers Act. Respondents submitted a written response contesting the alleged, potential violations of the Investment Advisers Act, as well as a submission urging that any enforcement proceeding should take place in U.S. District Court, rather than before an administrative law judge where Respondents would be deprived of a full and fair opportunity to litigate their case.

On March 30, 2015, the Commission issued an Order Instituting Administrative Cease-and-Desist Proceedings ("OIP"), Investment Advisers Act Release No. 4053 (Mar. 30, 2015). In the OIP, the Commission ordered the ALJ to "issue an initial decision no later than 300 days from the date of service," consistent with Rule 360(a)(2) of the Commission's Rule of Practice. *See id.*; 17 C.F.R. § 201.360(a)(2). On April 6, 2015, the Chief ALJ assigned ALJ Carol Fox Foelak to preside over this proceeding. Administrative Proceedings Release No. 2494 (Apr. 6, 2015). On May 7, 2015, the ALJ issued a Prehearing Order providing for a hearing just five months later, on October 13, 2015. Administrative Proceedings Release No. 2647 (May 7, 2015).

Meanwhile, in the spring and summer of 2015, Respondents worked to plan a defense and engage in motion practice: They answered the OIP on April 22, and on the same day moved for a more definite statement of factual allegations against them. On June 5, Respondents moved to halt the Enforcement Division's search for a substitute case for trial, noting that the Division appeared to be undertaking an expanded investigation, beyond the scope of the OIP. On June 8, Respondents moved for summary disposition. The motion to halt the search for a substitute case was denied on the ground that even if the investigation expanded, "there is no new investigation." Administrative Proceedings Release No. 2892 (July 1, 2015). The motion for summary disposition remains *sub judice* at the time of filing.

On August 21, 2015, Respondents sought an adjournment of the hearing date, in light of their ongoing federal-court challenge to the constitutionality of the administrative hearing. The ALJ denied this motion as well. Administrative Proceedings Release No. 3090 (Sept. 1, 2015).

II. The U.S. Court of Appeals For The Second Circuit Stayed These Proceedings Between September 2015 And July 2016.

Two days after the Commission issued the OIP, Respondents brought a constitutional challenge to the administrative enforcement proceedings in the Southern District of New York. Complaint, *Tilton v. SEC*, No. 15-cv-2472 (RA), 2015 WL 4006165 (S.D.N.Y. Apr. 1, 2015). Respondents sought a ruling from the District Court on whether the appointment scheme for the ALJs who act as hearing officers violated the Appointments Clause of the Constitution, *see* U.S. Const., art. II, § 2, cl.2, and whether the limitations on the President's authority to remove ALJs violated separation of powers, *see id.* § 1. Along with the constitutional challenge, Respondents sought a permanent injunction to stay the SEC's then-pending administrative proceeding to avoid the substantial costs of defending against that proceeding. *Id.* at 21.

The Complaint filed in district court acknowledged that a stay would not affect the SEC's ability to enforce its regulations against Respondents, but sought to have the threshold constitutional question, which would determine the forum for enforcement, answered first. Respondents identified irreparable harms that would result absent a stay even if Respondents succeeded in federal court, such as the threat to Patriarch's businesses, employees, and investors who, if Respondents were unsuccessful in the administrative proceeding, would feel the brunt of any sanction even if the proceeding was later found unconstitutional. *Id.* at 21-22. Additionally, staying the administrative proceeding while the constitutionality of the forum was adjudicated would avoid the cost of defending against the SEC's case a second time if Respondents succeeded in their constitutional challenge and the SEC chose to retry the case in federal court. *Id.* at 21. None of these harms would be recoverable even if Respondents succeeded on the constitutional claim. *Id.* at 22.

On June 30, 2015, Judge Ronnie Abrams found that the District Court lacked subject matter jurisdiction over Respondents' constitutional claims, and denied the motion for a preliminary injunction. *Tilton v. SEC*, No. 15-cv-2472 (RA), 2015 WL 4006165 (S.D.N.Y. June 30, 2015). Respondents immediately appealed to the Second Circuit, and were granted their motion for an expedited briefing schedule eight days later, on July 9, 2015. A day after oral argument, the Second Circuit stayed the administrative enforcement proceedings. Order, *Tilton v. SEC*, No. 15-2103, 2016 WL 3084795 (2d Cir. Sept. 17, 2015). In response, the ALJ issued a notice informing the parties that the Second Circuit had stayed proceedings and that "the prehearing schedule and hearing are postponed *sine die*." *In re Tilton et al*, Administrative Proceedings Release No. 3146 (Sept. 17, 2015).

On June 1, 2016, a divided Second Circuit panel affirmed, holding that Congress implicitly precluded federal jurisdiction over Respondents' Appointments Clause claim during the pending Commission proceeding, and not reaching the merits of Respondents' claim. *Tilton v. SEC*, No. 15-2103, 2016 WL 3084795 (2d Cir. June 1, 2016). After further briefing, the Second Circuit clarified that its stay of the administrative proceedings would remain in place until July 6, 2016 to permit Respondents to file a motion seeking a stay from the United States Supreme Court, or until the Supreme Court or a Justice ruled on the stay motion. Order, *Tilton v. SEC*, No. 15-2103, 2016 WL 3084795 (2d Cir. June 28, 2016). Respondents declined to seek a stay from the Supreme Court and instead filed a petition for rehearing or rehearing *en banc*, which is now pending before the Second Circuit.

III. Although The Parties Jointly Requested A Hearing Date In December 2016 To Allow Sufficient Time For New Counsel To Prepare This Complex Case, The ALJ Ordered The Parties To Trial In October—90 Days From Now.

The administrative enforcement proceedings before the ALJ have now resumed. Respondents' new counsel entered notices of appearance on July 8 and immediately began to

make their way through the voluminous case record generated by a five-and-a-half-year-long investigation concerning documents going back approximately 15 years, including millions of pages of documents produced in response to Enforcement Division requests and subpoenas; materials relating to 24 designated trial witnesses; and 11 expert reports exchanged thus far, totaling 425 pages, filed by 8 experts. Respondents' counsel is also engaging in ongoing discovery, including preparing subpoenas and responding to the Enforcement Division's filing of requests for subpoenas as recently as last week, and has now identified critical discovery materials not produced by the Division. New counsel have now begun to pursue Respondents' rights with respect to these deficiencies and it is evaluating potential additional witnesses and documents it may seek to introduce at trial.

On the very same day Respondents' new counsel entered notices of appearance in this proceeding, Respondents alerted the ALJ that they were working with the Enforcement Division toward a consensual proposal for a hearing date. In light of various conflicts on both sides, on July 11, the Enforcement Division wrote to the ALJ to request a December 2016 hearing date with Respondents' consent; and on July 13, Respondents wrote again to the ALJ to confirm and repeat the request for a December 2016 hearing date, pursuant to the agreement of the parties. But on July 15, the ALJ rejected the parties' joint proposal and instead ordered that the parties proceed to a hearing starting in September, seven weeks from the date of the order. *See* Administrative Proceedings Release No. 3990 (July 15, 2015) ("July 15 Order"). She stated that "a December 2016 hearing date is inconsistent with a timely resolution of this proceeding consistent with 17 C.F.R. § 201.360," *i.e.*, the 300-day rule. *Id.* at 2. While the hearing officer noted that "[r]ecently, counsel who previously represented Respondents withdrew, and new

counsel appeared for Respondents," she stated that "such a change cannot be allowed to delay the proceeding." *Id.* at n.3.

Respondents immediately moved for reconsideration or, in the alternative, for interlocutory review of the July 15 Order, in view of the significant prejudice to Respondents that would result from an early trial date, and the due process concerns such a rush to judgment would raise. At the same time, cognizant that the hearing officer had suggested she was constrained from moving the hearing date to December because doing so would be "inconsistent with a timely resolution of this proceeding consistent with" the 300-day rule, *see* July 15 Order, at 2, Respondents moved the hearing officer to request that the Chief Administrative Law Judge seek a moderate extension of the 300-day deadline.

The ALJ then reset the hearing to commence October 24, 2016. Administrative Proceedings Release No. 4004 (July 20, 2016) at 1 ("July 20 Order"). The ALJ gave the parties until August 15 to file amended witness and exhibit lists, and set various prehearing filing deadlines. *Id.* The ALJ indicated that she did not believe the factors cited by the parties in favor of the December 2016 hearing date—including the complexity of the case, the time pressure upon return from the Second Circuit's stay, and the appearance of new counsel—overcame the constraints of the 300-day rule. *Id.* at 1-2 ("Delaying the hearing until December 2016 as the parties request, is inconsistent with 17 C.F.R. §§ 201.161, .360.").

IV. The Commission Recently Approved Significant Amendments To Its Rules Of Practice, Most Of Which Will Not Automatically Apply To This Proceeding.

While Respondents' case was stayed, the rules of the game changed. On September 24, 2015, the SEC proposed a series of significant amendments to its Rules of Practice in administrative enforcement proceedings. On July 13, 2016, just days after the stay was lifted, the SEC unanimously adopted those amendments. *See* 17 C.F.R. pt. 201. While the

amendments do not go far enough to rectify the fundamental unfairness of proceedings like this one, they at least add some meaningful protective procedures for respondents. But because of the timing of the Commission's approval of the amendments, most, if not all, of the amended rules will not automatically apply in this proceeding.

LEGAL STANDARDS

Rule 100(c) authorizes the Commission, "upon its determination that to do so would serve the interests of justice and not result in prejudice to the parties to the proceeding, . . . [to] direct, in a particular proceeding, that an alternative procedure shall apply or that compliance with an otherwise applicable rule is unnecessary." Exercise of that authority is guided by Rule 300, which requires that all hearings "shall be conducted in a fair, impartial, expeditious and orderly manner." Rule 300.

While the Rules impose certain deadlines, the Commission is empowered to alter those deadlines where necessary to provide the parties with a full and fair opportunity to develop their case for hearing. For example, under Rule 360, a hearing officer must issue the initial decision within the time period set by the Commission in its order instituting proceedings—here, 300 days. However, either on "motion to the Commission" by the Chief Administrative Law Judge, Rule 360(a)(3), or on its "own motion," *In re John Thomas Capital Mgmt. Grp. LLC d/b/a Patriot28 LLC, et al.*, Investment Advisers Act Release No. 3749 (Dec. 30, 2013) (citing Rules 100(c), 161(a), and 360(a)(2)), if the Commission "determines that additional time is necessary or appropriate in the public interest, the Commission shall issue an order extending the time period for filing the initial decision," Rule 360(a)(3).

Similarly, pursuant to Rule 161(a), "the Commission, at any time, or the hearing officer, at any time prior to the filing of his or her initial decision . . . may, for good cause shown, extend or shorten any time limits prescribed by these Rules of Practice for the filing of any papers and

may, consistent with paragraphs (b) and (c) of this section, postpone or adjourn any hearing." Under Rule 161(b), while adjournments are generally disfavored, the Commission or the hearing officer should grant a request for an adjournment where the requesting party "makes a strong showing that the denial of the request or motion would *substantially prejudice their case*" (emphasis added). In making this determination, the Commission or the hearing officer "shall consider" all "relevant factors." *Id.*[6]

Finally, pursuant to Rule 400(a), the Commission may "at any time" review "any matter . . . submitted to it for review," either on its own initiative or at the request of a party. A hearing officer may certify its rulings for interlocutory review by the Commission if, "upon application by a party, within five days of the hearing officer's ruling, the hearing officer is of the opinion that: (i) [t]he ruling involves a controlling question of law as to which there is substantial ground for difference of opinion; and (ii) [a]n immediate review of the order may materially advance the completion of the proceeding." Rule 400(c). It is true that "issues that do not satisfy Rule 400(c) will almost never be appropriate for interlocutory consideration by the Commission," as the "Rule 400(c) inquiry is intended to identify the rare set of issues that are appropriate for interlocutory review." *McDuff*, Release No. 78066, at 9-10. However, even where an application for interlocutory review does not satisfy the Rule 400(c) inquiry, the Commission may grant interlocutory review in "extraordinary" circumstances, Rule 400(a), including where

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6 Relevant factors include, but are not limited to, "(i) [t]he length of the proceeding to date; (ii) [t]he number of postponements, adjournments or extensions already granted; (iii) [t]he stage of the proceedings at the time of the request; (iv) [t]he impact of the request on the hearing officer's ability to complete the proceeding in the time specified by the Commission; and (v) [a]ny other such matters as justice may require." Rule 161(b)(1). Rule 161(c), which concerns postponements and extensions of the time for filing papers and stays pending Commission consideration of offers of settlement, is not relevant here.

the hearing officer's refusal to postpone a hearing date will make it difficult for counsel to adequately represent the respondents. *See McDuff*, Release No. 78066, at 5, 10 n.49 (citing *Philip L. Pascale, CPA*, Admin. Proc. File No. 3-11194 (Nov. 24, 2003) (finding "extraordinary circumstances which justify Commission review," notwithstanding the denial of certification, in light of the law judge's refusal to postpone the hearing due to respondent counsel's necessary post-operative medical treatment)).

ARGUMENT

I. In The Interests Of Justice And The Public Interest, And To Prevent Substantial Prejudice To Respondents, The Commission Should Extend The 300-Day Deadline And Endorse The Parties' Joint Proposal Of A December 2016 Hearing Date.

The 300-day deadline in this matter will expire on November 12, 2016, excluding the period of the Second Circuit's stay. It will "not be possible [for the hearing officer] to issue the initial decision" before this deadline expires (*see* Rule 360) while at the same time fulfilling her "obligation to ensure that [these] administrative proceedings are conducted fairly in furtherance of the search for the truth and a just determination of the outcome." *In re Clarke T. Blizzard*, Investment Advisers Act Release No. 2032 (Apr. 24, 2002), at 2. Indeed, it appears impossible for the hearing officer to issue the initial decision before the deadline expires even under the current schedule.

Respondents understand that requests to extend Rule 360's 300-day deadline are not usually made until completion of the hearing and submission of the matter for decision, and that such requests are usually made by hearing officers at their own initiative. But in light of the extraordinary circumstances of this case, the instant request, and an extension of the 300-day deadline, is warranted. In addition, because the hearing officer does not have the authority to grant this relief herself, it is appropriate for the Commission to hear this application directly under Rules 100(c), 161(b), and 360(a). *See In re John Thomas Capital Mgmt. Grp. LLC d/b/a*

Patriot28 LLC, et al., Investment Advisers Act Release No. 3749 (citing Rules 100(c), 161(a), and 360(a) in granting extension of the 300-day deadline on the Commission's "own motion"); *In re Michael Sassano, et al.*, Investment Advisers Act Release No. 2679 (Nov. 30, 2007), at 4-5 (denying interlocutory review of a discovery order but granting Division's request, made directly to the Commission by simultaneous filing, for a 120-day tolling of the 300-day deadline, pursuant to its Rule 100(c) powers).[7]

For the reasons explained herein, additional time beyond the standard 300 days is "necessary or appropriate in the public interest" in this case, and the Commission should therefore "issue an order extending the time period for filing the initial decision" by a sufficient period of time to hold a hearing in December 2016 and render an initial decision in due course thereafter. Rule 360(a)(3). Such an extension will "serve the interests of justice and not result in prejudice to the parties to the proceeding," Rule 100(c), and, taking into account all "relevant factors," the denial of the parties' joint request for a December hearing date will "substantially prejudice" Respondents' case, Rule 161(b).

A. The Truncated Schedule Denies Respondents The Opportunity To Fully And Fairly Litigate Their Defense And Violates Their Due Process Rights.

As a matter of fundamental fairness and due process, Respondents cannot possibly receive a fair hearing if forced, in order to accommodate the deadlines in Rule 360, to proceed to trial in 90 days against the government, in an enforcement proceeding the government has been

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[7] Alternatively, the Commission can treat this as a request for interlocutory review of the hearing officer's decisions not to set the hearing for December, and not to seek an extension of the 300-day deadline. For the reasons explained in Section II—including staving off a due process violation, preserving the fundamental fairness of the proceedings, and the extraordinary circumstances of this case—interlocutory review of these decisions is warranted, should the Commission decline to hear Respondents' direct application.

investigating and preparing for years, with new counsel who were retained very recently. *See infra* pp. 20-26. And it would violate Respondents' right to the counsel of its choice by effectively punishing Respondents for changing counsel recently. *See infra* pp. 22-23.

The Commission has made clear that hearing officers have "an obligation to ensure that [their] administrative proceedings are conducted fairly in furtherance of the search for the truth and a just determination of the outcome." *In re Clarke T. Blizzard*, Investment Advisers Act Release No. 2032, at 2. Indeed, the Commission has acknowledged the overwhelming authority holding that "a fair trial in a fair tribunal is a basic requirement of due process that applies in the context of administrative proceedings." *Id.* at 2 n.9 (citing *In re Murchison*, 349 U.S. 133, 136 (1955); *N.Y. State Dairy Foods, Inc. v. Ne. Dairy Compact Comm'n*, 198 F.3d 1, 13 (1st Cir. 1999); and *Utica Packing Co. v. Block*, 781 F.2d 71, 77 (6th Cir. 1986)). One fundamental aspect of a fair trial is the right to be represented by counsel who have been given an adequate opportunity to prepare for trial. *See infra* pp. 24-25. Although Respondents are charged civilly, not criminally, they are being accused of committing fraud, the Division seeks a penalty of over $200 million dollars, and they may be barred permanently from securities work—each a severe sanction that triggers due process protections. It is fundamentally unfair that, under all of these circumstances, Respondents are being forced to commence trial of this exceedingly complex case in 90 days.

That concern is heightened by the choice of forum here: an SEC proceeding before an ALJ is not an Article III court; it is an arm of the very government entity prosecuting this case, beholden to procedural rules adopted by the prosecuting entity. Notably, the very legitimacy and fairness of the forum remain the subject of intense scrutiny in the courts and elsewhere, and application of inflexible procedural rules, as applied in the rulings challenged here, exacerbate

the perception and concern that these SEC administrative proceedings are fundamentally unfair and deny respondents due process. It is therefore imperative that this tribunal be particularly sensitive to such perceptions and concerns, as the Commission has instructed. *See In re Clarke T. Blizzard*, Investment Advisors Act Release No. 2032, at 2 ("Even the appearance of a lack of integrity could undermine the public confidence in the administrative process upon which our authority ultimately depends.").

The Commission has recently implicitly acknowledged that, for too long, SEC administrative proceedings against respondents such as Ms. Tilton and Patriarch have lacked the requisite hallmarks of due process. *See Mary Jo White Explains the New SEC Rules*, Wall St. J., Nov. 24, 2015, http://www.wsj.com/articles/mary-jo-white-explains-the-new-sec-rules-1448302777. Indeed, the hearing officer overseeing these proceedings has singled out the "truncated timelines" under the Rules as one of the "systemic causes" of unfairness for all respondents in SEC administrative proceedings. *See Office of the Inspector Gen.*, U.S. Sec. and Exch. Comm'n, Report of Investigation, Case # 15-ALJ-0482-I, at 20 (2016) (citing Sept. 14, 2015 interview with ALJ Foelak).

In light of these overarching concerns, an extension of the 300-day deadline is unquestionably justified.

B. Given The Voluminous Record And The Complexity Of The Issues Presented By The Government's Case, New Counsel Cannot Adequately Prepare For Trial In 90 Days.

Respondents have engaged new trial counsel appearing for the first time in this matter just over two weeks ago, after the Second Circuit's recent decision in the case. New counsel understandably need more time to prepare for trial than the 90 days afforded in the Order. Indeed, Respondents and their counsel will need to—and are more than willing to—engage in Herculean efforts even to be ready for a December hearing date. The ALJ has, appropriately,

permitted the parties to revise and supplement their exhibit and witness lists following the lifting of the Second Circuit stay, but those filing are due on August 15, and new counsel cannot do so before they complete the significant task of understanding the record and the universe of potential witnesses, and before the parties complete ongoing discovery.

In refusing the jointly-proposed schedule, the hearing officer stated that a new law firm's appearance as new counsel "cannot be allowed to delay the proceeding," July 15 Order at 2 n.3, and that "Respondents' hiring new counsel" is "not an adequate basis for substantial delay," July 20 Order at 2. This is inconsistent with Commission precedent. *See, e.g.*, *In re Stanley Jonathan Fortenberry*, Administrative Proceedings Release No. 1800 (Sept. 12, 2014), at 2-3 (granting continuance where trial counsel withdrew three weeks before the hearing); *In re Harrison Sec., Inc.*, Administrative Proceedings Release No. 611, at 4 (granting request to postpone hearing pursuant to Rule 161(b) because new attorneys should be given "a reasonable opportunity to become familiar with the issues before the hearing starts"); *cf. In re Clarke T. Blizzard*, Investment Advisors Act Release No. 2032, at 3 (disqualifying counsel and requiring appointment of new counsel, even though this decision "will necessitate further delay" as "new counsel prepares for [the] representation," because "[the Commission] must maintain the integrity of the proceedings [it is] empowered to conduct").[8] It is also inconsistent with common

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[8] *See also In re David J. Checkosky, et al*, Administrative Proceedings Release No. 296 (Apr. 1, 1988) (granting motion for postponement because "recently appointed lead counsel" had "not had the opportunity to familiarize herself with the matters involved in the hearing of this case and the prehearing matters to be performed," and had also undergone emergency surgery); *cf. United States v. Felipe*, No. 94 Cr. 395(LMM), 1996 WL 18985, at *1 (S.D.N.Y. Jan. 18, 1996) (ordering adjournment of trial for six months because the "nature and extent of the charges," the "amount of discovery in the case," and the fact that "new counsel would have only minimal time to prepare for trial . . . . fully warrant an adjournment of the trial date").

practice in federal court. *See, e.g.*, *United States v. Davenport*, 935 F.2 1223, 1235 (11th Cir. 1991) (granting unopposed motion for continuance so "recently retained counsel could prepare adequately for [defendant's] defense"); *Akmal v. Global Scholar*, No. C14-1859 (JLR), 2015 WL 1537573, at *2 (W.D. Wash. Apr. 6, 2015) (finding "that allowing Ms. Akmal's recently retailed counsel further time to review her case constitutes good cause" for extension). Indeed, the Commission has made clear that it is an abuse of discretion to deny a continuance where doing so leaves a respondent "without assistance of counsel at or near the hearing date." *In re Gregory M. Dearlove*, Exchange Act Release No. 57244 (Jan. 31, 2008), at 54.

It is well-established that a "party summoned to appear before a federal agency has a right to be assisted by counsel." *In re Morgan Asset Mgmt., Inc.*, Administrative Proceedings Release No. 657 (July 19, 2010); *see also* 5 U.S.C. § 555(b) ("A person compelled to appear in person before an agency or representative thereof is entitled to be accompanied, represented, and advised by counsel or, if permitted by the agency, by other qualified representative."). The Administrative Procedure Act not only guarantees the right to counsel, but also the right to counsel of one's choice. *In re Morgan Asset Mgmt., Inc.*, Administrative Proceedings Release No. 657, at 2; *see also SEC v. Csapo* , 533 F.2d 7, 10-11 (D.C. Cir. 1976); *SEC v. Higashi*, 359 F.2d 550 , 553 (9th Cir. 1966). This right encompasses the right for counsel of one's choice to be afforded an adequate opportunity to prepare. *Cf. Riggio v. Sec'y, Dep't of Corr.* , 704 F. Supp. 2d 1244, 1252-53 (M.D. Fla. 2010) ("Due to the trial court's erroneous denial of a continuance, Petitioner was denied his right to counsel of his choice."). This is especially important here, where Respondents are accused of fraud, the Division seeks a penalty of over $200 million dollars, and the Division seeks a permanent bar from the industry—each a severe

sanction that triggers due process protections and requires the assistance of well-prepared counsel to mount a vigorous defense.

The jointly-requested December hearing date would therefore be necessary, reasonable, and appropriate even if the issues presented were relatively straightforward, the evidence was modest in scope, and the government was fulfilling its disclosure and production obligations. But that is not the case at all. As noted above, the prospective trial evidence numbers in the millions of pages, including over 400 pages of expert reports, and there are 24 witnesses already designated for trial—and in addition, both sides may seek to add additional witnesses. *See supra* p. 13; *infra* pp. 26-27. All of these materials relate to a range of extraordinarily complex financial vehicles and products, including collateralized loan obligations ("CLOs"),[9] as well as a significant amount of complex accounting and financial reporting information for numerous entities that is critical to Respondents' defense to address.[10]

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[9] Merely explaining how a CLO is structured spans almost 5 pages in one of the SEC's expert's reports, and over 7 pages in one of Respondents' expert's reports. Indeed, in 2010, recognizing the complexity of these types of products, the Division created the "Structured and New Products Unit"—now known as the Complex Financial Instruments Unit—specifically to "focus on complex derivatives and financial products, including credit default swaps, collateralized debt obligations, and securitized products." SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence, Jan. 13, 2010, available at https://www.sec.gov/news/press/2010/2010-5.htm.

[10] The topics at issue include: the structure and operation of the Zohar CLOs, including their categorization of loans; the authority invested in the collateral manager and others under the pertinent transaction documents; GAAP compliance of the impairment analyses in the Zohar funds' financial statements; the proper calculation of the Zohar funds' monthly overcollateralization ratio tests; the disclosure of the Zohar Funds' strategies to investors and the availability of information sufficient to enable investors to monitor the performance of the loans held by the Zohar funds and their own investments; and the amounts paid to certain Respondents in subordinated collateral management fees and preference share distributions.

Respondents also intend to file pre-trial motions that will need to be prepared and resolved before the hearing, the disposition of which will materially alter the scope of relevant and admissible testimony and other evidence, the witnesses that will need to be called, and other important issues relating to trial preparation. Those submissions include but are not necessarily limited to the following:

- Motions for additional discovery concerning certain of the Division's witnesses about whom the Division has produced incomplete information, including regarding interviews taken, *see infra* pp. 27-29;
- Motions for additional discovery based on application of the SEC's new rules of practice;
- Motions to add certain experts as trial witnesses;
- Motions in limine challenging the manner of presentation of expert testimony, due on September 12 under the ALJ's July 20 Order;
- Motions in limine relating to the evidence to be adduced at trial, including expert testimony, due on September 12 under the ALJ's July 20 Order;
- Motions to dismiss, based on the arguments raised in the appellate proceedings and other indicia of the unconstitutionality and illegality of these SEC administrative proceedings; and
- Other motions necessary to preserve Respondents' rights, including in any appeal, and demonstrate the inherent absence of due process for Respondents.

While Respondents appreciate the hearing officer's view that Respondents' intent to file prehearing motions is "not an adequate basis" for extending the proceedings beyond 300 days because, according to the hearing officer, it should be sufficient for Respondents to "simply note such objections for the record," July 20 Order, Respondents' counsel respectfully submits that as responsible, ethical counsel, it will have to file motions as it deems necessary to assert and

protect Respondents' rights, including to preserve issues for appeal and exhaust administrative remedies with sufficient robustness to satisfy the Commission and the federal courts.[11]

In light of these complexities and challenges, an October 2016 hearing date is premature, infeasible, and unfair. Respondents' new counsel have an ethical obligation to familiarize themselves with this voluminous record, as well as relevant law, before trial, in carrying out their duties to advise and zealously represent their clients in these proceedings. *Cf. Burt v. Titlow*, 134 S. Ct. 10, 19, 571 U.S. ___ (2013) (Sotomayor, J., concurring) ("counsel must 'make an independent examination of the facts, circumstances, pleadings and laws involved and then' . . . provide[] the client with competent and fully informed advice, including an analysis of the risks that the client would face in proceeding to trial") (quoting *Von Moltke v. Gillies*, 332 U.S. 708, 721 (1948) (plurality op.)). And where the right to counsel exists, it "must be construed to mean counsel of one's choice." *Higashi,* 359 F.2d at 553 (describing the right to counsel of one's choice in SEC proceedings).

New counsel simply will not be able to adequately familiarize themselves with the extensive record and the relevant factual, expert, and legal issues, refine a trial strategy, pursue documents and information the Division has failed to produce, determine and designate which witnesses should be called at trial and which documents should be used out of the voluminous record, prepare pre-trial motions and briefs, prepare witnesses for trial, and prepare for cross-

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[11] Respondents' counsel is surprised and troubled by the hearing officer's admonition in the July 20 Order that "filing further frivolous motions may subject counsel to sanctions." That warning comes only approximately two weeks after Respondents' new counsel have entered their appearance, in response to our related applications to set this case for trial in December 2016 pursuant to the parties' joint proposal. In the face of our ethical obligation to zealously advocate for our clients, we face potential sanctions for filing future motions. While surely not the hearing officer's intent, that instruction could chill the exercise of our client's due process rights.

examinations, in 90 days. It denies Respondents a fundamentally fair process to set a schedule that makes it nearly impossible for counsel to prepare adequately.

That, as the trial court noted, this case involves a single individual respondent and four entities charged with violations of various sections of the Advisers Act, July 20 Order at 1, has no bearing on the complexity of the case or the volume of hearing or investigative materials, which are objectively enormous. The Enforcement Division investigated for more than five and a half years, and sought information going back approximately 15 years, before bringing this case. Parties produced millions of pages of documents in response to Enforcement Division requests and subpoenas, and nearly seven years after the investigation began, the Enforcement Division is *still requesting subpoenas* as of last week. The ALJ has permitted the parties to revise and supplement their exhibit and witness lists, but new counsel cannot do so before they understand the record and the universe of potential witnesses, before the Division produces additional information and documents, and before the parties complete ongoing discovery.

Moreover, an extension of the 300-day deadline imposed by Rule 360 is inevitable. The 300-day deadline expires in November 2016 (not counting the period of the Second Circuit stay). Because the Chief Administrative Law Judge must make an application to this Commission at least 30 days before the deadline, the hearing officer must necessarily seek an extension before the hearing commences. While the hearing officer's concern that retention of new counsel not "delay the proceeding," July 15 Order, is valid (and indeed shared by Respondents), an extension of the Rule 360 deadline will inevitably be sought. When compared to the unavoidable consequence of delay in seeking an extension—that Respondents will be denied a meaningful opportunity to be heard—the concern over timeliness is patently insufficient.

Respondents implore the Commission not to let fealty to the mechanical operation of the 300-day deadline override the profound fundamental fairness concerns raised by the circumstances presented here. This case is an enforcement action initiated by the government involving serious allegations; due process considerations cannot be summarily dismissed over the singular concern of delay, particularly where that delay is not the result of neglect or gamesmanship by Respondents, but instead the result of a federal appellate court proceeding involving the constitutionality of the appointment of the very administrative officer that will be hearing the case. Indeed, even lead counsel for the Division of Enforcement expressed surprise at the hearing officer's denial of the parties' proposed joint schedule on consent and described it as unusual.

C. Discovery Is Ongoing, In Part Because Of The Division's Failure To Produce Critical Information And Documents, And Key Witnesses Will Be Unavailable To Adequately Prepare For And Appear At An October 2016 Hearing.

Discovery is ongoing, in significant part because the SEC has failed to produce important information and documents material to the preparation of Respondents' defense. An October 2016 hearing date will short-circuit the discovery process, and Respondents will likely be deprived of, or will not have adequate time to take cognizance of, critical materials necessary for the preparation of their defense. *First*, the SEC has not yet produced *any* interview transcript or interview notes for six of its witnesses: Michael Craig-Schekman, Jeremy Hedberg, Matt Mach, John McDermott, Kevin O'Hagen, and David Aniloff. Rubin Decl. ¶ 7. *Second*, for three other witnesses (Ramki Muthukrishnan, Tim Walsh, and Steve Panagos), the SEC has produced only handwritten notes, and no interview transcript. Rubin Decl. ¶ 8. As a result, the notes on those witnesses lack basic information—the length of the interview, any documents relied on by the witness, or even the questions asked. Even apart from those basic deficiencies, the handwritten

notes are often illegible and include only disconnected phrases with no context, so it is impossible to know who participated in which interview. Respondents are entirely in the dark on what questions the SEC posed to these individuals or how it elicited the "answers" that appear to be in the notes—or even, at times, who is answering. *Third*, the SEC's designated witness list includes three *unnamed* "alternative representatives" from Rabobank, Standard and Poor's and Norddeutsche Landesbank Girozentrale ("Nord"). Based on the SEC's designation of these individuals, they could be called in addition to the named witnesses—but Respondents cannot prepare for these witnesses without knowing who they are. In total, the witnesses discussed in this paragraph concern nearly *half* of the SEC's designated experts and witnesses for trial. *Fourth*, the Division continues to seek discovery, having recently submitted several subpoenas for the ALJ's endorsement since the stay was lifted in this proceeding. These eleventh-hour, third-party subpoena requests to MBIA and the Zohar Funds—which, by dint of having a new collateral manager since Patriarch's March 2016 resignation, are now effectively third parties—suggest that the Division is actively seeking to supplement or modify its theory of the case, and that it is again speaking with witnesses. Respondents have, however, received no interview notes or supplemental statements. If such materials exist—and Respondents believe they do—Respondents deserve to receive them, and to have an adequate opportunity to digest them, in order to fairly and fully prepare for trial. Respondents, for their part, may seek permission to serve their own subpoenas, including subpoenas to compel the production of any additional potentially exculpatory materials, and will need time to pursue them.

Compounding all of the foregoing defects of the adversarial process, Respondents had no way to pursue enforcement of outstanding subpoenas during the ten months when this proceeding was stayed. Accordingly, procedural protections (albeit scant) that should mitigate

the opaqueness demonstrated by the SEC here have not been made fully available to Respondents. New counsel have now identified these troubling omissions in discovery and need sufficient time to pursue their rights and to marshal additional witnesses and experts to respond to whatever points these witnesses seek to make. For all of these reasons, Respondents will be severely prejudiced, and will be denied a fair hearing, if they are forced to proceed in October.

Separate and apart from Respondents' counsel's inability to adequately prepare for trial with discovery ongoing, Respondents will be substantially prejudiced by an October 2016 hearing date because a number of Respondents' witnesses, including expert witnesses, are unavailable to prepare for and appear at an October 2016 hearing, or have significant conflicts during this period. *See* Rubin Decl. ¶¶ 2-6. These scheduling conflicts—which were among the reasons the parties requested a December 2016 hearing date—are quintessentially sufficient "good cause" to justify the postponement of a hearing. *See, e.g., In the Matter of David J. Checkosky, et al.*, Administrative Proceedings Release No. 296 ("Under the circumstances, including the fact that one of the OCA's expert witnesses will be unavailable during the week of June 6, and another during the week of June 20, I am satisfied that good cause has been shown for the granting of the motion for the period requested.").

The witness scheduling conflicts include three of Respondents' five experts and other important witnesses:

- Respondents' expert Glenn Hubbard, Dean of the Graduate School of Business at Columbia University, an adviser to the President of the Federal Reserve Bank of New York, and a former Chair of the President's Council of Economic Advisers, has limited availability throughout the months of October and November 2016, including because he has expert reports due on October 3 and 11, is traveling October 4-5 and October 17, has board meetings on October 24 and 25, academic commitments October 31-November 3, and has board and academic commitments the week of November 7, *see* Rubin Decl. ¶ 2;

- Respondents' expert J. Richard Dietrich, Professor of Accounting and Chair of the Department of Accounting and Management Information Systems at the Fisher College of Business at The Ohio State University, and a former Academic Fellow at the Office of the Chief Accountant at the SEC, is unavailable on October 24, 26, 28, and 31, and November 2, 4, 7, 9, 11, and 14 due to his teaching schedule at Ohio State, and he is unavailable November 1 due to an academic obligation, *see* Rubin Decl. ¶ 3;

- Respondents' expert Marti Murray, is unavailable throughout October and November 2016, including because she has to draft two expert reports that are due on October 28 and November 21, has to prepare for and attend expected depositions on October 31 and the last week in November, and has to prepare for and attend a trial in Cayuga County, Ohio at which she will be a testifying expert between November 7 and November 11, *see* Rubin Decl. ¶ 4;

- Respondents' witness Carl Schopfer, the Chief Operating Officer of MD Helicopters—one of the companies controlled and managed by Ms. Tilton, who is its CEO, and to which the Zohar Funds are lenders—has work-related conflicts from October 14-18 and a vacation planned for October 21 through November 7, *see* Rubin Decl. ¶ 5; and

- Respondents' witness Scott Whalen, the Director of Portfolio Management for Patriarch Partners, LLC, is scheduled to be on vacation the last week in October and at a professional conference on November 9, *see* Rubin Decl. ¶ 6.

Given that the Second Circuit's stay extended for nearly ten months and was lifted abruptly only weeks ago, it is no surprise that Respondents' experts, in particular, might have new and different commitments. Indeed, that certain of Respondents' experts are largely unavailable until mid-November is among the reasons Respondents sought a December 2016 date in the first place. Although the hearing officer dismissed Respondents' concerns regarding the availability of witnesses because the parties can issue trial subpoenas to compel attendance, and because expert witnesses will be permitted to appear by video conference if necessary, those mechanisms are not sufficient to protect Respondents' rights here, because the witnesses discussed above will not have the opportunity to adequately prepare for their testimony, even if their appearance could be arranged or compelled.

D. The Parties Jointly Requested A December 2016 Hearing Date, In Joint Recognition That The Interests Of Justice Weigh Strongly In Favor Of That Date.

The parties jointly requested a December 2016 hearing date, in shared recognition of the compelling nature of the circumstances described above and the fact that the interests of "justice" weigh strongly in favor of that date. *See* Rule 161(b)(1)(v); *In re Harrison Sec., Inc.*, Administrative Proceedings Release No. 611, at 2 (noting multiple extensions of time granted to Respondents where the Division did not oppose the requests). As discussed above, there are compelling reasons why an October hearing date will present significant obstacles to adequately preparing for trial in this complex matter and presenting their case. Moreover, the other factors set out in Rule 161(b)(1) overwhelmingly weigh in favor of postponement, and in the limited instances where they arguably cut the other way, they do not come close to overriding the substantial prejudice to Respondents if the October hearing date is not put off.

In particular: (i) the proceedings to date have not been unduly "length[y]"—to the contrary, except for the period in which the action was stayed by the Second Circuit, the proceedings moved at a brisk pace; (ii) Respondents have sought only one previous postponement, adjournment, or extension—a request to adjourn the trial in light of Respondents' appeal to the Second Circuit and to allow Respondents to investigate four witnesses added by the Division about which there was no existing evidence—which request was not granted; (iii) the "stage of the proceedings at the time of the request" weighs in favor of a postponement, as Respondents' motion for summary disposition is *sub judice* and the request for a December hearing date was made immediately after the Second Circuit lifted its stay of the proceedings; (iv) while the postponement to December will impact the hearing officer's ability to complete the proceeding in the time specified by the Commission, it will do so only marginally, as the 300 days do not run out until November 12, 2016 (not counting the period of the Second Circuit

stay), and the schedule put in place by the hearing officer will in any case necessitate an extension of the 300-day deadline. Moreover, while inexcusable or unnecessary delay should be avoided, Rule 300 makes clear that proceedings must be scheduled so as to obtain a just, impartial, and orderly hearing; and (v) "any other such matters as justice may require" weigh heavily in favor of a postponement, for the reasons explained above.

For all of these reasons, the 300-day deadline should be extended so as to permit the hearing officer to hold a hearing in December 2016 and render an initial decision in due course thereafter, and the Commission should instruct the ALJ to approve the parties' joint proposal of a December 2016 hearing date.

II. In The Alternative, The Commission Should Grant Interlocutory Review And Vacate The Orders Setting An October 2016 Trial Date.

Alternatively, the Commission can treat this as a request for interlocutory review of the hearing officer's decisions not to set the hearing for December 2016, and not to seek an extension of the 300-day deadline. Pursuant to Rule 400(a), the Commission may, "at any time," direct that "any matter be submitted for review." Rule 400. There are two independent bases for granting interlocutory review of the ALJ's Orders setting an October 2016 hearing date.

A. Interlocutory Review Should Be Granted Because The Orders, If They Stand, Violate Respondents' Due Process Rights.

It is appropriate for the Commission to grant interlocutory review of a hearing officer's decision where it "involves a controlling question of law as to which there is substantial ground for difference of opinion; and (ii) an immediate review of the order may materially advance the completion of the proceeding." Rule 400(c). Here, both conditions are amply satisfied: The Orders, if they stand, will make it impossible for Respondents to receive a fair hearing or to adequately defend themselves against the SEC's charges, resulting in denial of their due process rights, as well as their statutory right, under the Administrative Procedure Act (5 U.S.C.

§ 555(b)), to counsel of their choice. These are controlling questions of law. In addition, if interlocutory review is granted and the Commission rectifies this constitutional error before it results in irreparable harm to Respondents, that will eliminate the need for a retrial on the basis of the denial of due process from this rush to judgment, and thereby materially advance the completion of the proceedings. Conversely, if the Orders are left to stand, the initial decision in this proceeding will need to be reversed and vacated for constitutional error, either by the Commission or a federal court, and the matter will need to be retried. The Commission should accordingly certify interlocutory review of the Orders.

Respondents respectfully disagree with the ALJ's characterization of their motion for certification as "patently fail[ing]" to meet the standards for certification for interlocutory review reflected in the Rule 400(c). July 20 Order at 2. Surely, certifying for interlocutory review an order setting a trial date that denies Respondents adequate time to prepare their defense, precludes them from calling key expert and fact witnesses, and thereby deprives them of due process would "materially advance the completion of the proceeding," because this deprivation of due process, if left to stand, would require reversal of any resulting decision and a rehearing of the case. The "controlling question of law" here is whether the trial schedule that the hearing officer has ordered affords Respondents the due process rights to which they are entitled under the U.S. Constitution. Respondents therefore consider their request for interlocutory review to have been consistent with the letter, spirit and intent of Rule 400(c), and they now put this critically important issue before the Commission.

B. Interlocutory Review Should Be Granted Because The Orders Present Extraordinary Circumstances Justifying Commission Review.

Although the circumstances set out in Rule 400(c) of the Rules, discussed above, are the traditional vehicle for interlocutory review of a hearing officer's ruling, the Commission recently

clarified that there also "extraordinary circumstances that are appropriate for interlocutory review but that do not involve issues that meet the standards of Rule 400(c)." *McDuff*, Exchange Act Release No. 78066, at 10. The trial schedule set by the hearing officer, even as now modified, presents such "extraordinary circumstances," and it is therefore appropriate for the Commission to grant interlocutory review, even if the standards of Rule 400(c) were not met.

The Commission in *McDuff* made clear that "extraordinary circumstances which justif[y] Commission review" of an ALJ's ruling existed where the hearing officer had "refus[ed] to postpone [a] hearing due to respondent counsel's necessary post-operative medical treatment." *Id.* (citing *Philip L. Pascale, CPA*, Order Granting Postponement of Administrative Proceedings, Admin. Proc. File No. 3-11194 (Nov. 24, 2003)). In other words, it is appropriate to grant interlocutory review of a hearing officer's refusal to postpone a hearing where the circumstances militating in favor of adjournment are extraordinary. This is because the prejudice caused to a party by being forced to proceed with a hearing without adequate representation is severe and irreparable.

This concern is all the more manifest in this case, where the stakes for Ms. Tilton and the Patriarch entities are catastrophic, and dwarf those of other recent SEC administrative proceedings, individually or cumulatively. As noted above, the amount that the Division seeks in disgorgement from Ms. Tilton far exceeds the amount collected through litigated administrative hearings in all of 2015 combined. *See supra* p. 5. By contrast, there is no exigency demanding the immediate trial of this case. Ms. Tilton is not a registered investment adviser, the Patriarch entities are no longer registered investment advisers, and no Patriarch entity serves as a collateral manager to any of the Zohar funds, having resigned those positions in

February 2016. As no Respondent is managing the Zohar funds, there is no risk that the alleged continuing breaches or future harms to Zohar fund investors are ongoing.

The factors discussed herein militating in favor of adjourning the hearing in this case to December 2016 are nothing less than extraordinary, and call out for interlocutory review so the prejudice to Respondents can be corrected before it infects the entire proceeding.

III. The Commission Should Direct That The Newly Amended SEC Rules of Practice Be Applied To This Proceeding.

Just last week and for the first time in decades, the Commission unanimously adopted a number of meaningful amendments to its Rules of Practice. *See Amendments to the Comm'n's Rules of Practice*, Release No. 78319 (July 13, 2016), https://www.sec.gov/rules/final/2016/34-78319.pdf ("Amended Rules"). Among other things, the Amended Rules: (i) make adjustments to the timing of hearings in administrative proceedings; (ii) allow parties to each take up to seven depositions of fact witnesses, expert witnesses, or document custodians (without regard to a witness's availability for trial); (iii) clarify the rules for the use and admissibility of certain evidence in an administrative proceeding; and (iv) modify the procedural requirements for filing a petition for review of an initial decision. *Id.*

While the amendments do not go far enough to rectify the fundamental unfairness of proceedings like this one, they at least add some meaningful procedural protections for respondents, as the Commission itself acknowledged. *See Mary Jo White Explains the New SEC Rules*, Wall St. J., Nov. 24, 2015, http://www.wsj.com/articles/mary-jo-white-explains-the-new-sec-rules-1448302777. But because of the concerning timing of the Commission's approval of

the amendments,[12] most, if not all, of the amended rules will not automatically apply in this proceeding. *See* Amended Rules at 71-76.

The Commission nevertheless has the power to direct the ALJ to apply the Amended Rules in this proceeding, and should do so here in "the interests of justice." *See* 17 C.F.R. § 201.100(c). Rule 100(c) explicitly provides the Commission with broad discretion to "direct, in a particular proceeding, that an alternative procedure shall apply or that compliance with an otherwise applicable rule is unnecessary." *Id.* The Commission may apply alternative rules where would serve "the interests of justice and not result in prejudice" to any party to the proceeding. *Id.*; *see also Adoption of Amendments to the Rules of Practice & Delegations of Auth. of the Comm'n*, Release No. 49412 (Mar. 12, 2004). Indeed, the Commission has frequently invoked Rule 100(c) to disregard certain Rules of Practice or to apply alternative procedures. *See, e.g.*, *In re Optionsxpress, Inc., et al.*, Securities Act Release No. 9514 (Jan. 17,

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12 After months of anticipation and discussion of the issuance of the new rules for public comment, the Commission proposed the amendments on September 24, 2015—seven days after the stay of these administrative proceedings was imposed by the Second Circuit—and solicited comments until December 4, 2015. *See Amendments to the Comm'n's Rules of Practice*, Release No. 34-75976 (Sept. 24, 2015), https://www.sec.gov/rules/proposed/2015/34-75976.pdf; *Amendments to the Comm'n's Rules of Practice*, 80 Fed. Reg. 60091-01 (Oct. 5, 2015) ("Proposed Rules"). Then, six months later, and just one day after the Second Circuit's stay of this proceeding lapsed, the Commission announced that the amendments would be included on a "summary agenda" in an open meeting on July 13, 2016. *See* Order, *Tilton v. SEC*, No. 15-2103 (2d Cir. June 27, 2013) (Dkt. 125); Notice of Sunshine Act Meeting (July 13, 2016), https://www.sec.gov/news/openmeetings/2016/ssamtg071316.htm. Without discussion, the amendments were approved and the final amended rules were issued that day, including the Commission's specific guidance regarding applicability of the rules to pending proceedings. *See* Amended Rules at 71-76. Thus, in implementation and timing, the automatic application of the new rules is precluded as to Respondents, as well as Barbara Duka—two parties who have recently challenged the constitutionality of the SEC's administrative proceedings in federal court.

2014) (disregarding as "unnecessary" the requirement under Rule 431(d) for the parties to "file a statement in support of or in opposition to" the entry of a notice of finality"); *In re Michael Sassano, et al.*, Investment Advisors Act Release No. 2679 (extending the 300-day period for an additional 120 days in order to allow the Commission to produce, and respondents to review, voluminous documents); *In re Nasdaq Stock Mkt., LLC for Review of Action Taken by Theconsolidated Tape Ass'n*, Exchange Act Release No. 55909 (June 14, 2007) (appointing an ALJ to preside over the matter and conduct further proceedings where the record was insufficient for the Commission to make the necessary determinations).

Respondents request that the Commission order, pursuant to Rule 100(c), that the Amended Rules apply in the remaining proceedings in this action, as far as is practicable. In light of the procedural posture of this proceeding, certain of the Amended Rules are obviously not applicable. It is entirely logical, however, to apply the Amended Rules regarding scheduling the hearing and a deadline for the initial decision, deposition and expert discovery, admissibility of evidence, the filing of a motion for a ruling as a matter of law following the Commission's presentation of its case-in-chief, and appellate procedure in this proceeding going forward.

Doing so will accomplish the Commission's goal of providing these long-overdue benefits to respondents "without sacrificing the public interest or the Commission's goal of resolving administrative proceedings promptly and efficiently." Amended Rules at 18-19. It is completely feasible, for example, for the parties to conduct deposition discovery prior to the hearing. And, as the Commission recognized, allowing deposition discovery will "ultimately result in more focused prehearing preparations, with issues distilled for the hearing and post-hearing briefing." Proposed Rules at 60093. In fact, SEC Division counsel have served *multiple*

discovery subpoenas to third parties. In SEC counsel's view, at least, discovery is still ongoing. The Amended Rules could—and should—apply to this proceeding.

Similarly, there is no reason that the rules relating to the admissibility of evidence at a hearing and procedural rules regarding an appeal should not apply here, where the hearing has yet to occur and where the parties and the hearing officer have sufficient notice. Applying such rules would serve the interests of justice and Respondents should not be denied these benefits simply because the Commission instituted proceedings against them prior to approving the Amended Rules.

Applying the Amended Rules here would "serve the interests of justice" and will not prejudice either party. In fact, a refusal to grant the additional protections of the Amended Rules would undermine the interests of justice and unfairly prejudice Respondents. The very legitimacy and fairness of the Commission's administrative proceedings are under review in the courts and elsewhere, and several commenters recognized the importance of the benefits provided by the Amended Rules in taking much-needed steps toward administrative proceedings that protect the due process rights of respondents involved. *See, e.g.*, *Comments on Proposed Rule: Amendments to the Comm'n's Rules of Practice*, Release No. 34-75976, 2015 WL 9673549 (Dec. 4, 2015) (comments from the U.S. Chamber of Commerce); *Comments on Proposed Rule: Amendments to the Comm'n's Rules of Practice*, Release No. 34-75976, 2015 WL 9673547 (Dec. 4, 2015) (comments from Joseph A. Grundfest, Professor of Law and Business, Stanford Law School); *Comments on Proposed Rule: Amendments to the Comm'n's Rules of Practice*, Release No. 34-75976, 2015 WL 8489932 (Dec. 4, 2015) (comments from the Financial Services Roundtable).

Even the Commission has stated that the amendments were intended to "modernize" the Rules of Practice and "to provide parties with an opportunity to develop arguments and defenses through deposition discovery, which may narrow the facts and issues to be explored during the hearing." *See* Press Release, Sec. & Exch. Comm'n, SEC Proposes to Amend Rules Governing Administrative Proceedings (Sept. 24, 2015)https://www.sec.gov/news/pressrelease/2015-209.html; *Amendments*; Proposed Rules at 60092. Indeed, Commission Chair Mary Jo White acknowledged that the Rules of Practice, which "haven't been modernized in almost 10 years," were in need of refinement in order to convey that administrative proceedings are fair, both in appearance and in reality. *Mary Jo White Explains the New SEC Rules*, Wall St. J., Nov. 24, 2015, http://www.wsj.com/articles/mary-jo-white-explains-the-new-sec-rules-1448302777. The rationale for amending the rules applies with equal force to the Respondents in this proceeding as it does to respondents in prospective proceedings. And this should be no issue for the Division, which continues to seek discovery, having submitted several such subpoenas for the ALJ's endorsement since the stay was lifted in this proceeding.

CONCLUSION

For the foregoing reasons, Respondents respectfully request that the Commission: (a) extend the 300-day deadline in this proceeding and set the hearing in this matter for December 2016; (b) in the alternative, grant interlocutory review of the ALJ's Orders setting an October 2016 hearing date, refusing to enter the December 2016 hearing date jointly requested by the parties, and declining to seek an extension of the 300-day deadline in this proceeding; and (c) order that the just-amended Rules of Practice apply to these proceedings in their entirety.

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Rule 450(d) Certification: Undersigned counsel certifies that this brief contains 11,437 words and therefore complies with the length limitations set forth in Rule 450(d).

Dated: New York, New York
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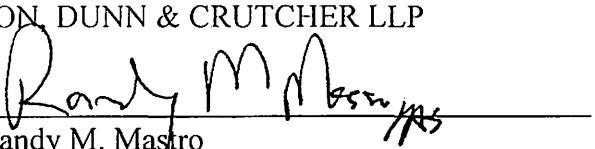
By: 

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