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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17342

In the Matter of

RD LEGAL CAPITAL, LLC and
RONI DERSOVITZ

MOTION FOR PROTECTIVE ORDER

Pursuant to Rule 322(a) of the Rules of Practice of the Securities and Exchange Commission, RD Legal Capital, LLC and Roni Dersovitz ("Respondents") respectfully request that the Court enter a protective order maintaining under seal and limiting from disclosure to the public the unredacted version of Respondents' Memorandum in Support of Motion for Summary Disposition, dated February 15, 2017 (the "Unredacted Memorandum") and Exhibits T and U thereto.

Respondents have attached as Appendix A to this motion a redacted copy of their memorandum in support of the proposed motion for summary disposition and ask that, if the instant request for a protective order is granted, this redacted memorandum be filed with their earlier request for leave.

BACKGROUND

On February 15, 2017, Respondents submitted to the Court a letter requesting leave to file a motion for summary disposition under Rule of Practice 250. Respondents attached to that letter copies of the Unredacted Memorandum and Exhibits A through V thereto. In the e-mail

conveying the letter and its attachments to the Court, Respondents requested confidential treatment.

On February 16, 2017, the Division of Enforcement submitted a letter to the Court opposing Respondents' request for leave, and Respondents submitted a letter in further support of their request. On February 23, 2017, the Court denied Respondents' request for leave as untimely. Order at 1 (Feb. 23, 2017). The Court further directed that Respondents had until March 2, 2017 to file a motion pursuant to Rule 322 "explaining why their summary disposition filing, or a portion thereof, should be subject to a protective order." *Id.* at 2.

DISCUSSION

Under Rule 322(a), "any person who is the owner, subject or creator of a document subject to subpoena or which may be introduced as evidence . . . may file a motion requesting a protective order to limit from disclosure to . . . the public documents or testimony that contain confidential information." 17 C.P.R. § 201.322(a). Although documents introduced in a public hearing are generally presumed to be public, a motion for a protective order shall be granted "upon a finding that the harm resulting from disclosure would outweigh the benefits of disclosure." 17 C.F .R. § 201.322(b).

I. SUMMARY OF DOCUMENTS AT ISSUE[1]

Respondents seek protection of a limited portion of their summary disposition brief and two of its exhibits. Respondents seek to redact only those portions of their brief—Part V.B and the introductory paragraph corresponding thereto—that present Respondents' argument, in the context of Respondents' request that the Court strike the Division's request for Tier III penalties, that Respondents have not obtained substantial pecuniary gain from the events alleged in the

[1] Under Rule 322(a), a motion for protective order "should include a general summary or extract of the documents without revealing confidential details." 17 C.F .R. § 201.322(a).

OIP.[2] This argument relies on and discusses in detail nonpublic personal financial information of RD Legal Capital, LLC ("RDLC") and Mr. Dersovitz individually. Respondents further seek to place under seal Exhibits T and U to the motion, which set forth and tabulate nonpublic financial information related to Respondents, including personal financial information of Mr. Dersovitz.[3]

II. THE HARM THAT WOULD RESULT FROM PUBLIC DISCLOSURE OF THE DOCUMENTS AT ISSUE OUTWEIGHS THE BENEFITS.

Public disclosure of the information in Part V.B and Exhibits T and U would result in significant harm to Respondents. These portions of Respondents' summary disposition filing include Mr. Dersovitz's individual financial information, as well as nonpublic information regarding RDLC's net revenue and expenses. Courts commonly protect this type of information—often elicited in the context of a disgorgement and civil penalties analysis—from public disclosure. *See, e.g.*, *David B. Havanich, Jr.*, File No. 3-16354, Release No. 936, at 2 n.5 (ALJ Jan. 4, 2016) ("Disclosure of financial information concerning an individual is presumed harmful."); *David Mura*, File No. 3-15045, Release No. 753, at 2 n.3 (ALJ Mar. 11, 2015) (same).

Meanwhile, public disclosure of Part V.B and Exhibits T and U would serve no benefit. Because neither the Court's Order denying leave nor the parties' briefing on the request for leave addressed the substance of the proposed summary disposition filing in any detail (they instead focused on (i) timeliness and (ii) whether or not Respondents' request for leave made certain

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[2] *See* Unredacted Memorandum at 2–3 (paragraph beginning "The Division can also never show" and ending "all at a personal cost to himself."); *id.* at 26–27.

[3] *See id.* Ex. T (Net Draw to Roni Dersovitz from Combined Operating Companies (RDLC, RDLF, and RDLG) from 2011–2016); *id.* Ex. U (Net Revenue and Expenses from Operation of Funds from 2012–2016).

showings[4]), there is no need for public disclosure for purposes of shedding light on any issue that those filings discuss. In any event, the full unredacted materials are available to both the Division and the Court, and Respondents are not opposing the disclosure of the vast majority of the information contained in their summary disposition submission.

Although generally the record in a public hearing is presumed to be public, the harm that would result from disclosure of this particular information plainly outweighs the benefits. Respondents respectfully request that the Court enter a protective order accordingly.

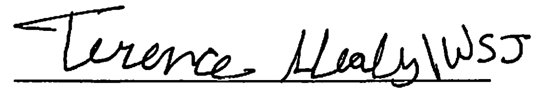
CONCLUSION

For the reasons set forth above, Respondents respectfully request that the Court enter a protective order pursuant to Rule 322 maintaining the Unredacted Memorandum and Exhibits T and U thereto under seal and limiting their disclosure to the public, and permitting Respondents to submit the attached redacted version of their memorandum in support of their proposed motion for summary disposition.

[4] The Division's letter in opposition to Respondents' request for leave acknowledges that it does not address the merits of the substantive arguments contained in Respondents' summary disposition submission. *See* M. Birnbaum ltr. to C. Foelak at 2 n.1 (Feb. 16, 2017).

Dated: March 2, 2017

Respectfully submitted,



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CERTIFICATE OF SERVICE

The undersigned certifies that the foregoing Motion for Protective Order was served on this 2nd day of March 2017 by U.S. Postal Service on the Office of the Secretary and by electronic mail on the following counsel of record:

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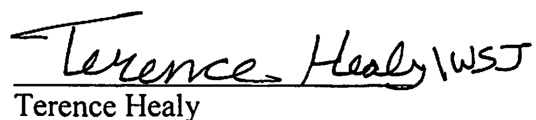

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Appendix A

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17342

In the Matter of

RD LEGAL CAPITAL, LLC and
RONI DERSOVITZ

RESPONDENTS' MEMORANDUM IN SUPPORT OF MOTION FOR SUMMARY DISPOSITION

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TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. BACKGROUND 3

A. The Funds Deliver Double-Digit Returns to Their Investors 3

B. The Funds Employed Diligent Valuation Procedures Consistent with GAAP 5

C. The Order Instituting Proceedings 7

III. LEGAL STANDARD FOR SUMMARY DISPOSITION 7

IV. THE COURT SHOULD ENTER SUMMARY DISPOSITION ON THE DIVISION'S CLAIMS RELATED TO VALUATION OF THE FUNDS' ASSETS 8

A. Respondents Employed a Reasonable and Appropriate Valuation Process 9

1. Respondents' Valuation Methodology Was Robust 10

2. Respondents' Valuation Inputs Were Objective 12

3. Unrebutted Expert Testimony Confirms That Respondents' Valuation Process Was Sound 13

4. History Has Vindicated The Reasonableness and Accuracy of Respondents' Valuations 15

B. The Division's Individual Criticisms Of The Valuation Process Are Unfounded 16

1. Respondents Used An Appropriate Discount Rate in Valuing the *Peterson* Receivables 16

2. The Valuation Process Appropriately Incorporated Legal Analysis When Assessing the Risk Associated With the Funds' Investments 18

3. Respondents Did Not Mischaracterize The Collateralization of the *Peterson* Plaintiff Receivables 19

4. Respondents Disclosed Changes in the Law Firm A Receivables and Law Firm B Receivables 19

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Page

C. The Division Cannot Point To Any Evidence To Support Their Claims That Respondents' Valuation of the Funds' Assets Was Unreasonable 23

V. THE COURT SHOULD ENTER SUMMARY DISPOSITION ON THE DIVISION'S REQUEST FOR ELEVATED PENALTIES 25

A. Investors Suffered No Losses 26

B. Respondents Did Not Obtain Substantial Pecuniary Gain 26

C. There Is No Evidence of a Significant Risk of Substantial Losses to Investors 27

VI. CONCLUSION 29

TABLE OF AUTHORITIES

Page(s)

Cases

In re Allied Capital Corp. Sec. Litig., No. 02-cv-3812, 2003 WL 1964184 (S.D.N.Y. Apr. 25, 2003) 18, 25

City of Omaha, Neb. Civilian Emp. Ret. Sys. v. CBS Corp., No. 08-cv-10816, 2010 WL 1029290 (S.D.N.Y. Mar. 16, 2010) 14, 15

Comverse Tech., Inc., SEC Release No. 400, 2010 WL 2886397 (July 22, 2010) 8

Epirus Capital Mgmt., LLC v. Citigroup Inc., No. 09-cv-2594, 2010 WL 1779348 (S.D.N.Y. Apr. 29, 2010) 25

Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC., 479 F. Supp. 2d 349 (S.D.N.Y. 2007) 18

Hausler v. JPMorgan Chase Bank, NA., 845 F. Supp. 2d 553 (S.D.N.Y. 2012) 20

Home Loan Servicing Sols., SEC Release No. 3713, 2015 WL 5782427 (Oct. 5, 2015) 8

Jay T. Comeaux, SEC Release No. 3902, 2014 WL 4160054 (Aug. 21, 2014) 8

John P. Flannery, SEC Release No. 3981, 2014 WL 7145625 (Dec. 15, 2014), *vacated on other grounds sub nom.*, *Flannery v. SEC*, 810 F.3d 1 (1st Cir. 2016) 28

Kornman v. SEC, 592 F.3d 173 (D.C. Cir. 2010) 8, 28

Lawrence M. Labine, SEC Release No. 973, 2016 WL 824588 (Mar. 2, 2016) 29

In re Lehman Bros. Sec. & ERISA Litig., 799 F. Supp. 2d 258 (S.D.N.Y. 2011) 9, 24

Peterson v. Islamic Republic of Iran, 264 F. Supp. 2d 46 (D.D.C. 2003) 7

Rockies Fund, Inc. v. SEC, 428 F.3d 1088 (D.C. Cir. 2005) 26, 27

SEC v. Mannion, No. 10-cv-3374, 2013 WL 1291621 (N.D. Ga. Mar. 25, 2013) 24

Yu v. State St. Corp., 686 F. Supp. 2d 369 (S.D.N.Y. 2010), *leave to replead granted*, 2010 WL 2816259 (S.D.N.Y. July 14, 2010) 9

TABLE OF AUTHORITIES
(continued)

Page

Statutes and Rules

15 U.S.C. § 77q(a) 8

15 U.S.C. § 78j(b) 8

15 U.S.C. § 78u-2 8

15 U.S.C. § 78u-2(a)(1), (c) 28

15 U.S.C. § 78u-2(b)(3) 26

15 U.S.C. § 78u-2(b)(3)(B) 27

22 U.S.C. § 8772 20

28 U.S.C. § 1610 20

42 U.S.C. § 10609 21

N.Y. C.P.L.R. § 5234 20

Regulations

17 C.F.R. § 201.250(c) 7

81 Fed. Reg. 50212 (July 29, 2016) 8

Exec. Order No. 13599 (Feb. 5, 2012) 20

RD Legal Capital, LLC ("RDLC") and Roni Dersovitz ("Dersovitz" and, together with RDLC, "Respondents") respectfully ask the Court to enter partial summary disposition in this matter under Rule 250(c) of the Rules of Practice of the Securities and Exchange Commission on two issues: (1) any claims related to the valuation of the assets held in the funds at issue; and (2) the request by the Division of Enforcement (the "Division") for Tier III penalties.

I. INTRODUCTION

This is an extraordinary case for the Division to bring. Respondents manage two private funds that have delivered double-digit returns to their investors every year since their formation in 2007. Rather than any investors having *lost* money, all investors in Respondents' funds have preserved their principal and earned significant gains. By any measure, the performance of the funds has been exceptional and has outpaced all relevant benchmark indices—again, with no investor losses. Respondents achieved these results by executing the basic investment strategy (discounting future cash flows on receivables in the legal industry) described to investors in the funds' offering documents. This hardly presents the picture of a fraud.

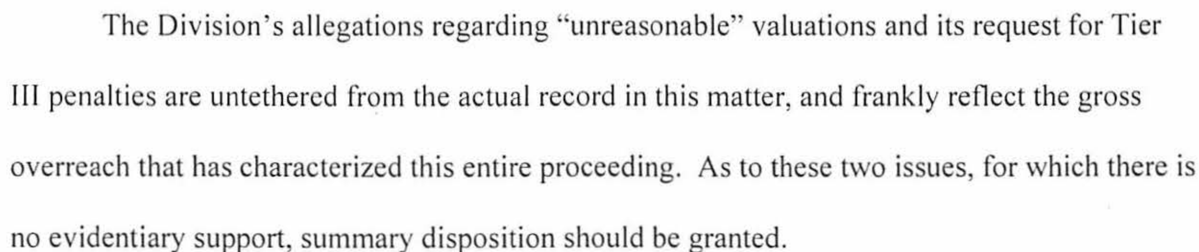
Yet, against this backdrop, where no investors actually suffered harm, the Division attempts to stitch together a case of fraud. The Division's case focuses to an unusual degree on simple marketing materials, and tries to parse out isolated words or sub-clauses from these documents while ignoring both the overall language in those documents and, more importantly, the "total mix" of information that was made available to the funds' investors (all of whom were accredited and sophisticated). To make these claims, the Division also wholly ignores the actual language in the offering memoranda and other governing documents for the funds. As will be shown at trial, the claims of fraud in this case lack the most basic proof and will collapse on the

merits. But that is for a later time.

Respondents come to the Court now in an effort to shorten the hearing and remove from the presentation of evidence certain issues for which there are no material facts in dispute and for which Respondents are entitled to judgment as a matter of law. Specifically, Respondents ask the Court to enter summary disposition as to: (1) any claims related to the valuation of the funds' portfolio, and (2) the Division's request for Tier III penalties.

As will be shown below, the uncontroverted evidence establishes that Respondents complied with all industry standards in valuing the portfolio assets, including employing an independent third-party valuation agent, and, moreover, the majority of the assets have now collected at the very values they had been assigned, further demonstrating the reasonableness of the original valuations. There is no evidence the Division can present to suggest that the assets were *not* reasonably valued, and entering judgment on this issue would shorten the trial by approximately one week.

Similarly, there is no evidentiary basis for the Division to obtain elevated penalties in this matter. While Respondents are confident they will prevail on the merits at trial, they nonetheless ask the Court to strike the Division's request for Tier III penalties. As the Court knows, Tier III penalties require a showing of "substantial losses" to investors, "significant risk" of such losses, or "substantial pecuniary gain" to the respondents. The Division can never meet this standard. As noted above, all investors in Respondents' funds earned significant annual double-digit gains on their investments—without losses—and the Division cannot show there was a "significant risk" of "substantial losses" by merely saying the words. It needs evidence, which it lacks.



The Division's allegations regarding "unreasonable" valuations and its request for Tier III penalties are untethered from the actual record in this matter, and frankly reflect the gross overreach that has characterized this entire proceeding. As to these two issues, for which there is no evidentiary support, summary disposition should be granted.

II. BACKGROUND

RDLC is the investment manager to two private funds, RD Legal Funding Partners, LP (the "Domestic Fund") and RD Legal Funding Offshore Fund, Ltd. (the "Offshore Fund") (together, the "Funds"). Roni Dersovitz is the President of RDLC and serves as its Chief Investment Officer.

A. The Funds Have Delivered Double-Digit Returns to Their Investors

Both the Domestic Fund and the Offshore Fund were formed in 2007. Since that time, the performance of the Funds has been nothing short of extraordinary. From its formation in 2007 through the present, all investors in the Domestic Fund have earned a 13.5% return per annum.[1] Fully participating investors in the Offshore Fund earned a return of 13.5% from 2007

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1 *See* Exhibit A, Amended Expert Report of Leon M. Metzger dated February 13, 2017 ("Metzger") ¶ 24.

through 2014, and an average of 11.4% in 2015.[2] Even during the financial crisis, when the capital markets saw historic downturns and many alternative investment funds marked significant investor losses, the investors in the Funds that RDLC manages realized significant gains.

The structure of the Funds differs from most traditional hedge funds. There is no management fee. There is no performance fee. The Funds do not follow any version of a "2-and-20" model. Instead, the manager of the Funds receives a return only after all investors in the Funds receive their full targeted cumulative return of 13.5% per annum.[3]

The return to investors in the Funds is cumulative. Thus, if an investor fails to receive his or her full return in any given month, the entire amount of that shortfall is reserved and all future net profits are allocated to the capital accounts of the investor. Until all such cumulative shortfalls are satisfied, the investment manager, RDLC, receives nothing.[4]

RDLC and Mr. Dersovitz achieved these results for their investors by following the basic investment strategy disclosed in the Funds' offering documents. RDLC discounts future cash flows on receivables in the legal industry. Specifically, the Funds generate returns for their investors, while maintaining capital, through: (a) purchasing from law firms receivables representing their legal fees derived from litigation, settlements, or judgments; (b) purchasing from plaintiffs receivables representing their portion of proceeds from final judgment awards or settlements; (c) providing loans to law firms through secured lines of credit; and (d) providing

2 The investment manager decided to close the Offshore Fund in 2015, and that fund is being wound down.

3 Under the structure of the Funds, investors earn a targeted return of 13.5% per annum based on their average capital account balance. Any net profits in excess of the return to investors are allocated to the capital account of the investment manager, RDLC. Put more simply, the first 13.5% of profit in the Funds each year goes to the investors; any excess is allocated to the investment manager.

4 *See, e.g.*, Exhibit Q (Confidential Private Offering Memorandum, Limited Partnership Interests of RD Legal Funding Partners, LP dated June 2013) ("June 2013 Domestic CPOM") at 3-4; Exhibit R (Confidential Explanatory Memorandum, RD Legal Funding Offshore Fund, Ltd. dated June 2013) ("June 2013 Offshore CEM") at 3-4.

capital to law firms to pursue certain opportunities that do not fall within the other categories.[5]

B. The Funds Employed Diligent Valuation Procedures Consistent with GAAP

The assets held in the Funds are Level 3 assets under accounting principles generally recognized in the United States ("GAAP").[6] Under GAAP, Level 3 assets include financial instruments or obligations for which no secondary market exists and which are restricted as to their transferability. Investment funds are required under GAAP to value Level 3 assets in their portfolios at "fair value." The standards for determining fair value are set forth in Financial Accounting Standard ("FAS") 157).[7] Respondents have always valued the assets in the Funds at fair value under ASC 820/FAS 157.

The processes Respondents followed for valuing the assets in the Funds met industry standards and led to portfolio valuations that were not only reasonable, but that also have been validated as those assets have collected.[8] As explained in detail in Section IV.A below, Respondents' valuation processes included the following procedures:

- Respondents employed an independent, nationally-recognized third-party valuation agent, Pluris Valuation Advisors, LLC ("Pluris"), to value the portfolio

5 *See, e.g.*, Exhibit Q, June 2013 Domestic CPOM at7-8; Exhibit R, June 2013 Offshore CEM at 8.

6 *See, e.g.*, Exhibit A, Metzger ¶ 120; Exhibit B, Expert Report of David X. Martin dated January 27, 2017 ("Martin") ¶ 12; Exhibit C, RD Legal Funding Partners LP Financial Statements for the Year Ended December 31, 2013 ("2013 Domestic Financials") at 14; Exhibit D, RD Legal Funding Offshore Fund, Ltd. Financial Statements for the Year Ended December 31, 2013 ("2013 Offshore Financials") at 17.

7 Under the new nomenclature for financial accounting standards, FAS 157 has been renamed ASC 820. For purposes of this motion, Respondents will use the term FAS 157 throughout for consistency, as the guidance is the same. *See* Exhibit B, Martin ¶ 64.

8 Exhibit A, Metzger ¶¶ 117-137; Exhibit B, Martin ¶¶ 50-69.

assets on a monthly basis,[9] and Respondents marked the portfolio each month to the values the independent agent assigned;[10]

- The independent auditor for the Funds, Marcum LLP, reviewed and tested the valuation process for the Funds as part of its regular audit procedures, and the auditor found that the Funds' valuation processes met appropriate standards;[11]
- The independent auditor also had its own valuation expert review the model and analysis of the Funds' third-party valuation agent and found the valuations were reasonable;[12]
- Respondents engaged independent outside legal counsel to analyze various receivables in the portfolio to confirm both the expected likelihood and timing of payout on those receivables in support of the valuation process.[13]
- Most strikingly, the majority of the Funds' assets have historically collected at the values they had been assigned, providing proof that the assumptions made to value those assets were not only reasonable but highly accurate.[14]

In the face of these thorough procedures, the Division has not identified any expert witness to testify about the valuation of the assets in the Funds or the valuation procedures employed by RDLC. By contrast, Respondents' experts have explained both that the valuation

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9 *See* Exhibit E, Deposition Transcript of Leo Zatta dated Mar. 30, 2016 (excerpted) ("Zatta Tr.") at 33:6-12.

10 *See, e.g.*, Exhibit F, Deposition Transcript of Yuanguo "Eric" Liu dated May 5, 2016 (excerpted) ("Liu Tr.") at 38:10-17; Exhibit G, Deposition Transcript of Philip Larochelle dated May 19, 2016 (excerpted) ("Larochelle Tr.") at 64:1-6; Exhibit H, Deposition Transcript of Espen Robak dated March 2, 2016 (excerpted) ("Robak Tr.") at 279:5-12.

11 *See* Exhibit I, Deposition Transcript of Dennis Schall dated January 11, 2017 (excerpted) ("Schall Tr.") at 169:11-20.

12 *Id.* at 129:9-13.

13 *See* Exhibit B, Martin ¶¶ 54 & n.14, 67, 71 & n.30.

14 *See, e.g.*, Exhibit B, Martin ¶ 56 & Ex. 10.

procedures RDLC followed met all industry standards[15] and that the values assigned to the portfolio assets were reasonable and accurate.[16] This testimony now stands unrebutted.

C. The Order Instituting Proceedings

The Order Instituting Proceedings ("OIP") asserts in part that Respondents violated the federal securities laws by withdrawing money from the funds using valuations based on "unreasonable assumptions." (OIP ¶ 1.) The vast majority of the OIP focuses on the Funds' financing of the legal fees and plaintiff proceeds arising from a default judgment relating to multiple civil actions associated with the 1983 Iranian terrorist bombing of the United States Marine Barracks in Beirut, Lebanon. *See Peterson v. Islamic Republic of Iran*, 264 F. Supp. 2d 46 (D.D.C. 2003).

The values associated with the *Peterson*-related investments have proven to be accurate, and the Funds and their investors have received their expected return based on those valuations. As no evidence supports the allegations that the Funds improperly valued the Level 3 assets in their portfolio or the imposition of Tier III penalties, Respondents request that the Court grant their motion for partial summary disposition and streamline the upcoming hearing in this matter.

III. LEGAL STANDARD FOR SUMMARY DISPOSITION

Rule 250(c) provides that a hearing officer may grant summary disposition "if there is no genuine issue with regard to any material fact and [] the movant is entitled to summary disposition as a matter of law." 17 C.F.R. § 201.250(c). Once a party moving for summary disposition has carried its burden on the factual record, the Division may not rely on bare allegations or denials but must present specific facts showing a genuine issue of material fact for

15 *See generally* Exhibit A, Metzger ¶¶ 13.v, 119-37, 141; Exhibit B, Martin ¶¶ 15, 50-74, 78.

16 *See* Exhibit B, Martin ¶¶ 15, 50, 64-69.

resolution at the hearing. *See Jay T. Comeaux*, SEC Release No. 3902, 2014 WL 4160054, at *2 (Aug. 21, 2014).[17] Here, there are no material facts in dispute related to the Division's claims based on the valuation of the Funds' assets or the Division's ability to seek elevated penalties against Respondents in this matter. Therefore, summary disposition should be entered.

IV. THE COURT SHOULD ENTER SUMMARY DISPOSITION ON THE DIVISION'S CLAIMS RELATED TO VALUATION OF THE FUNDS' ASSETS

The Division alleges that Respondents violated the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. (OIP ¶ 75.) While the Division raises various allegations in the OIP, the claim relevant to this motion is that Respondents defrauded investors by using valuations based on "unreasonable assumptions" to withdraw money from the Funds. (*Id.* ¶¶ 1, 60.) As explained below, the Division's valuation allegations lack any evidentiary support. To the contrary, the undisputed evidence establishes that Respondents employed robust, reasonable, and sound valuation procedures to reasonably value the assets in the Funds.

The Division's burden to overcome the evidence that Respondents employed an appropriate valuation methodology is particularly high given that the assets in question were Level 3 assets. Level 3 assets are illiquid assets for which "there rarely are observable market prices" because they "are not frequently bought or sold." *Home Loan Servicing Sols.*, SEC Release No. 3713, 2015 WL 5782427, at *6 (Oct. 5, 2015). The valuation of such assets requires the exercise of the investment manager's discretion and judgment. Indeed, FAS 157, the accounting principle governing the determination of fair value for Level 3 assets, "expressly

17 *See also Kornman v. SEC*, 592 F.3d 173, 182 (D.C. Cir. 2010) (finding summary disposition properly granted where non-movant "proffered no evidence to contradict either his admissions or the [movant]'s evidence"); Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50212, 50224 n. 112 (July 29, 2016); *Comverse Tech., Inc.*, SEC Release No. 400, 2010 WL 2886397, at *1 (July 22, 2010).

contemplates that different models, based on different assumptions and the assignment of different weight to different inputs, may be used to determine fair value." *In re Lehman Bros. Sec. & ERISA Litig.*, 799 F. Supp. 2d 258, 312 (S.D.N.Y. 2011). Thus, the mere fact that the Division might prefer the use of different assumptions or inputs does not mean that Respondents' valuation methods violated ASC 820/FAS 157 or that the resulting valuations were unreasonable. *Id.*

As the U.S. District Court for the Southern District of New York explained regarding the valuation of illiquid assets, the "determination that certain models, assumptions, and inputs were likely to provide accurate estimations of fair value was a matter of judgment." *Id.* The court explained that such decisions made a company's statement "that it valued assets at fair value in accordance with [FAS 157] false or misleading only if [the company] had not truly believed that the models, assumptions and inputs would produce fair values in accordance with [FAS 157]." *Id*; *see also Yu v. State St. Corp.*, 686 F. Supp. 2d 369, 379-80 (S.D.N.Y. 2010) ("[I]f the stated valuations complied with the disclosed methods, they would not be actionable as 'false or misleading,' because they would correspond to the value that the offering documents led investors to expect."), *leave to replead granted*, 2010 WL 2816259 (S.D.N.Y. July 14, 2010).

A. Respondents Employed a Reasonable and Appropriate Valuation Process

In the case at hand, Respondents went to extraordinary lengths to ensure that their valuation methodology was robust and that the inputs used in the valuation process were based on an objective assessment of the risk characteristics of the underlying receivables. For its part, the Division has offered no evidence suggesting that the valuations at issue reflected anything other than Respondents' genuinely held assessment of the assets' values. Ultimately, the fact that Respondents reasonably valued the assets in the Funds' portfolio has been endorsed by

unrebutted expert testimony and confirmed by events, which shows that the valuations at issue were not only reasonable, but accurate.

1. Respondents' Valuation Methodology Was Robust

Respondents have ensured the robustness of their valuation model by involving the independent analysis and input of a variety of professionals throughout the origination and valuation process. Since 2011, RDLC has employed Pluris, a nationally-recognized third-party valuation firm, to provide monthly valuations of the Funds' assets.[18] RDLC selected Pluris for its experience valuing thinly-traded debt obligations, which are similar in nature to legal fee receivables.[19] Each month, RDLC provides Pluris updated information on the assets held in the Funds, including payment schedules, participation interests, and other factual data that may affect valuation.[20] Pluris reviews the information provided by RDLC along with historical payment patterns in the portfolio, delinquency rates, and interest rates for similar illiquid instruments.

Pluris also conducts independent research and has the ability to directly discuss the assets with the counterparties to RDLC, including the law firms whose receivables were purchased by the Funds. For example, the founder and president of Pluris, Espen Robak, testified that he gained an independent understanding of the factors impacting the discount rate and expected repayment date for the *Peterson* receivables by reading the district court opinions and other materials written about the case and having detailed discussions with the lead attorney, Steven Perles.[21]

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18 *See* Exhibit E, Zatta Tr. at 33:6-12.

19 *See id.* at 82:18-20.

20 *See, e.g.*, Exhibit G, Larochelle Tr. at 34:25-35:3.

21 *See* Exhibit H, Robak Tr. at 194:7-199:22, 258:17-264:21.

With the totality of the information it gathers, and using a proprietary model developed for this purpose,[22] Pluris conducts an updated monthly discounted cash flow analysis on each asset in the portfolio based on factors such as estimated repayment dates, interest rates, and market-based discount rates.[23] Pluris then provides a Portfolio Valuation Report to RDLC estimating the value of the assets as of month end.

A Valuation Committee at RDLC reviews the monthly valuation reports provided by Pluris and analyzes the appropriate fair values for the assets in the Funds. Since 2011, RDLC has never deviated from the values Pluris has recommended.

In addition, the independent auditor of the Funds, Marcum LLP ("Marcum"), reviews and tests the valuation of the Funds' assets, as well as the valuation process followed by RDLC, as part of its regular audit procedures.[24] Due to the complex nature of the assets at issue, Marcum also employs an "internal audit process" to confirm the valuations, which includes an analysis by Marcum's internal valuation expert.[25] Dennis Schall, the assurance partner for Marcum's Alternative Investment Group, described their specialized valuation auditing process:

> When we identify a portfolio that we want someone from our advisory group to get, we provide them with the valuation report, we have a conversation with them, we tell them what the client does, we give them whatever he needs, we give them that documentation. From there, he reviews the report. We then have conversations with the client and/or the valuation firm, in this particular case Pluris. My valuation expert will ask independent questions, whatever he wants to ask or she wants to ask, and from all that data, they prepare the report.[26]

After conducting an independent review of Pluris and its valuations of the Funds' assets,

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22 Exhibit F, Liu Tr. at 18:17-21.

23 *See, e.g.*, *id.* at 38:10-17; Exhibit G, Larochelle Tr. at 64:1-6; Exhibit H, Robak Tr. at 279:5-12.

24 *See* Exhibit I, Schall Tr. at 33:18-20.

25 *Id.* at 129:9-13.

26 *Id.* at 131:10-23.

Marcum's valuation expert concluded that Pluris was a qualified appraiser, that Pluris' valuation methods and assumptions were reasonable and appropriate, and that Pluris' fair value conclusions were reasonable.[27]

2. Respondents' Valuation Inputs Were Independently Analyzed

While the Division suggests in the OIP that Respondents somehow manipulated the inputs into this valuation process in order to inflate the reported value of the assets, it has failed to develop any evidence that could create a material issue of fact on this issue. To the contrary, the undisputed evidence shows that Pluris relied on independent experts even as to these so-called "inputs."

Respondents enlisted several independent legal due diligence advisors to conduct legal and risk reviews of selected receivables—including those arising from the *Peterson* litigation.[28] At the origination stage, Respondents engaged one outside law firm to perform an enhanced risk review of any position greater than $500K.[29] From 2007 through 2014, in conjunction with the Wiss & Company accounting firm ("Wiss"), a second outside law firm performed quarterly audits of selected delinquent assets; Wiss then included status updates of these assets in its quarterly "Agreed-Upon Procedures" reports, which Respondents made available to investors.[30]

In addition, in connection with the *Peterson* receivables, Respondents engaged outside counsel from the law firm Reed Smith to perform extensive analysis of the strength of the

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27 *See, e.g.*, Exhibit L, Mem. of Anthony R. Banks dated February 9, 2015, at 4 ("Conclusion: . . . As a result of all the factors presented in the report, the value conclusion is reasonable.").

28 *See* Exhibit B, Martin ¶¶ 54 & n.14, 67, 71 & n.30.

29 *See* Exhibit B, Martin ¶ 71 n. 30. This enhanced review is in addition to the standard internal review performed on all prospective receivables by Respondents' inside counsel. *Id.*

30 *See* Exhibit B, Martin ¶¶ 54, 67 & nn.27-28 (citing "Agreed-Upon Procedures" report for the third quarter of 2013); Exhibit O, Deposition Transcript of Roni Dersovitz dated January 19, 2017 (excerpted) ("Dersovitz Tr.") at 190:7-192:20 ("[RDLC] . . . had an investor website where we posted . . . the agreed-upon procedures.").

Peterson plaintiffs' claims, which that firm captured over a span of more than a year and a half in a dozen detailed memoranda submitted to Respondents and made available to Pluris.[31] Similarly, Respondents utilized outside counsel from another third-party law firm, Smith Mazure, to evaluate and monitor the strength and status of certain case inventories, including the case inventory that served as collateral for receivables from the Osborn firm, which the Division refers to in the OIP as "Law Firm A."[32] As one of Respondents' experts explained, these independent law firms evaluated the receivables to help determine the likelihood and timing of payout on the receivables, which are key factors in determining the discount rate used to value Level 3 assets.[33]

This process resulted in different valuations based on the specifics of the particular receivable.[34]

3. Unrebutted Expert Testimony Confirms that Respondents' Valuation Process Was Sound

Respondents' experts – Leon M. Metzger ("Metzger") and David X. Martin ("Martin") – provide unrebutted testimony that the valuation procedures RDLC followed met all industry standards for Level 3 assets and that the values assigned to the portfolio assets were reasonable and accurate. The Division's response to these experts is silence; the Division has not offered any expert of its own to address the reasonableness of Respondents' valuation methodology, and

31 *See* Exhibit B, Martin ¶ 54 & n.14 (citing memoranda dated Aug. 17, 2012; May 8, 2013; and March 3, 2014).

32 Exhibit V, Deposition Transcript of Corey Tavel dated January 6, 2016 (excerpted) ("Tavel Tr.") at 22:9-20 (Smith Mazure was hired by Wiss & Company to audit law firms dealing with RD Legal); *id.*, at 126:4-7 (explaining Smith Mazure audited Osborn Law); Exhibit S, Deposition Transcript of Daniel A. Osborn dated January 12, 2017 (excerpted) ("Osborne Tr.") at 65:10-67-1 (explaining that he periodically shared with Smith Mazure his expectations regarding settlements of his pending cases).

33 Exhibit B, Martin ¶¶ 17, 54.

34 *See, e.g.*, Exhibit M, January 2014 Pluris Valuation Report; Exhibit H, Robak Tr. at 130:6-9 (explaining that the "base yield" is the discount rate); Exhibit B, Martin ¶ 17.

such testimony would not be within the scope of knowledge of any percipient witness.

As confirmed by ample evidence revealed in discovery and the uncontroverted testimony of Respondents' experts, Respondents' valuation model was vigorous, reasonable, and in compliance with applicable accounting rules, industry standards, and best practices.[35] As Martin explained, Respondents' valuation model was compliant with ASC 820/FAS 157, the accounting principle governing the determination of fair value.[36] ASC 820/FAS 157 instructs that the fair value of the Funds' assets be determined according to the "exchange price" notion.[37] The "exchange price" focuses on the price that would be received when selling the asset (an exit price), rather than the price that would be paid to acquire the asset (an entry price).[38] Thus "a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability."[39]

Martin's testimony confirms that Respondents' valuation model complied with these requirements. Respondents' assignment of credit ratings to all its litigation receivables reflected a market approach.[40] Further, the valuations of Respondents' assets took into account individualized receivable discount rates that reflected non-performance risk related to timing and the nature of the underlying litigation, including likelihood of success.[41] In sum, Respondents employed a sound fair market value approach in marking their assets, in compliance with ASC

35 *See generally* Exhibit B, Martin ¶¶ 15, 50-74, 78; Exhibit A, Metzger ¶¶ 13.v, 117-37.

36 *See* Exhibit B, Martin ¶ 64; *see generally City of Omaha, Neb. Civilian Emp. Ret. Sys. v. CBS Corp.*, No. 08-cv-10816, 2010 WL 1029290, at *7 (S.D.N.Y. Mar. 16, 2010) ("The SEC recognizes the standards of the Financial Accounting Standard Board as authoritative.").

37 Exhibit B, Martin ¶ 64.

38 *Id.*

39 *Id.* ¶ 65.

40 *See id.* ¶ 67.

41 *Id.*

820/FAS 157.[42]

Respondents' valuation procedures also conformed to valuation principles promulgated by the International Association of Financial Engineers. Indeed, Metzger's uncontroverted testimony establishes that Respondents' procedures align with all 18 of the applicable principles.[43] (The other 11 principles are inapplicable to the Funds.) The applicable principles include that valuation be performed in good faith, that all investors be treated equitably, and that valuation be performed in accordance with a disclosed valuation policy.[44]

4. History Has Vindicated the Reasonableness and Accuracy of Respondents' Valuations

There is additional, and particularly stubborn, evidence that Respondents did not make unreasonable assumptions in connection with the valuation of their assets—the fact that Respondents' valuations have proven remarkably accurate. The undisputed record—including significant intervening facts postdating the initiation of this proceeding—and the passage of time have repeatedly borne out the valuation analyses performed by Respondents' independent valuation agent.

For example, the Trustee of the *Peterson* Qualified Settlement Fund began the distribution of monies to *Peterson* plaintiffs on October 19, 2016, and approved an initial distribution to *Peterson* attorneys on November 24, 2016—thereby validating Respondents' confidence that the primary risk to both classes of *Peterson* positions was duration risk rather than credit risk.[45]

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42 *See id.* ¶¶ 15, 67; Exhibit A, Metzger ¶ 128; Exhibit O, Dersovitz Tr. at 157:14-15; Exhibit H, Robak Tr. at 130:5-7; Exhibit I, Schall Tr. at 87:21-88:10.

43 *See* Exhibit A, Metzger ¶ 134.

44 *Id.*

45 *See* Exhibit K, S. Jacob Ltr. to Hon. K. Forrest dated Jan. 13, 2017.

Moreover, RDLC retained KPMG LLP ("KPMG") in 2015 to provide valuations of certain *Peterson* assets. The fair value determinations KPMG made came out higher, rather than lower, than the corresponding values Pluris had assigned.[46] Put differently, Pluris was more conservative than KPMG in its valuations.

Pluris' conservative valuations are further confirmed by the conduct of the counterparties to RDLC. By September 2016, the two *Peterson* law firms with which Respondents entered into assignment and sale agreements had completed repayment of their full balances owed to Respondents, and made these repayments at amounts above the independent valuations of those receivables provided by Pluris.[47] In other words, the largest *Peterson*-related positions paid out *in excess* of their most recent valuations.

In light of these undisputed facts it is difficult to see how the Division can argue in good faith that the assumptions underlying the original valuations for those assets were somehow "unreasonable." (OIP ¶ 1.)

B. The Division's Individual Criticisms Of The Valuation Process Are Unfounded

The OIP identifies four specific complaints the Division lodges against Respondents' valuation procedures. (OIP ¶¶ 60-74.) As explained below, none of these charges has merit and none creates a triable issue of fact regarding the reasonableness of Respondents' valuation process.

1. Respondents Used an Appropriate Discount Rate in Valuing the *Peterson* Receivables

The Division first alleges that Respondents, when providing Pluris with inputs in

46 *Compare* Exhibit N, KPMG ltr. to R. Dersovitz dated Jan. 13, 2016, re: Valuation Estimates for the Plaintiff Receivables as at December 31, 2015, at 4 *with* Exhibit P, Pluris Valuation Report for RD Legal Capital, LLC, An Analysis of a Portfolio of 10 Receivable Positions as of September 30, 2015, at 5.

47 *See* Exhibit B, Martin ¶ 56 & Ex. 10.

connection with the *Peterson* receivables, improperly relied on an implied rate of return that the Funds had achieved on the sale of other receivables for which "the primary risk was timing rather than litigation outcome." (OIP ¶ 64.) But as the uncontroverted evidence, expert testimony, and passage of time all demonstrate, Respondents were *correct* to think that the primary risk for the *Peterson* receivables was duration risk, and Respondents had sound rationales for their decision to assign a top credit rating to these assets. Indeed, the actual realized returns (by weighted average or "IRR") on *Peterson* receivables that were fully paid off by September 2016 was 33.40%—substantially higher than the average IRR of 24.75% for Respondents' non-*Peterson* receivables that paid within the same timeframe[48]—thus demonstrating that the comparison to prior receivables was appropriate.

Moreover, the Division's armchair speculation regarding supposed litigation risk associated with the *Peterson* receivables fails to take into account numerous considerations that Respondents weighed in reaching their determination that these positions were "the best deal in the book."[49] These include the *sui generis* circumstances of *Peterson* itself, as analyzed extensively in memoranda from outside counsel, where the assets at issue had been restrained by a federal court, blocked by executive order of the President of the United States, and expressly earmarked by the U.S. Congress for distribution to the *Peterson* victims; the numerous and redundant potential alternative sources of recovery available to the *Peterson* plaintiffs, as confirmed in sworn testimony from *Peterson* attorney Steven Perles, who was in direct contact with Pluris; and the multiple layers of additional collateral Respondents were able to negotiate in

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48 Exhibit B, Martin ¶ 37.

49 Exhibit O, Dersovitz Tr. at 212:7.

connection with the bulk of the *Peterson* receivables, as quantified by unrebutted testimony.[50]

Not only does the OIP fail to address any of these factors or to give any credit to Respondents' business judgment in the field they pioneered, but the Division has declined to adduce any evidence or proffer any expert testimony that in any way supports its contention that Respondents' inputs were inappropriate. The Division has "establishe[d] nothing more than that [it] disagree[s] with some of [Respondents'] investment valuations," but "alleging disagreement with some . . . valuations does not equate to alleging fraud." *In re Allied Capital Corp. Sec. Litig.*, No. 02-cv-3812, 2003 WL 1964184, at *4 (S.D.N.Y. Apr. 25, 2003); *see also Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC.*, 479 F. Supp. 2d 349, 367 (S.D.N.Y. 2007) ("[A] bald allegation that the valuations were overstated [is] insufficient.").

2. The Valuation Process Appropriately Incorporated Legal Analysis When Assessing the Risk Associated With the Funds' Investments

The OIP suggests that there is something unusual about the fact that Pluris' professionals are not attorneys, and therefore must not "understand the legal issues underlying the litigations in which the Funds invested." (OIP ¶ 65.) This is nonsense. First, there is no requirement—under the law, GAAP, or common sense—that a *valuation agent* be an expert in the substance of the underlying business of every client for whom it provides its services, and indeed such a requirement would require a degree of specialization that would surely drive numerous valuation

50 *See, e.g.*, Exhibit B, Martin ¶ 54 & n.14 (citing Reed Smith Memoranda to R. Dersovitz dated Aug. 17, 2012; May 8, 2013; and March 3, 2014); Exhibit J, Deposition Transcript of Steven R. Perles dated January 24, 2017 (excerpted) ("Perles Tr.") at 44:11-53:24, 114:1-121:9 (discussing the Terrorism Risk Insurance Act of 2002; Executive Order 13599; the Iran Threat Reduction and Syria Human Rights Act of 2012; U.S. District Judge Katherine B. Forrest's order concerning proceeds from the sale of the building at 650 Fifth Avenue; and the Feinberg fund); Exhibit H, Robak Tr. 194:7-199:22, 258:17-264:21 (discussing communication between Mr. Robak and Mr. Perles); Exhibit B, Martin ¶¶ 26-30 (quantifying and analyzing the collateral coverage for the *Peterson* attorney-fee receivables); *see also, e.g.*, Exhibit A, Metzger ¶¶ 69, 98, 111-12 (deeming "immaterial" the difference between "the Funds' investments in receivables related to the *Peterson* case, which had a dedicated government-restrained pool of money set aside to satisfy the judgments," and investments in legal receivables related to settlements).

firms out of business. Second, the sworn testimony of Pluris' principal makes clear that Pluris was communicating with, and calibrating its valuation model based on information ascertained from, the attorneys directly involved in underlying litigations such as *Peterson*—who most certainly did "understand the legal issues" involved.[51] Finally, as discussed further above, from the perspective of the integrity of Respondents' valuation process as a whole, the source of the independent check on Respondents' evaluation of the *legal* claims underlying the Funds' positions was never meant to be Pluris; rather, this assurance comes from the numerous other professionals enlisted by Respondents who *are* legal experts.[52]

3. Respondents Did Not Mischaracterize the Collateralization of the *Peterson* Plaintiff Receivables

The Division suggests it was improper to treat each *Peterson* plaintiff's portion of the default judgment as collateral, given that many other plaintiffs had potential claims to the same pool of assets. (OIP ¶ 66.) As a threshold issue, the Division has no evidence to support the numerous alleged facts embedded in its allegation. The Division has presented no witness competent to testify that Pluris' valuation was unreasonable, to testify regarding what the "correct" amount of collateral should have been, or to address how any such difference in reported collateral would have materially affected the valuation.

In any event, the undisputed expert and fact witness testimony demonstrates that there was nothing improper about Pluris' valuation methodology or *Peterson* valuations. Respondents provided information to Pluris regarding the amounts of collateral backing assets in the Funds' portfolio, including the *Peterson* assets, and Pluris considered this information as one of many

51 *See* Exhibit H, Robak Tr. 194:7-199:22, 258:17-264:21 (discussing conversations with the Perles law firm); *see also id.* at 350:24-353:9 (discussing conversations with the Osborn law firm).

52 *See* Section IV.A.2, *supra* (citing, e.g., Exhibit B, Martin ¶¶ 54 & n.14, 67 & nn.27-28, 71 & n.30).

factors that may impact the ultimate valuation of any given position in the Funds.[53]

The decision to treat the *Peterson* plaintiffs' portion of the default judgment as collateral was entirely reasonable. To the extent the Division is suggesting that there were plaintiffs from other cases (*i.e.*, non-*Peterson* plaintiffs) with potential claims to the frozen assets, that is of no moment because under New York law the first judgment holder to obtain a writ of execution against an asset has first priority, and the *Peterson* Plaintiffs appear to have had priority by this standard.[54] The Division has not made any allegation to the contrary.

In any event, it was entirely reasonable to treat the plaintiffs' portions of the default judgment as collateral because there were multiple sources of funds available to satisfy those judgments.[55] In addition to the approximately $2 billion of Citibank Assets that have been frozen since 2008 and made available to satisfy the judgments against Iran, in early February 2012 President Obama signed an Executive Order blocking all property of the Government of Iran and Iranian financial institutions in the United States. *See* Exec. Order No. 13599, 77 Fed. Reg. 6659, 6659 (Feb. 5, 2012). And in late summer of 2012, Congress passed the Iran Threat Reduction and Syria Human Rights Act of 2012, which included a provision that accelerated the payments that were due to the *Peterson* plaintiffs. *See* 22 U.S.C. § 8772.[56] In addition, in 2009 the U.S. Attorney obtained forfeiture of 650 Fifth Avenue in New York City, and the District Court judge presiding over the *Peterson* case subsequently ordered that 48.70% of the proceeds

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53 Exhibit H, Robak Tr. at 47:20-25.

54 N.Y. C.P.L.R. § 5234; *Hausler v. JPMorgan Chase Bank, NA.*, 845 F. Supp. 2d 553 (S.D.N.Y. 2012); Exhibit O, Dersovitz Tr. at 216:23-218:17.

55 Exhibit B, Martin ¶¶ 26-30.

56 At the time, the Peterson plaintiffs had already filed a motion for summary judgment to turn over the Citibank Assets under Section 201(a) of the Terrorism Risk Insurance Act ("TRIA"), which provides that "in every case in which a person has obtained a judgment against a terrorist party . . . the blocked assets of that terrorist party shall be subject to execution or attachment." Terrorism Risk Insurance Act of 2002 ("TRIA"), Pub. L. No. 107-297, § 201(a), 116 Stat. 2322, 2337 (codified as 28 U.S.C. § 1610).

from the sale of that building be set aside for the *Peterson* plaintiffs. *See* Stipulation and Order of Settlement Between the United States and Certain Third-Party Claimants at 9, 1:08-cv-10934-KBF.[57] Finally, Congress also passed the Justice for United States Victims of State Sponsored Terrorism Act, which provides a mechanism for victims of terror – such as the *Peterson* plaintiffs – to receive restitution. 42 U.S.C. § 10609 (2016).

In addition to the multiple sources of collateral, the Funds were further protected by the fact that the Funds only took a portion of the plaintiffs' total award. This helped ensure over-collateralization, because the Funds advanced only what it thought it could collect, and not necessarily the total amount of the particular plaintiff's default judgment.[58]

4. Respondents Disclosed Changes in the "Law Firm A" Receivables and "Law Firm B" Receivables

Finally, the OIP also raises the concern that certain receivables from "Law Firm A" and "Law Firm B" (understood to be Osborn and Cohen, respectively) had "accrued to such high valuations that it was *doubtful* whether those inflated amounts could be covered." (*See* OIP ¶ 69 (emphasis added).)

The Division's allegation reflects a fundamental misunderstanding of what it means to value a Level 3 asset. The valuation of such assets necessarily involves—and is the expression of—a lack of certainty and the exercise of judgment.[59] Vague, speculative, and uninformed conclusions by the Division about increased risks to the collectability of individual receivables within the Funds' portfolio are insufficient to make out a case for fraud.

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57 The district court order was subsequently vacated and remanded for further proceedings. *See In re 650 Fifth Ave. & Related Properties*, 830 F.3d 66 (2d Cir. 2016).

58 For the *Peterson* attorney receivables—as distinguished from the *Peterson* plaintiff receivables—the collateral consisted of the amount of the legal fee receivable *plus* additional collateral that Respondents had obtained from the attorneys (Thomas Fay and Steven Perles), which included other assets of those two attorneys and their law firms. *See generally* Exhibit E, Zatta Tr. 85:20-86:6.

59 *See* Exhibit A, Metzger ¶¶ 120-122.

More importantly, the Division falsely claims that "Dersovitz failed to disclose to [Pluris] changes in certain cases that influenced whether Dersovitz reasonably could expect to collect on those investments, which in turn led to inflated valuations for assets in the Funds by understating their riskiness." (OIP ¶ 68.) To the extent that this vague allegation relates to the Law Firm A and Law Firm B receivables, it is directly contradicted by undisputed evidence. Indeed, Pluris' principal testified that the Osborn valuation was adjusted[60] based on various inputs, including telephone calls with the Osborn firm about its roster of cases and expected collections,[61] and written information from the Osborn firm.[62] And, as noted above, Respondents engaged outside counsel from the law firm Smith Mazure to audit the case inventory that served as collateral for receivables from the Osborn firm, and Pluris had access to the work product Smith Mazure generated.[63]

In short, the Division's characterization of how Respondents went about valuing the Osborn and Cohen receivables completely ignores the robust valuation process that Respondents followed in connection with the valuation of *every* receivable in the Funds' portfolio. As described in Section IV.A above, that process was run by a number of outside, independent professionals that included not only Pluris, but numerous other third parties, including the independent auditor for the Funds, Marcum. The suggestion, moreover, that Respondents "failed to disclose" information about the Osborn and Cohen receivables is belied by the fact that Respondents' management of these receivables was well documented in the "Agreed-Upon Procedures" reports ("AUPs") that Wiss & Company prepared three times annually from 2007

60 Exhibit H, Robak Tr., at 68:14-15.

61 *Id.* at 351:2-11.

62 *Id.* at 352:5-13 (explaining Osborn discussed the firm's "roster of cases" and "[t]hey were very optimistic").

63 Exhibit O, Dersovitz Tr., at 190:7-192:20 (explaining RDLC, Pluris, and Marcum all relied on Smith Mazure's audit of the Osborn firm).

through 2014.[64] It was no secret—neither to investors nor to Pluris—that the Law Firm A and Law Firm B receivables were subject to "work outs." The AUPs were available to investors from, among other places, the RD Legal website.[65] Pluris was able to communicate—and did communicate—directly with the attorneys from whom the Funds had purchased these receivables.[66] Respondents thus relied on the expertise of Pluris to value these receivables and fully disclosed the work out arrangements to their investors.

Once again, the Division has neither adduced nor proffered a shred of factual or expert evidence to substantiate its insinuation that the approach Respondents took toward particular receivables was inappropriate or unreasonable. Rather, the evidence demonstrates that Respondents have at all times relied on their robust and sound valuation process to assess the value of the Osborn and Cohen receivables based on the information available at any given time.[67]

C. The Division Cannot Point to Any Evidence to Support Its Claims that Respondents' Valuation of the Funds' Assets Was Unreasonable

Ultimately, the Division has not identified any expert witness to testify about the valuation of the assets in the Funds or the valuation procedures employed by RDLC, and has not elicited any percipient witness testimony to undercut the robust valuation procedures Respondents employed and the accurate valuations that resulted from those procedures. Indeed, neither the OIP nor anything in the record so much as hints at what the Division believes any

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64 *See* Exhibit B, Martin ¶¶ 54, 67 & nn.27-28 (citing "Agreed-Upon Procedures" report for the third quarter of 2013).

65 *See* Exhibit O, Dersovitz Tr. 190:7-192:20 ("[RDLC] . . . had an investor website where we posted . . . the agreed-upon procedures.").

66 *See e.g.*, Exhibit H, Robak Tr. 351:2-11.

67 *See e.g.*, Exhibit B, Martin Ex. 5B (indicating that four paid-off Osborn receivables had Actual Annualized Return Rates ranging from 21.06% to 21.69%).

particular valuation should have been, or what source or method Respondents should have consulted or employed to ascertain that correct value.

As a consequence, the Division has not indicated the *extent* of Respondents' purported overvaluation, making it impossible for a factfinder to determine whether any such overvaluation was material. This on its own is sufficient basis for summary disposition. *See SEC v. Mannion*, No. 10-cv-3374, 2013 WL 1291621, at *12 (N.D. Ga. Mar. 25, 2013) (granting summary judgment to defendant on SEC's overvaluation claims under Investment Advisers Act because "[a]bsent evidence of the extent of [defendant's] overvaluations, whether these overvaluations are material cannot be determined.").

Despite taking years to build its case, the Division can point to nothing more than bare, unsubstantiated assertions that Respondents' assessment of certain inputs into the valuation methodology was incorrect. Such differences of opinion on the proper value to ascribe Level 3 assets—which necessarily involves the exercise of judgment on the part of the Investment Manager and the professionals, both internal and external, engaged in the valuation process—cannot constitute securities fraud. Fair value accounting "expressly contemplates that different models, based on different assumptions and the assignment of different weight to different inputs, may be used to determine [the] fair value" of Level 3 assets. *Lehman Bros.*, 799 F. Supp. 2d at 311; *see also, e.g., Allied Capital Corp. Sec. Litig.*, 2003 WL 1964184, at *1 ("[V]aluing [assets] for which no current market exists involves the exercise of judgment, and is inherently imprecise."). The Division's subjective view that the Funds' receivables should have been given lower values simply cannot establish the existence of an illegal scheme under the securities laws. *See Epirus Capital Mgmt., LLC v. Citigroup Inc.*, No. 09-cv-2594, 2010 WL 1779348, at *6 (S.D.N.Y. Apr. 29, 2010) ("Essentially, plaintiffs simply disagree with defendants' valuation

methods, which does not equate to alleging fraud.").[68]

In short, the record confirms what common sense would have suggested from the outset: Respondents' valuation model, informed by Respondents' extensive experience in the alternative investment space that they pioneered, has more predictive power than does the Division's speculative Monday-morning quarterbacking.[69]

V. THE COURT SHOULD ENTER SUMMARY DISPOSITION ON THE DIVISION'S REQUEST FOR ELEVATED PENALTIES

In a case where no investors lost money, and all investors earned significant gains on their investment, the Division has requested Tier III penalties against Respondents. This request is wholly unsupported by the facts in this case. Thus, while Respondents are confident that they will prevail on the merits at trial, they nonetheless ask the Court to enter summary disposition on the request for elevated penalties. The ability of the Division even to seek such penalties may affect whether Respondents would need to consider presenting an inability-to-pay defense at trial.

As the Court knows, to obtain Tier III penalties the Division would have to show that investors suffered "*substantial* losses," were exposed to a "*significant* risk" of such losses, or that Respondents obtained "substantial pecuniary gain" from the acts alleged in the OIP. *See* 15 U.S.C. § 78u-2(b)(3).[70] This is a burden the Division cannot meet.

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68 *See also* Exhibit A, Metzger ¶ 121 & n.68.

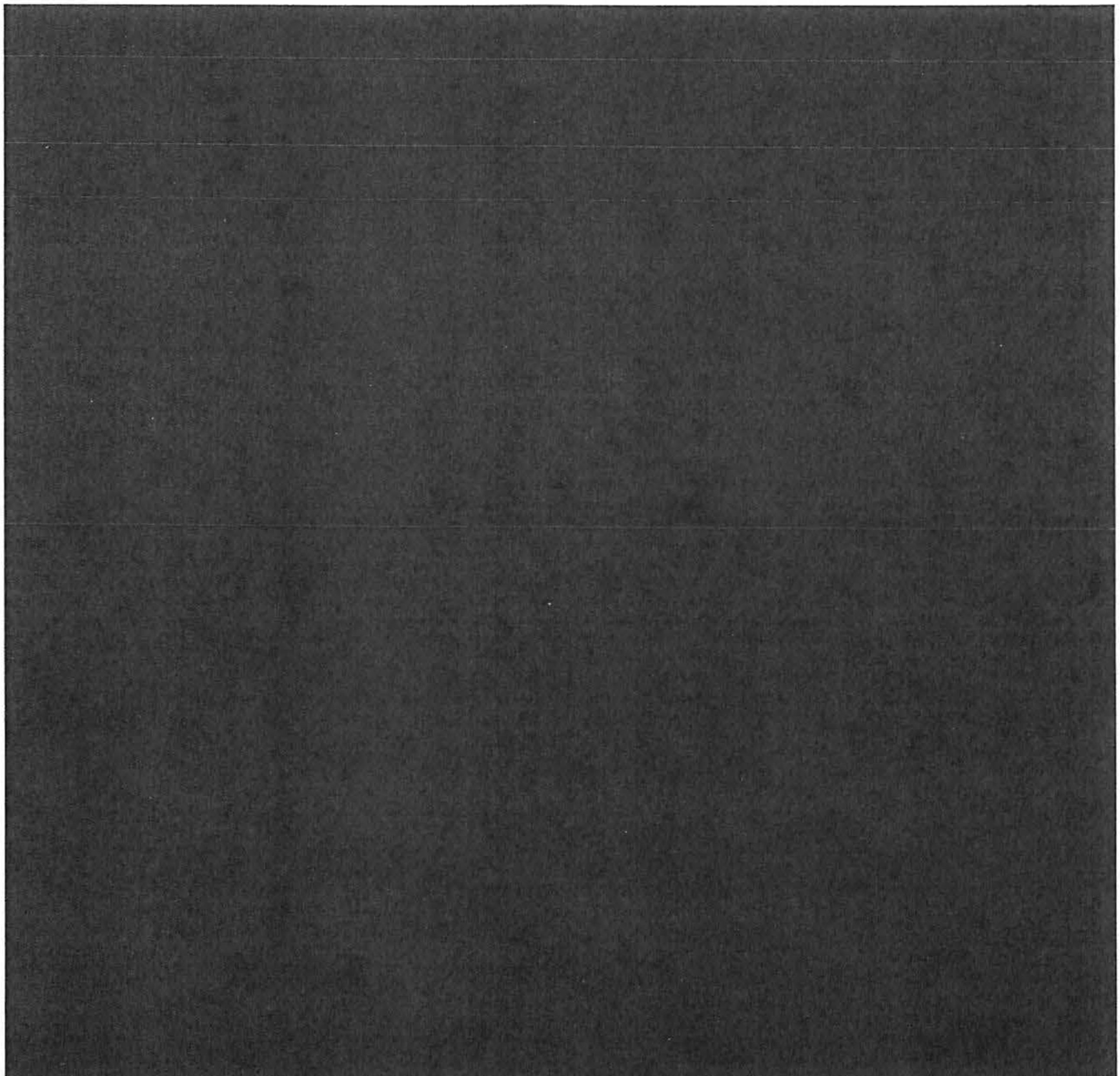
69 *See generally* Exhibit B, Martin ¶ 51–57 (discussing Respondents' information advantage).

70 Tier III penalties are only appropriate where the Division can demonstrate violations that (1) "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," and (2) "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission." 15 U.S.C. § 78u-2(b)(3). Both of these elements must be met. *See, e.g.*, *Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1099 (D.C. Cir. 2005) (vacating sanction where SEC did not explain "how petitioners' conduct either resulted in or created a significant risk of substantial loss to others").

A. Investors Suffered No Losses

The returns of the Funds are not in dispute. As noted above, from its formation in 2007 through the present, all investors in the Domestic Fund have earned a 13.5% return per annum. Fully participating investors in the Offshore Fund earned a return of 13.5% from 2007 through 2014, and an average of 11.4% in 2015. These are facts the Division cannot rebut.

B. Respondents Did Not Obtain Substantial Pecuniary Gain



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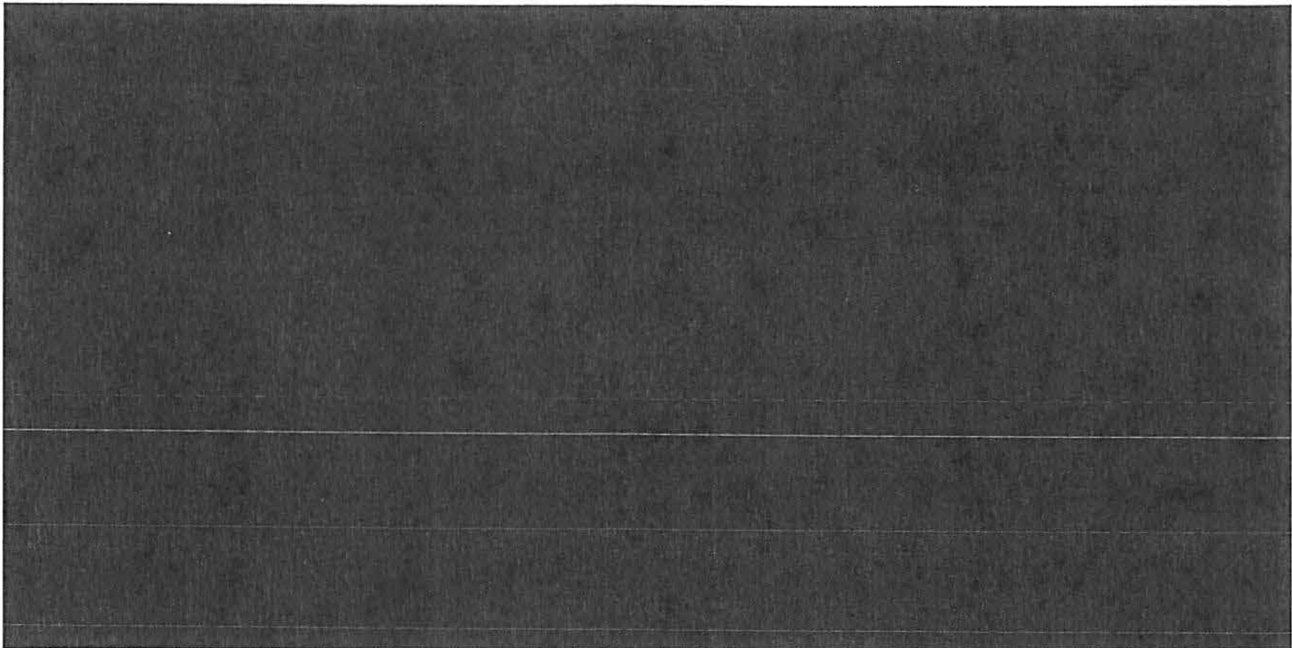

C. There Is No Evidence of a Significant Risk of Substantial Losses to Investors

Given the above, to keep alive its request for Tier III penalties, the Division would have to demonstrate that there had been a "*significant* risk" of "*substantial* losses" to investors.[75] But where is the evidence of that? The Division has none, and will be unable to present any at trial. The Division cannot stand behind mere words on a page in the OIP when confronted with facts. It is required to respond with evidence. *See Kornman v. SEC*, 592 F.3d 173, 182 (D.C. Cir. 2010) (affirming summary disposition where non-movant "proffered no evidence to contradict" the evidence presented).

A review of the *Peterson* cases is instructive. Over the period covered in the OIP, receivables related to the *Peterson* cases represented between approximately 25% and 68% of

75 *See* footnote 71, *supra*.

the assets in the portfolio.[76] Did these receivables create a "significant risk" of "substantial losses"? On the contrary. The undisputed evidence shows that "the *Peterson* receivables actually reduced the risk profile of the overall portfolio." (Exhibit X, Martin ¶ 13.)[77] This expert testimony is unrebutted, as the Division has not identified any expert witness to testify on this subject. If receivables representing up to 68% of the assets in the portfolio actually reduced risk, where is the evidence of a "significant risk" of "substantial losses" to investors from the conduct alleged?

Civil penalties are only appropriate where there has been a willful violation and levying a penalty would be in the public interest. 15 U.S.C. §§ 78u-2(a)(1), (c); *see John P. Flannery*, SEC Release No. 3981, 2014 WL 7145625, at *40 (Dec. 15, 2014), *vacated on other grounds sub nom.*, *Flannery v. SEC*, 810 F.3d 1 (1st Cir. 2016). In this case, where investors made substantial returns on their investments, and Respondents have been carrying the business out of their own assets, the imposition of civil penalties would be contrary the public interest. *See Lawrence M. Labine*, SEC Release No. 973, 2016 WL 824588, at *41 (March 2, 2016) (civil penalties not appropriate where, *inter alia*, respondent "had a good faith belief that [investments] would succeed" and where clients "ultimately got back, on average, sixty-five percent of their principal payment"). Indeed, individuals such as Mr. Dersovitz who place their own capital at risk to preserve the assets of their investors in time of stress should be acknowledged for their stewardship of a fund, not penalized.

There are no material facts in dispute related to the Division's inability to meet the basic elements for obtaining Tier III penalties. Accordingly, the Court should enter summary

76 Exhibit A, Metzger ¶ 94.

77 "Any claim that the concentration of *Peterson* receivables materially increased the overall risk to the portfolio is . . . fundamentally flawed." Exhibit B, Martin ¶ 14. *See also id.* ¶¶ 21-39 & Exs. 1-5.

disposition on this issue.

VI. CONCLUSION

For the reasons stated above, the Court should grant summary disposition to Respondents with regard to all claims relating to valuation and the Division's request for Tier III penalties.

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Respectfully submitted,

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