Hughes
Hubbard

Hughes Hubbard & Reed LLP
1775 I Street, N.W.
Washington, D.C. 20006-2401
Telephone: +1 (202) 721-4600
Fax: +1 (202) 721-4646
hugheshubbard.com

Terence M. Healy
Partner
Direct Dial: +1 (202) 721-4676
terence.healy@hugheshubbard.com

May 12, 2017

Hon. Jason S. Patil
Administrative Law Judge
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: *In the Matter of RD Legal Capital, LLC, et al.*
Administrative Proceeding No. 3-17342

Dear Judge Patil:

We represent RD Legal Capital, LLC and Roni Dersovitz ("Respondents") in the above matter. We write the Court in response to the letter of the Division of Enforcement (the "Division") dated May 5, 2017 (the "Letter") related to the valuation claims in this proceeding.

Following the closing arguments at trial—in which the Division did not mention valuation or argue in support of any of its allegations related to valuation—the Court asked if the Division was still pursuing any claims that Respondents had artificially inflated the value of the assets in the Funds.[1] Tr. 7065:25-7066:25. The Court then directed the Division to submit a letter identifying all hearing evidence supporting any allegations that "the valuations of the funds were unreasonable and inflated." Tr. 7067:10-14; Post-Hr'g. Order 1.

In the Letter submitted in response, the Division has failed to identify any evidence that the valuations at issue were unreasonable or inflated. In fact, the Division makes no effort to meet this burden and instead makes the remarkable statement that it is now *not* asserting that the valuations were "incorrect." Ltr. at 2, n.1. Instead, the Division argues, in effect, that it does not *approve* of how those valuations were used to allocate the profits and losses of the Funds each month, and that these facts are "directly relevant to remedies in this case." *Id.* at 1. As to responding to the Court's order to identify evidence showing the valuations were in fact unreasonable, the Division has taken a pass.

1 "Funds" as used herein identifies RD Legal Funding Partners, LLP and RD Legal Funding Offshore Fund, Ltd.

The Division provided no evidence at trial to support the claims in the Order Instituting Administrative and Cease-and-Desist Proceedings ("OIP") related to the valuation of the assets in the Funds. The evidence that was presented at trial showed that (1) Respondents process for valuing the Funds' assets was reasonable and (2) the values assigned to the receivables was accurate. Respondents respectfully renew their request that the Court enter disposition as a matter of law under Rule of Practice 250 over the claims as stated in paragraphs II.A.1.(ii) and II.G.60-74 in the OIP.

I. Background

In the OIP, the Division alleges that Respondents "employed a scheme" to withdraw millions of dollars from the Funds by overstating the value of the portfolio based on "unreasonable assumptions." OIP ¶¶ 1, 60. After raising these allegations in the first paragraph of its complaint, the Division has taken virtually no action—either in the discovery phase or the trial itself—to actually support them. The Division never offered an expert witness to testify to the esoteric issue of how to properly value illiquid assets such as the receivables in Respondents' Funds. The Division did not mention valuation in its opening statement at trial and, as noted above, made no effort to support its valuation claims in its closing argument—a fact which did not go unnoticed by the Court. The Division offered no witnesses which supported its allegations on valuation, and the witnesses it did call on these issues (Espen Robak, Dennis Schall, and Philip LaRochelle) directly contradicted the Division's theory.

Respondents find it telling that the Division never presented the issues of how Respondents valued the assets in the portfolio to the Commission's Division of Economic Risk and Analysis ("DERA"). Tr. 27:23-24. If the Division were truly pursuing a theory that Respondents assigned "unreasonable" values to the assets, one would expect the Division would have consulted DERA on these technical issues.

Respondents moved for leave to seek summary disposition on the valuation allegations in the pretrial phase of this case. *See* Tr. 18:4-8. At the close of the Division's case, Respondents moved for judgment on these issues as a matter of law under Rule 250(d). Tr. 3931:25-3935:11. The Court denied the motion at that time, Tr. 3962:11-17, and Respondents raised the issue again at the close of evidence. Tr. 6841:7-23.

II. The Evidence in the Record Establishes that the Valuations of the Funds' Assets Were Reasonable and Consistent with the Requirements of U.S. GAAP

The record evidence affirmatively shows that the receivables held in the Funds were valued reasonably and in a manner consistent with the requirements of accounting principles generally recognized in the United States ("GAAP"). The process Respondents followed to set values for the assets each month, in which an independent third-party valuation agent was engaged to provide valuation services, was also reasonable and consistent with best industry practices.

As shown at trial, the assets in the Funds are Level 3 assets within the meaning of GAAP. Ex. 1290_0010; Ex. 1290_0013-0017. Level 3 assets include financial instruments or obligations for which no secondary market exists and which are restricted as to their transferability. Ex. 1290_0013. Determining the value of Level 3 assets necessarily requires the application of judgment, Tr. 1928:2-1929:16,[2] and generally accepted accounting principles "expressly contemplate[] that different models, based on different assumptions and the assignment of different weight to different inputs, may be used to determine" the reasonable value of such assets. *Id.*[3]

GAAP requires investment funds to value the assets in their portfolios at "fair value." *See* Tr. 1830:1-3; Tr. 3961:24-3964:2. The standards for determining fair value are set forth in Financial Accounting Standard ("FAS") 157. Tr. 4055:8-14. As was disclosed to investors, the assets in the Funds were always valued at "fair value" within the meaning of GAAP. Ex. 1290_0010.

The process Respondents followed to set the fair value of the assets in the Funds each month was independent and reasonable.

A. Use of Independent Third-Party Valuation Agent

Since 2011, Respondents have employed a nationally-recognized third-party valuation agent, Pluris Valuation Advisors, LLC ("Pluris"), to value the portfolio assets. Ex. 2396_0009. Each month, Respondents mark the portfolio to the values Pluris has assigned.

Espen Robak, the founder and principal of Pluris, testified that Pluris uses a proprietary model to value the assets in the Funds based on inputs including the purchase price, interest rate, net book value, contract funding date, and contract ending date. Tr. 1844:21-1846:9; Tr. 1848:23-1850:25; *see* Ex. 355A. Pluris applies new discount rates to each receivable each month, Tr. 1862:12-13, with higher discounts given to receivables seen as having higher risk. Tr. 1848:8-10. One risk that is evaluated is simply that "someone might not pay." Tr. 1833:13-15. The risk of default is implicit in the final discount rates determined under the Pluris model. Tr. 1909:3-8; Tr. 1917:11-21. Some of the positions had very high discount rates, which captured a number of risks such as timing, default, and illiquidity. Tr. 1909:16-1910:13; Tr. 1918:8-16.

The valuations Pluris provides are independent. On occasions when Pluris and Respondents disagreed on an input, such as an expected repayment date, Pluris would listen to the views of the manager but would typically incorporate its own date into the model. Tr.

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2 *See In re Lehman Bros. Sec. & ERISA Litig.*, 799 F. Supp. 2d 258, 312 (S.D.N.Y. 2011) (valuation of Level 3 assets "a matter of judgment"); *In re Allied Cap. Corp. Sec. Litig.*, No. 02-cv-3812, 2003 WL 1964184, at *1 (S.D.N.Y. Apr. 25, 2003) ("[V]aluing [assets] for which no current market exists involves the exercise of judgment, and is inherently imprecise.").

3 *Lehman Bros.*, 799 F. Supp. 2d at 312.

1944:20-1946:4; Tr. 1978:23-1979:8. Mr. Robak testified that he did not recall Respondents ever directly asking Pluris to change a valuation, and Pluris would not have changed a valuation without supporting data. Tr. 1948:25-1949:13. Mr. Robak made clear that Pluris makes the final determination as to the valuations provided in its reports. Tr. 1950:16-20.

When asked about the specific valuation allegations in the OIP, Mr. Robak rejected each allegation. Mr. Robak testified that the assumptions used to value the portfolio were reasonable, Tr. 1976:24-1978:15 (rejecting OIP ¶ 1), and that Respondents did not provide Pluris, directly or indirectly, the input for what discount rates to apply. Tr. 1979:2-8 (rejecting OIP ¶ 63). Pluris independently determined the discount rate for each receivable each month. *Id.*

Mr. Robak testified that the credit rating Respondents assigned to each obligor was given little weight and had only "a slight correlation" to the discount rate Pluris applied to the underlying receivable. Tr. 1847:1-22 (rejecting OIP ¶ 65). Mr. Robak also testified that he and his staff, though not lawyers, analyzed the legal risks associated with the receivables and have sufficient understanding of those risks to apply reasonable discount rates. Tr. 1911:10-24; Tr. 1979:19-23 (rejecting OIP ¶ 65). They gained this understanding by reviewing legal analysis from the law firms and by having direct conversations with the attorneys involved, including Steven Perles, lead counsel for the *Peterson* plaintiffs. Tr. 1911:10-24; Tr. 1962:3-22.

As to the assets related to the Osborn law firm (part of the Division's newly-coined axis of *"Contested Receivables"*), Mr. Robak testified that Pluris has applied significant discount rates to these receivables, each "well north of 20 percent." Tr. 1980:17-1981:14 (rejecting OIP ¶ 69). Pluris has divided these receivables by risk profiles, with some of the positions having over 30 percent discount rates. *Id.* When Respondents extended what they believed to be the expected payment dates on the Osborn positions, Pluris made the final determination on what expected payment date to use in its model. Tr. 1981:14-1982:3. Mr. Robak testified that Pluris always had adequate information to make appropriate fair-value determinations for the assets in the portfolio. Tr. 1982:14-19 (rejecting OIP ¶ 68). Pluris spoke to Dan Osborn directly and reviewed reports prepared by Wiss & Co. and the Smith Mazure law firm related to the Osborn positions. Tr. 1940:24-1941:17.

Mr. Robak testified that Pluris never requested information from Respondents which it did not receive, Tr. 1982:10-13, and that the assets in the Funds' portfolio were not unreasonably inflated. Tr. 1982:7-9 (rejecting OIP ¶ 70).

This testimony from Mr. Robak, establishing the reasonableness of the valuation of the Funds' assets, went unrebutted at trial.

B. <u>The Valuations of the Assets Were Independently Audited</u>

Dennis Schall, the lead audit partner for the Funds' outside auditor, Marcum, LLP ("Marcum"), testified that Marcum reviewed and tested Respondents' valuation processes as part of its regular audit procedures. Tr. 3157:21-24. Marcum had its own internal valuation expert review the Pluris valuation model and analyze the reasonableness of the methods and assumptions used. Tr. 3159:8-19. The valuation specialist consistently concluded that Pluris' valuations were reasonable. Ex. 2476; Ex. 2480; Ex. 2483.

C. Unrebutted Expert Testimony Showed the Valuations Were Reasonable and Appropriate

The unrebutted testimony of experts David Martin and Leon Metzger further establishes that Respondents' valuation methodology was reasonable and appropriate. Mr. Martin found Respondents' approach to asset valuation consistent with FAS 157 and industry standards. Tr. 4054:10-4055:14; Ex. 2393_0007; Ex. 2393_0009. Mr. Martin testified that Pluris' valuation process was independent, Tr. 4039:23-4040:25; that Pluris analyzed risk appropriately, Tr. 4112:12-4113:11; and that Pluris factored legal risk into its model and discount rates. Tr. 4106:3-5.

Mr. Metzger similarly concluded that Respondents' valuation methodology conformed to recognized valuation principles. Tr. 5082:23–5083:13; Ex. 2396_0042-0049. Mr. Metzger testified that Respondents' valuations were made in good faith, investors were treated equitably, valuations were performed at appropriate intervals, the firm disclosed its valuation policy to investors, and the valuations were verifiable. Tr. 5161:17-5168:8; Ex. 2396_0043-0044. Mr. Metzger also found that Respondents' valuation methodology conformed with the SEC's own guidance that a company "acts in good faith when its fair value determination is the result of a sincere and honest assessment," as was the case here. Tr. 5264:15-5165:2.

The Division has offered no evidence to contradict this testimony.

D. Collections Made on the Portfolio Receivables Vindicate the Valuations Assigned

Since the time the OIP was filed, many of the receivables in the portfolio have collected. These collections have confirmed that (1) Respondents' valuation methodology was reasonable and (2) the valuations assigned to the underlying receivables were highly accurate (and if anything too low). For example, the Fay and Perles law firms paid approximately $88 million to the Funds pursuant to the assignment and agreements they had signed. Ex. 2333; Ex. 2998.[4] The combined valuations Pluris had assigned to these positions, at their highest point, were approximately $72 million, demonstrating that the Pluris methodology was both reasonable and conservative. Ex. 2393_0023; Ex. 2393_0048.

Also, it should be noted that Mr. Robak testified Pluris applied a "portfolio approach" to valuing the Funds' assets. Tr. 1977:10-14. Under this approach, some individual assets may end up being marked too high or too low in a given month, but over the entire portfolio the valuations will be reasonably accurate. *Id.* The objective evidence supports this view. For

4 The Funds collected approximately $99 million from the Fay firm and the Perles firm in May and September 2016. These collections included amounts owed on positions held by Constant Cash Yield ("CCY"). The net collection to the Funds from Fay and Perles was approximately $88 million.

example, the overall *Peterson* receivables have collected approximately $150 million to date and the Osborn receivables have collected approximately $14 million. Tr. 6609:6-8; Ex. 3116_0001. There was never a point in time when these "Contested Receivables" were collectively valued in excess of $164 million. Ex. 2. The "portfolio approach" has worked well.

Moreover, the "portfolio approach" to valuation is appropriate for the Funds' because the return to investors is based on the overall performance of the entire portfolio, not the success or failure of any given receivable. *See* Ex. 1706_0024. It is therefore misleading for the Division to critique the valuations of any set or subset of receivables (not that it has offered any evidence of any receivable having been mismarked) without looking at all the valuations in the portfolio at that time.

III. The Division Has Failed to Identify Any Evidence that the Asset Valuations Were Unreasonable or Inflated

The Division cites no evidence in its Letter showing that the valuations of the Funds' assets were unreasonable or inflated. It has conceded this issue, and now states it does not assert that the values assigned were "incorrect." Ltr. at 2, n.1. The Division nonetheless charges forward seeking to argue that these not-incorrect values were somehow improper.

A. The Valuations Accounted for All Risks Affecting Potential Collection

The Division makes the blanket statement that Respondents valued the so-called "Contested Receivables" as if "*they were riskless*." Ltr. at 7 (emphasis added). This assertion, at best, flatly ignores the evidence in the case. Mr. Robak testified that Pluris considers many risk factors in arriving at its discount rates, including illiquidity, timing risk, and the basic risk of nonpayment. Tr. 1833:8-15-1835:10. Mr. Robak made clear that *all* of the discount rates across Respondents' entire portfolio are "very substantial," Tr. 1938:18-1939:4, and that for more high-risk positions, like Osborn, even higher. Tr. 1829:7-13; Tr. 1939:17-20. Mr. Robak testified that all of the Osborn positions have discount rates "north of 20 percent" and some positions have discounts above 30 percent. Tr. 1980:17-1981:13. No one can argue in good faith that a receivable with a 30 percent discount rate is being valued as if it were *riskless*.

The Division argues the asset valuations did not account for "litigation risk" and states that "all of the assets" in the Funds were valued as if the only risk was duration and not collectability. Ltr. at 4 (emphasis in original). This statement again ignores the actual testimony and evidence in the case. The model Pluris used to value the Funds' assets accounted for multiple risks beyond duration, including nonpayment. Tr. 1833:8-1835:10. Indeed, Mr. Robak testified that he believed the Osborn receivables had a "substantial risk" of nonpayment, Tr. 1898:24-1899:5. The range of discount rates applied to the Funds' various receivables demonstrates that Pluris incorporated multiple risk factors beyond duration into its analysis. *See* Ex. 2319 (showing applied discount rates between a low of 13.59% and a high of 40.84%).

In its Letter, the Division speaks of "litigation risk" in the abstract but cites no evidence in the record of any such "risk" that was not duly incorporated into the actual portfolio valuations. The so-called "Contested Receivables" the Division now trumpets include the assets related to Osborn, the Cohen firm, and *Peterson.* Ltr. at 1. As shown above, the Osborn receivables were assigned significant discount rates, all "north of 20 percent," Tr. 1980:17-1981:14, due to the fact that Pluris believed there was a "*substantial risk*" of nonpayment. Tr. 1898:24-1899:5 (emphasis added). There can be no greater "risk" to a receivable than it not paying. What other "risk" does the Division contend is not adequately captured in the discount? For the Cohen positions, Pluris assigned a similarly high discount rate of 20. Ex. 2319. These discounts accounted for all the risks associated with these positions which—like Osborn—were "workouts" of prior positions that had underperformed.

In addition, both the Osborn and Cohen positions were fully disclosed to investors (and to Pluris) in the Independent Accountants' Report on Agreed Upon Procedures ("AUP"). These reports—which included descriptions of the "risks" of the litigation to which those receivables were exposed—were provided to investors each quarter. Ex. 2018; Ex. 2092. The offering documents for the Funds also advised investors as to the existence of the AUPs. Ex. 1372_0015. Mr. Robak testified that he and his staff received the AUP reports, Tr. 1941:5-8, and were thus aware of the issues described therein and factored those risks into their valuations. The Division proffered no evidence that the discounts Pluris applied were unreasonable, and the blanket assertions of "litigation risk" in its Letter cannot substitute for evidence.

With two of three groups of "Contested Receivables" addressed, the Division is left with only *Peterson* as the remaining assets with allegedly unaccounted for "litigation risk." But the evidence at trial directly—and overwhelmingly—contradicts this theory. First, Espen Robak and Pluris *clearly* had full knowledge of the details and status of the *Peterson* case, spoke with the attorneys involved, reviewed legal memoranda concerning the case, and monitored its progress through the court system. Tr. 1911:10-24; Tr. 1962:3-22. All attendant risks on the *Peterson* receivables—including what the Division now calls "litigation risk" but which is more accurately categorized as collection risk (as used in the offering documents) or duration risk—were factored into the discount rates Pluris assigned to the various positions.

Second, the Division never established what "litigation risk" actually existed in *Peterson*, and all the competent trial testimony on this issue was uniform in finding that no meaningful risk was present. Steven Perles testified he was "absolutely" confident the *Peterson* plaintiffs would collect when he received funding from Respondents, Tr. 1685:5-24; Thomas Fay testified he always knew the families of the Marines would be compensated, Tr. 2455:16-2456:14; Tr. 2460:21-2461:6; James Martin testified he viewed the *Peterson* decision as "final" and that it would not "be interfered with," Tr. 3409:14-15; David Martin testified the *Peterson* assets lowered the risk of the portfolio, Tr. 3996:19-3999:14; and Mr. Dersovitz testified it was the "best trade in the book" and was always just a question of duration, Tr. 5726:8-5728:6; Tr. 5950:25-5951:19.

The Division cannot build a valuation case based on "litigation risk" when all such risks were already incorporated into the valuations.

B. The Division Seeks to Renegotiate the Structure of the Funds to Fit Its Theory

What can be seen throughout the Division's letter is that its true objection is not to how the assets in the Funds were valued, or whether those valuations were in fact reasonable, but to how the profits and losses of the Funds were allocated each month. Specifically, the Division objects to the basic *structure* of the Funds that allowed Respondents to withdraw their gains each month, whether realized or unrealized. The Division protests that, by withdrawing such gains, Respondents "pulled cash out of the funds" and put cash "further out of reach of investors." Ltr. at 4-5. But the Division ignores (again) that this is the very structure of the Funds created under the offering documents (and disclosed to investors). Respondents explained this point in their opening statement at trial and cited to the language in the offering documents that "net profits and net losses of the Partnership (*including realized and unrealized gains and losses*) from investments held in the partners' capital accounts will be allocated" to the limited partners with any excess return allocated to the general partner. Tr. 84:19-23; Ex. 1706_0024 (emphasis added). This is the structure investors bargained for, whether the Division now "approves" of it or not.

Moreover, the Division continues to incorrectly represent that the structure of the Funds allowed Respondents to withdraw their gains while investors were left with "IOUs" and "nothing but paper returns." Ltr. at 6, 4. These assertions ignore, again, the evidence. Under the structure of the Funds, both the general partner *and* redeeming investors could withdraw cash from the Funds based on unrealized gains. Ex. 1706_0024. Indeed, the Division's own investor witnesses at trial, each of whom testified to receiving back their principal plus a positive return, were able to redeem their investments based, in part, on the unrealized gains of the *Peterson* receivables. S*ee, e.g.,* Tr. 240:20-241:9, Tr. 243:10-25. When the Funds became illiquid, and there was no cash to withdraw, then neither the limited partners *nor* the general partner were able to withdraw gains. The general partner thus has had no greater access to gains in the funds than do investors.[5]

IV. Conclusion

At trial, Amy Hirsch testified to the damning effect on a fund when it is alleged to have inflated its asset values to benefit the manager. Tr. 4512:23-4513:19. After having raised such serious allegations in a public filing, the Division made no efforts to prove them. The evidence in the record is clear. There is no basis to maintain the Division's valuation claims. The Court should enter judgment on these issues as a matter of law.

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5 The general partner has had to continue to pay, however, the expenses of operating the Funds, despite having received no revenue from the Funds since 2015. The financial cost of shouldering this obligation has fallen on Mr. Dersovitz. So, while some investors have had to wait to realize some of their gains, Mr. Dersovitz has had to commit additional capital to maintain the operation of the business and preserve the Funds' assets.

For these reasons, Respondents respectfully renew their request that the Court enter disposition under Rule 250 over any allegations related to the valuation of the funds' assets as stated in paragraphs II.A.1.(ii) and II.G.60-74 in the OIP.

Respectfully submitted,

Terence Healy /KS

Terence Healy

cc: David K. Willingham (email only)
Michael D. Roth (email only)
Michael Birnbaum (email only)
Jorge Tenreiro (email only)
Victor Suthammanont (email only)