RECEIVED
MAR 05 2018
OFFICE OF THE SECRETARY

UNITED STATES OF AMERICA
Before the
U.S. SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17387

In the Matter of

DONALD F. LATHEN, JR.,
EDEN ARC CAPITAL MANAGEMENT, LLC,
EDEN ARC CAPITAL ADVISERS, LLC.

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF THE APPLICATION OF EDEN ARC CAPITAL ADVISORS, LLC AND EDEN ARC CAPITAL MANAGEMENT, LLC FOR RECOVERY OF LEGAL FEES AND EXPENSES PURSUANT TO THE EQUAL ACCESS TO JUSTICE ACT

Harlan Protass
PROTASS LAW PLLC
260 Madison Avenue
New York, NY 10165
T. 212-455-0335
F. 646-607-0760
hprotass@protasslaw.com

Counsel for RespondentsDonald F. Lathen, Jr., Eden Arc Capital Management, LLC and Eden Arc Capital Advisors, LLC

TABLE OF CONTENTS

TABLE OF AUTHORITIES

<u>Statutes and Regulations</u>

<u>Other Authorities</u>

Petitioners Eden Arc Capital Advisors, LLC ("EACA") and Eden Arc Capital Management, LLC ("EACM") ("the Eden Arc Respondents"), by and through their undersigned counsel, respectfully submit this reply memorandum of law in further support of their application for the recovery of legal fees and expenses incurred in connection with the referenced matter pursuant to the provisions of the Equal Access to Justice Act, 5 U.S.C. § 504, et seq. (the "EAJA").

REPLY ARGUMENT

I.

THE DIVISION MISCONSTRUES THE STANDARD FOR WHEN AN AWARD UNDER THE EAJA IS WARRANTED

In its opposition to the EAJA application, the Division implies that Congress only intended prevailing defendants to be awarded their legal fees and costs when the government engages in abusive conduct. (Div. Br at p. 6-7). This is an inaccurate statement of the law.

The EAJA provides, in pertinent part, that "an agency that conducts an adversary adjudication *shall* award, to a prevailing party other than the United States, fees and other expenses incurred by that party in connection with that proceeding, *unless* the adjudicative officer of the agency finds that the position of the agency was substantially justified or that special circumstances make an award unjust." 5 U.S.C. § 504(a)(1) (emphasis added). As noted by Judge Richard Posner, although the term "substantially justified" is neither defined nor self-evident, "If it just meant not frivolous, there would be no problem because usually it's pretty easy to distinguish a frivolous from a nonfrivolous case. But the courts have not taken that road." *United States v. Thouvenot, Wade & Moerschen, Inc.*, 596 F.3d 378, 381 (7th Cir. 2010).

When Congress enacted the EAJA in 1980 it was well aware that, at common law, courts could already award attorney's fees against a losing party who "acted in bad faith, vexatiously, wantonly or for oppressive reasons." House Report (Judiciary Committee) No. 99-120(I), p.5. In passing the EAJA, Congress clearly intended to provide a less stringent standard for awarding legal fees to litigants with limited financial means who had prevailed in cases against the federal government. That standard was "substantial justification"

In 1985, Congress amended the EAJA and, while doing so, rebuked courts for "misconstruing the Act," particularly with respect to the meaning of "substantial justification." The House Report issued with the 1985 amendment observed that although courts have been divided on the meaning of "substantial justification":

> Several court have held correctly that "substantial justification means *more than merely reasonable*. Because in 1980 Congress rejected a standard of "reasonably justified" in favor of "substantially justified," *the test must be more than mere reasonableness*.

H.R. 99-120(I) p.9 (May 15, 1985).

Under the EAJA, an eligible party prevailing against the government is entitled to an award for its attorney's fees and litigation expenses. To escape that liability, it is not enough for the government to show that it acted reasonably; rather it must establish that its position was substantially justified.

II.

THE EDEN ARC RESPONDENTS ARE ELIGIBLE FOR THE REIMBURSEMENT OF LEGAL FEES AND EXPENSES <u>PURSUANT TO THE PROVISIONS OF THE EAJA</u>

As detailed below and notwithstanding the Division's arguments to the contrary, there can be no doubt that the Eden Arc Respondents are eligible for the reimbursement of legal fees and expenses pursuant to the provisions of the EAJA.

A. The Eden Arc Respondents' Financial Disclosures Are More Than Sufficient to Determine Their Net Worth At the Time of the OIP

The Division initially argues that the Eden Arc Respondents have not provided "full disclosure" sufficient to demonstrate their net worth as of the OIP date. This is simply not true.

The Eden Arc Respondents provided extremely detailed and fully documented net worth and income statements at the time of trial utilizing the SEC's own Form D-A as a template. The net worth presentations for Respondents EACM and EACA at trial were extremely simple and straightforward. At the time of the trial, EACM had no assets or liabilities. EACA had only one asset, which was its capital account balance in the Fund. It had no liabilities.

Mr. Lathen's personal Form D-A required much lengthier disclosures because of his numerous assets and liabilities. In addition to the Form D-A itself, Mr. Lathen provided numerous supporting exhibits showing a full breakdown of his and his wife's assets and liabilities, annotated line-by-line to the underlying source documentation substantiating each individual asset and liability. The underlying source documentation included 52 separate documents comprised of roughly 700 pages. After the Division complained that this was insufficient, Mr. Lathen provided a supplemental disclosure consisting of another 700 pages of bank, brokerage, credit card and other records. The Division then examined Mr. Lathen over the course of two separate days with respect to minutia on these documents. For example:

> Q. Okay. And then what about -- can you find the -- in the binder, the one diamond earring where it says only one, can you find that in the binder?
> A. Okay.
> Q. Is it page 21?
> A. Yeah, I think -- my recollection is that we purchased the -- obviously a pair of diamond earrings for $3,450, which this

> invoice reflects. My wife lost one of them, so we only have one now.

Tr. 2365:16-25.

On December 15, 2017 Mr. Lathen submitted an affidavit wherein he stated that the net worth of EACM and EACA at the time of the OIP were "substantially the same" as at the time of trial. In support of this conclusion he provided a Bank of America account statement for EACM at the time of the OIP and a Performance and Capital Summary for EACA's investment in the Fund at the time of the OIP (attached as Exhibits 3 and 4 respectively to the Supplemental Memorandum of Law filed by the Eden Arc Respondents on December 29, 2017). The Bank of America account and the Fund investment were the sole assets owned by EACM and EACA, respectively, at the time of the OIP. Notwithstanding the Division's protestations to the contrary, there is no mystery whatsoever regarding the net worth of EACM and EACA at the time of the OIP.[1]

Mr. Lathen stated in his December 22, 2017 affidavit that he did not have a net worth statement as of the OIP date and that to recreate one would be burdensome. However, he was able to provide an estimate of his net worth by starting from his Form D-A at trial and working backward to the OIP date. He also provided his bank statements as of the OIP date because these were readily available from his trial disclosures.

Before addressing each of the arguments raised by the Division about the supposed deficiencies in the Eden Arc Respondents' financial submissions, it is worth noting what the Commission's EAJA regulations state and what the Eden Arc Respondents have produced. According to the SEC's regulations:

---

[1] The Division does not contest the net worth of the Fund nor do they contest the adequacy of the Fund's submissions supporting same.

> Each applicant, except a qualified tax-exempt organization or cooperative association, must provide with its application a detailed exhibit showing the net worth of the applicant and any affiliates (as defined in § 201.34(f) of this part) when the proceeding was initiated. The exhibit may be *in any form convenient to the applicant* that provides full disclosure of the applicant's and its affiliates' assets and liabilities and *is sufficient to determine whether the applicant qualifies under the standards in this subpart*."

17 C.F.R. § 201.42 (a) (emphasis added).

In adopting its internal regulations with the "any form convenient" language, the Commission explicitly recognized that an overly proscriptive Rule 201.42(a) might create undue burdens for applicants:

> The Commission's Office of the General Counsel opposed the provision in the proposed Model rules requiring fee award applicants to submit a detailed statement of their net worth. This was viewed as unduly burdensome on eligible applicants and creating administrative problems since confidential financial information was sought. The Administrative Conference therefore simplified the requirement and gave applicants greater leeway in structuring the submission.

Equal Access to Justice Act Rules, 47 Fed. Reg. 610 (Jan. 6, 1982)

The Eden Arc Respondents have submitted net worth statements for each of them and for Mr. Lathen and a financial statement for the Fund. They have submitted the following back up documentation:

- 298 pages of bank and brokerage account records;
- 375 pages of credit card records;
- 559 pages of tax records; and
- 170 pages of loan documents, insurance records, tuition bills and other assorted financial records.

These disclosures, together with the accompanying affidavits related to the OIP date net worth, were more than "sufficient to determine whether the applicant qualifies" *vis a vis* the statutory threshold.

B. The Division's Arguments Concerning Respondents' Financial <u>Disclosures and Eligibility Lack Merit and Should Be Disregarded</u>

The Division *first* argues that the Eden Arc Respondents have not provided "full disclosure" sufficient to determine their net worth at the OIP date. They assert that no contemporaneous document for EACA was provided for the OIP date. The Division also complains about receiving only a single August 2016 bank statement for EACM. The Division appears to have misunderstood the import of Exhibit 4 to the Applicants' December 29, 2017 Memorandum of Law. That document shows the value of EACA's *only* asset – its investment in the Fund – at June 30, 2016 and September 30, 2016, the time period directly straddling the date of the OIP. It <u>is</u> the contemporaneous documentation for EACA to support its net worth at the time of the OIP. Likewise, the EACM Bank of America account was EACM's <u>only</u> asset at the time of the OIP. In summary, while the Division is correct that the Eden Arc Respondents' disclosures regarding their net worth at the time of the OIP are spare, they are nonetheless complete and "sufficiently detailed." They leave little doubt regarding their net worth at the time of the OIP.

The Division raises a *second* argument that Mr. Lathen's personal net worth disclosures for this proceeding were inadequate. As mentioned previously, the form of disclosure under 17 C.F.R. § 201.42 is not prescribed by the Commission to ensure that it is not "unduly burdensome" to applicants. Mr. Lathen has taken a reasonable approach to his financial disclosures in connection with this proceeding. However, to put this issue to rest, Mr. Lathen is submitting herewith an affirmation dated March 1, 2018, which includes a chart showing each asset and liability reported on his Form D-A, listing the values shown on that Form D-A side-by-side with its value on the date of the OIP, along with supporting documentation for items that changed significantly. There can therefore be little debate but that the Eden Arc Respondents have now fully met their obligations under § 201.42 (a). Moreover, Mr. Lathen's net worth at the OIP date is consistent with the estimate he provided in his December 22, 2017 affirmation.

Third, the Division asserts that even Mr. Lathen's net worth disclosures at trial were "insufficient." The Division ruminates about "alleged" liabilities, Mr. Lathen's lifestyle and its inability to see the timing of drawdowns on credit facilities. The Division laments that Mr. Lathen's net worth is only a "snapshot in time." But <u>all</u> net worth statements are a snapshot in time and Congress decided that a net worth snapshot, rather than lifestyle or any other factor, would be the appropriate metric for determining eligibility. Contrary to the Division's contentions, Mr. Lathen's liabilities at trial were assiduously documented and subject to rigorous cross-examination by the Division. It is disingenuous for the Division to now characterize these liabilities as "alleged."

The remainder of the Division's arguments hinge upon the premise that the Eden Arc Respondents' disclosures are deficient because they have not factored in the net worth of the Fund, which the Division asserts is an affiliate of the Applicant EACA. This is a perplexing argument. Respondents have already argued their views on affiliation in their initial application and the net worth statement of the Fund has been provided. The Division is free to argue, and the Court is free to decide, whether treating the Fund as an affiliate is appropriate. But the disclosures are not deficient in any way and determining the net worth of each of EACA and EACM under various affiliation scenarios is simple and straightforward. In any event, the net worth of each applicant, regardless of how the Court determines affiliates, would be well below the statutory threshold.

Finally, the Division's argument that the Eden Arc Respondents are "perilously close" to the $7 million statutory threshold completely falls away now that Mr. Lathen has provided information showing his precise net worth statement as of the OIP date. The Division (and the Court) no longer have to engage in "guesswork" in determining eligibility under the statute.

In conclusion, the Eden Arc Respondents respectfully submit that that they have more than adequately established their net worth at the time of the OIP and that it is well within the statutory threshold for EAJA eligibility.

III.

THE EDEN ARC RESPONDENTS INCURRED LEGAL FEES AND EXPENSES IN CONNECTION WITH LITIGATION OF THE REFERENCED MATTER

Although the Division asserts that the Fund's assets must be deemed to be the Eden Arc Respondents' assets for purposes of determining their eligibility for an EAJA award, in Point III of its brief it contends that they did not "incur" any legal fees since their bills were paid by the Fund – that is, with the very assets that the Division says must deemed to belong to them for EAJA purposes. In addition to its "having your cake and eating it too" aroma, the Division's argument is wrong for a number of other reasons. It hinges upon an unduly crabbed interpretation of what it means to "incur" legal fees under the EAJA. It is contrary to the fundamental rule of law that a party's liability should not be reduced by the injured parties' receipt of indemnification from other sources. And, it would undermine a core public policy purpose of the EAJA – to provide a deterrent against regulatory agencies bringing weak cases against individuals and entities that have limited resources to fight back.

Given the Division's assertion that the Eden Arc Respondents and the Fund must be treated as a single entity for purposes of determining financial eligibility for an EAJA, it belies logic for the Division to contend that the Eden Arc Respondents should be denied an EAJA award because their legal fees were paid by the Fund. The Division elected to bring this case knowing that it would be defended with the Fund's assets, or not defended at all. The Fund is precisely the type of small entity that Congress sought to protect by enacting the EAJA. It set a threshold for EAJA eligibility in 1988 at $7 million (over $14 million in inflation adjusted 2017 dollars). The Fund (whether or not its assets are aggregated with the Eden Arc Respondents' assets) qualifies easily even under the non-inflation adjusted 1988 threshold.

The title of the statute – Equal Access to Justice Act – and the fact that eligibility for an award is limited to persons and organizations of limited financial means – "suggest that Congress's concern was not limited to frivolous cases – that it wanted the government to take care before deploying its formidable litigation resources against a weak opponent." *United States v. Thouvenot, Wade & Moerschen, Inc.*, 596 F.3d 378, 382 (7th Cir. 2010). Although many courts have cited Congress's goal in enacting the EAJA as removing financial disincentives for small business to fight government overreach, in practice it does nothing of the sort. The EAJA caps legal fees at a small fraction of the market rate, it requires applicants to undergo years of financially ruinous litigation before they can seek an award, and then it requires them to initiate additional costly litigation to even try to obtain an award. The distant possibility of obtaining an EAJA award, which, at best, would cover a small fraction of actual expenditures, does not in any meaningful way "level the playing field" and encourage persons and organizations of limited financial means to stand up to regulatory overreach. As recognized by the D.C. Circuit, the more important function of the EAJA is "to discourage the federal government from using its superior litigating resources unreasonably" against persons and organizations with limited financial means. *Battle Farm Co. v. Pierce*, 806 F.2d 1098, 1101 (D.C. Cir. 1986). In other words, Congress hoped to encourage federal agencies to exercise additional caution before unleashing their vast resources against small actors by requiring agencies to pay defendants' fees and expenses if they lost such cases and by stating that agencies could only escape such liability by demonstrating that their position was substantially justified.

From the outset, the Division threw enormous resources into trying to win a case which had weak facts, little to no legal support and barely any connection to the Commission's stated mission "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[2] It had at least 5 enforcement attorneys working on the investigation. They sent subpoenas to at least 109 different companies which produced nearly a million pages of records in response. It deposed Mr. Lathen for 18 hours over four days. It deposed his step-father, his wife, his accountant, his employee and an investor in his Fund. It interviewed an additional 31 witnesses. After issuing the OIP, it assigned 4 enforcement attorneys to work on the case full-time for several months. They filed 9 pre-hearing motions, objected to nearly every exhibit offered by Respondents before the trial began, and 6 separate times unsuccessfully sought to block Respondents from presenting evidence of their good faith reliance on counsel. In short, the Division approached this litigation like it was fighting against a Fortune 500 company rather than a single hedge fund with assets of less than $7 million. All for a case in which there was not even an allegation of harm to investors or to the general financial markets, and where the only supposed victims were financial behemoths who were allegedly being "duped" into paying bonds they were in fact obligated to pay, just earlier than they hoped to.

The Eden Arc Respondents submit that if the EAJA is to have any deterrent effect whatsoever on the Division, and the Commission as a whole (which authorized the Division to bring this case), this is precisely the type of case that should result in an award. The Division could simply have requested that Respondents stop doing what they were doing, which they likely would have done since the investment strategy had run its course. Instead, it chose to bring a fraud case against small-fry opponents, in a matter of no great importance to the financial

2 See https://www.sec.gov/Article/whatwedo.html.

markets, where investors were benefited rather than harmed, asserting claims lacking any clear legal support for which it lacked any evidence of scienter. The Division employed its immense resources to put the Eden Arc Respondents in a position in which they had to use the Fund's assets to either fight against allegations of fraud that they knew to be unjustified, or make a career ending capitulation, which the Commission would then publicize to the world in a press release portraying them as fraudsters. If this is not a situation in which the Commission should be required to pay an award to sustain the EAJA's deterrent effect, it is hard to imagine what is.[3]

According to the Division, the Eden Arc Respondents are not entitled to an award because they have not "incurred" any fees or expenses, since their legal bills were paid for by the Fund. Even if it mattered that the Fund as opposed to the Eden Arc Respondents actually paid the legal fees (which it should not, given the Commission's insistence on treating the Fund's assets as belonging to the Eden Arc Respondents for EAJA purposes), it is beyond dispute that the term "incurred" as used in the EAJA does not simply mean "paid" or "obligated to pay." "Case law from multiple circuits establishes that the plain meaning of 'incurred' does not require the plaintiff to have paid counsel or to have a legal obligation to pay counsel." *Turner v. Commissioner of Soc. Serv.*, 680 F.3d 721, 723 (6th Cir. 2012). A party whose attorney is working for free "incurs" legal fees for purposes of the EAJA. *Nadarajah v. Holder*, 569 F.3d 906, 916 (9^{th} Cir. 2009). A party whose defense is entirely paid by his insurer is "incurs" legal fees under the EAJA. *Ed A. Wilson v. GSA*, 126 F.3d 1406 (Fed. Cir 1997). Fees are also "incurred" by a party who is represented at no cost to him by a salaried union attorney (*Temme v.*

---

3 The Commission has been roundly criticized in the press for excessive tenacity in pursuing minor infractions in its administrative courts. See, e.g., Gretchen Morgenson, *In S.E.C.'s Streamlined Court, Penalty Exerts a Lasting Grip,* N.Y. Times, May 4, 2017 (discussing administrative proceeding in which respondent expend $1 million in legal fees to defend against charges that involved "the financial equivalent of a foot fault").

Bemis Co., 762 F.3d 544, 549 (7th Cir. 2014)) or who's legal fees are indemnified by his employer (*Morrison v. Commissioner of Internal Revenue*, 565 F.3d 658 (9th Cir. 2009)). As the court observed in *Ed. A. Wilson, Inc.* "[g]enerally, awards of attorneys' fees where otherwise authorized are not obviated by the fact that individual plaintiffs are not obligated to compensate their counsel. The presence of an attorney-client relationship suffices to entitle prevailing litigants to receive fee awards." *Id.* 126 F.3d at 1409

In *Morrison*, the Ninth Circuit examined whether a taxpayer had "incurred" legal fees in connection with a tax court proceeding in which he and his company had jointly prevailed against the IRS.[4] The tax court found that Morrison had not "incurred" any legal fees since the legal bills had been paid in full by his company, despite Morrison's assertion that he was obligated to repay his company from any fee recovery. The Ninth Circuit observed that the tax court had effectively defined the term "incur" to mean "paid" and noted that this was too narrow a definition to give effect to the statute as a whole. Based upon analysis of EAJA cases, the court reasoned that legal fees could be "incurred" by a party whose fees were paid by a third-party. The court found that such a party would "incur" legal fees for purposes of determining his eligibility under a fee-shifting statute if either: (1) he assumes an absolute obligation to repay the third-party that fronted the fees; or (2) he assumes a contingent obligation to pay the third-party in the event he obtains a recovery from the fee-shifting statute.

The Division cites to a pair of cases from the early 1990s holding that a party does not "incur" fees under the EAJA if it obtained contract indemnification from a third-party. In 2009, writing for the Seventh Circuit, Judge Posner noted the split between more recent circuit

4 *Morrison* involved application of the fee-shifting provisions of 26 U.S.C. 7430, which is applicable to proceedings against the I.R.S. As noted by the court therein, that statute is effectively identical to the EAJA and there is "little dispositive difference" between the two statutes. *Morrison*, 565 F.3d at 662, n.4.

court decisions and these two early EAJA cases. He squarely rejected the older cases, finding the reasoning in the more recent decisions "compelling." *United States v. Thouvenot, Wade & Moerschen, Inc.*, 596 F.3d 378, 383 (7th Cir. 2010) (finding that a party "incurs" fees for purposes of the EAJA if he assumes a contingent liability to repay a third-party with an award of fees, or if his fees are paid by a third-party under a contractual indemnity agreement). Subsequent cases have further established that third-party financing of litigation does not impact a prevailing party's ability to recover attorney's fees under a fee-shifting statute. *See Temme v. Bemis Co.*, 762 F.3d 544, 549 (7th Cir. 2014) ("third-party financing of litigation is generally not a bar to an award of attorneys' fees"); *Turner v. Comm'n of Soc. Sec.*, 680 F.3d 721, 724 (6th Cir. 2012) ("it is well-settled that the existence of an unsatisfied contingency . . . does not preclude a fee award, even where the statute limits fees to those 'incurred' by the plaintiff in that action.").

Allowing recovery of legal fees to a prevailing party whose legal fees are paid by a third-party is consistent with the general legal proposition that a wrongdoer's liability should not be diminished because the party it injured had the foresight to secure an alternative source of payment. As stated by the Federal Circuit, "Denying a small business, which in its keen acumen has obtained insurance to insulate itself from liability . . . and thus from potential insolvency, an award of fees for the attorney services that it procured as part of its policy would thwart the [EAJA's] purpose of deterring unreasonable governmental action." *Ed A. Wilson Inc* 126 F.3d at 1410.

Here, the Eden Arc Respondents had the foresight to include in their agreement with the Fund a promise by the Fund to pay their legal fees should a claim be asserted against them for work done on the Fund's behalf. The fact that the Eden Arc Respondents contracted for this indemnity from the Fund, rather than from an insurance company, should make no difference. As the Seventh Circuit stated while comparing EAJA cases in which applicants were indemnified by insurers and by employers, "we cannot see what different it makes [to the EAJA analysis] who the indemnitor is." *Thouvenot,* 596 F.3d at 383. Had the Fund not promised to indemnify them, the Eden Arc Respondents would have had to have obtain comparable protection from an insurance company and would have required additional compensation from the Fund to offset this expense. In effect, the Eden Arc Respondents reduced the amount they charged the Fund for their services in exchange for the Fund acting as their insurer. If a party's eligibility for an award under the EAJA hinges upon the absence of such an indemnity agreement, it is being penalized for having the foresight to pay for its legal defense upfront by acquiring an indemnity agreement. Nothing in the EAJA suggests such a purpose.

The Division somehow contends that the Eden Arc Respondents should be denied an award because they entered into a formal written agreement to memorialize their promise to turn over any EAJA award to the Fund after winning the case. Under the Fund's Limited Partnership Agreement, the Applicants were liable to reimburse the Fund for all of the legal fees it advanced had they lost the case. Although the Partnership Agreement is not explicit on what happens should the Eden Arc Respondents win the case and recover legal fees, there was never any question that any legal fee recovery would go to the Fund. The Fund, and by implication its investors, bore the financial burden of defending the Eden Arc Respondents against the Division's case. As fiduciaries of the Fund, the Eden Arc Respondents could never conceivably retain such an award for themselves. The agreement that the Division cites to was created to memorialize the Eden Arc Respondents' undisputed obligation to return any EAJA award to the Fund, and to prevent the Division from arguing that an EAJA would be a windfall to them or to the Eden Arc Respondents or Mr. Lathen when it would in fact be nothing of the sort.

IV.

THE DIVISION'S POSITION WAS NOT SUBSTANTIALLY JUSTIFIED

To meet the substantial justification test, the Division's position must be "justified to a degree that could satisfy a reasonable person," which requires that the Division carry its burden to demonstrate that its position had "a reasonable basis both in law and fact." *Pierce v. Underwood*, 487 U.S. 552, 565 (1988). In determining whether the Division has met its burden, this Court must consider, first, the reasonableness of the underlying government action at issue, and, second, the reasonableness of the position asserted by the government in pursuing that action in court. When the court "decide[s] whether the government's litigation position is substantially justified, the EAJA ... favors treating a case as an inclusive whole, rather than as atomized line items." 28 U.S.C. § 2412(d)(2)(D)(2005); *Al-Harbi v. INS*, 284 F.3d at 1094. In any EAJA proceeding, the government bears the burden of proving that its position was substantially justified.

Here, the Division's case was – from the outset – a series of long-shots. First, the Division had to construct a scheme to defraud out of a series of isolated contractual disputes, the fraud being that the Eden Arc Respondents had not provided information to arms-length issuers of survivor's option bonds and CDs who had not, but could have, asked for such information. Second, the Division had to advance an "economic stake" definition of beneficial ownership that was directly at odds with the title-holder definition in the contracts of survivor's option bond and CD issuers and prove that participants did not possess that economic stake when Lathen's Participant Agreements plainly evidenced otherwise. Third, the Division had to prevail on an issue of first impression under New York law when the Eden Arc Respondents enjoyed the statutory advantage of "presumption" and the Division's required margin of victory was "clear and convincing." Finally, the Division had to prove that Mr. Lathen acted with scienter, something utterly inconsistent with a mountain of evidence that Mr. Lathen believed that he was acting lawfully, including the extensive legal advice he sought and received about how to set up and run the investment strategy. The Division ultimately failed to prevail on any of these issues. And, given its odds from the get-go on each of the foregoing four issues, its overall position when it filed the OIP, considered as an *inclusive whole*, clearly was not substantially justified.

A. The Division's Fraud Theory Was Wholly Untenable

The Division ignored abundant warning signs that its fraud theory was wholly untenable, vitiating its current claims of substantial justification.

The Eden Arc Respondents' investment strategy was first broadly reported by the *Wall Street Journal* in March 2010. That article noted that the strategy was legal, issuers were generally aware of it and issuers believed that it was contractually and legally valid. When the Division pursued the *Staples* matter, it was advised by several issuers that they would have redeemed bonds even if they had seen the Staples' side agreements. The Division was advised by Bank of New York, the largest trustee in the survivor's option market, that beneficial ownership was defined in issuers' governing documents as the account title-holder. The Division also learned of the 2010 FBI memorandum, which advised that the Staples operation had been thoroughly vetted and that no one who had been consulted (including the US Attorney's Office and the South Carolina Attorney General) could identify anything unlawful about it.[5] Thus, before initiating its investigation of the Eden Arc Respondents, the Division knew or should have known that its fraud construct was, at best, tenuous.

[5] Authored by FBI Special-Agent Ron Grosse, the FBI Memorandum was filed in federal district court in South Carolina in October 2013, approximately one month after the Division filed its complaint in the *Staples* matter. It reported that the South Carolina Attorney General's

(continued ...)

Also, very early on in its investigation, the Division knew that Mr. Lathen had successfully redeemed bonds with the vast majority of issuers whose bonds and CDs he had purchased. Moreover, since Mr. Lathen redeemed a substantial volume of bonds and CDs and took no steps to evade issuers' notice (indeed he redeemed these instruments in a manner that virtually ensured that he would not stay below the radar), a strong inference exists that issuers were aware of and acquiesced to his strategy. The Division also knew that Mr. Lathen had encountered disputes with some issuers and had provided additional information when requested. It knew that he had brought his investment strategy to the attention of the New York banking regulators when confronted with Goldman Sachs' refusal to redeem CDs. It knew he had shared the supposed evidence of fraud (the Participant Agreements) with numerous companies which had agreed to redeem bonds after reviewing them. Finally, the Eden Arc Respondents advised the Division in March 2016 that it had adopted enhanced disclosure language in its redemption letter template and that dozens of issuers had redeemed thereafter without incident.[6] This powerful evidence – that issuers had actually received the so-called fraudulently withheld information and redeemed anyway – was nonetheless shrugged off by the Division.

(... continued)

Office, the United States Attorney's Office for the District of South Carolina and the Atlanta Regional Office of the U.S. Securities and Exchange Commission had all evaluated the Staples' investment strategy and found nothing unlawful about it. The memorandum also noted that several bond issuers had been contacted in connection with the FBI's inquiry and that they had opined that Staples had merely "taken advantage of a little-known loophole." We do not know whether the FBI memorandum was known to the Division before it filed charges in the *Staples* matter. But the staff of the Division responsible for the instant matter was well aware of the FBI Memorandum before the OIP was filed as against the Eden Arc Respondents.

6 The Eden Arc Respondents' enhanced disclosure advised issuers that Mr. Lathen had entered into a separate written agreement with a Participant and that the Fund had provided financing for the joint tenancy accounts.

The bottom line is that the Division manufactured an alleged scheme to defraud out of a handful of *bona fide* contractual disputes between sophisticated and well-represented parties. Its fraud theory was entirely unjustified.

B. The Division's Position With Respect to Scienter Was Wholly Unjustified

The principal dispute herein was whether Mr. Lathen believed what he was doing was wrong or whether he instead acted in good faith. Evidence of good faith was abundant while evidence of wrongfulness or recklessness was virtually non-existent.

During the investigation, the Eden Arc Respondents fully cooperated with the Division, responding to numerous subpoenas and answering all of its questions over four days of on-the-record testimony. From this voluminous body of information, the Division learned that Mr. Lathen: (1) had consulted lawyers before he launched his business and had continuously sought legal advice as the business developed over time; (2) treated his participants with transparency, fairness and compassion;[7] (3) fully disclosed his business and all of its risks to his investors; (4) closely followed developments in connection with other similar businesses; (5) fully disclosed his operation to the brokerage firms through which he conducted business; (6) voluntarily registered with the SEC as an investment adviser; (7) proactively reached out in an open and transparent fashion to FINRA; and (8) vigorously challenged issuers who refused to pay, even reaching out to the New York Department of Financial Services and the Consumer Financial Protection Bureau in connection with one of his disputes.

All such good faith evidence (and still more) was available to the Division during the investigative phase. Not only were these facts plainly evident in the subpoena materials and

[7] Indeed, when participant Dennisse Alamo told Mr. Lathen that the SEC had contacted her, he advised her to "speak with [them] and be fully open and truthful about our arrangement. I have nothing to hide nor should you."

Mr. Lathen's deposition testimony, but these facts were repeatedly highlighted to the Division in numerous white papers, correspondence, meetings, phone calls and three Wells Submissions. A reasonable person would have viewed all this evidence of good faith as dispositive as to the question of scienter. Instead, the Division was unpersuaded and filed the OIP in August 2016.[8]

After the Division filed the OIP, the Eden Arc Respondents informed the Division that it would present evidence about the advice it had received from counsel and waived attorney-client privilege. The Division then filed six separate motions challenging the Eden Arc Respondents' ability to present evidence concerning the advice it had received from counsel. While these motions were pending, the Eden Arc Respondents provided the Division with all their privileged communications, and the Division interviewed and subpoenaed documents from Mr. Lathen's attorneys. Thus, even if this Court finds that the Division's case was substantially justified as of the date of the OIP (which it should not), such substantial justification dissolved when the Division received such privileged communications and gained access to Mr. Lathen's attorneys.

At trial, this Court learned not only of the aforementioned incidences of good faith, but also that (among other things): (1) Mr. Lathen's attorneys had either drafted or reviewed all of the important documents he used to carry out his business; (2) Mr. Lathen was advised by his attorneys at all times that his operation was entirely lawful; (3) Mr. Lathen's attorneys opined that they believed Mr. Lathen had a sincere interest in operating his business in a lawful manner and in "getting it right"; and (4) one of Mr. Lathen's attorneys, Robert Flanders,

[8] Shortly before filing the OIP, the Division settled the *Staples* case after several rounds of court-ordered mediation. The scienter-based fraud charges against the Staples were dismissed with prejudice. The Staples settlement, coming so close in time to the Division's decision to move forward on OIP, was yet another red flag that the Division's case was not substantially justified.

explicitly advised Mr. Lathen to provide only the information required in issuers' offering documents and "nothing more." The Court also heard favorable character witness testimony concerning Mr. Lathen and learned that Mr. Lathen had a long, distinguished and unblemished career in the securities industry. All such information was available to the Division before the trial commenced.

The Division's scienter narrative at trial and post-trial briefing is telling proof that its scienter position was, and always had been, hopelessly unjustified. Faced with the overwhelming evidence of Mr. Lathen's good faith, the Division advanced a narrative that Mr. Lathen merely maintained an outward veneer of transparency, legitimacy and legality with third parties while secretly knowing that his conduct was wrongful. The Court wisely rejected the Division's theory of scienter and rightly concluded that Mr. Lathen acted in good faith and did not possess a culpable state of mind. The Division's farfetched scienter presentation at trial and post-hearing briefing amply demonstrates its position was not "justified to a degree that would satisfy a reasonable person." Since scienter was a threshold consideration for determining liability, the Division's unjustified position on scienter alone is grounds for approving the Eden Arc Respondents' EAJA claims.[9]

---

9 Likewise, the Division's case assumed scienter and it made no attempt during trial to prove negligence on a standalone basis. The Division put on no evidence at the hearing defining the standard of care Mr. Lathen purportedly should have followed when communicating with issuers or what conduct would have constituted its breach. The Court noted that Division could not meet its burden when it failed to provide evidence of the standard of care. Its failure to even declare a position on standalone negligence, much less try to prove it, creates a strong inference that its position regarding same was not substantially justified.

C. This Division's Position With Respect to Beneficial Ownership Was Wholly Unjustified

The Division argued that: (1) Participants were not beneficial owners of the bonds and that Lathen made misrepresentations to issuers when he characterized Participants as "beneficial owners" in his redemption letters; and (2) issuers' governing documents required that Participants possess an economic stake in survivor's option securities and Mr. Lathen's contractual structure stripped Participants of that economic stake. If the Division had undertaken a more careful review of the relevant contracts, it may have realized that its beneficial ownership position was incorrect or, at least, highly questionable.

As the Eden Arc Respondents argued, and as this Court agreed, beneficial ownership is defined in issuers' governing documents as the title holder to the account at the brokerage firm. Even under the Division's alternative definition of beneficial ownership – one requiring an economic interest – the Court concluded, based on a review of Mr. Lathen's Participant Agreements, that the Division's position was still wrong. Instead, the Court determined that "participants appear to have met the beneficial ownership requirements . . . even if the Division were correct that the offerings contained a beneficial ownership requirement." The Division's position on beneficial ownership, so plainly refuted by the written contracts at issue herein, was not justified to a degree to satisfy a reasonable person.

D. This Division's Position with Respect to Joint Tenancies With Participants Was Wholly Unjustified

This Court's joint tenancy analysis was extremely robust. It concluded that Mr. Lathen intended to create joint tenancies with Participants and that the Division had not rebutted the presumption that he had established valid joint tenancies under New York Law. This Court went further, though, also considering the separate question of whether the Participant Agreements may have prevented the creation of valid joint tenancies under New York law. This

Court conceded that the second question was ultimately a matter of first impression under New York law (which should be decided by a New York court). It then analyzed each version of the Participant Agreement to assess whether any may have interfered with the creation of a valid joint tenancy. This Court's "inclination" was that three of five versions did not interfere with creation of joint tenancies and that two of five versions "may" have interfered.

The Eden Arc Respondents acknowledge that the standalone question of whether the Division's joint tenancy argument was substantially justified is complicated. The Eden Arc Respondents further acknowledge that, at least with respect to two aforementioned versions of the Participant Agreement, the Division's joint tenancy argument was at least plausible. However, the more relevant question is whether the Division was substantially justified in bringing a federal securities fraud case that hinged on an issue of first impression under New York law. As the Eden Arc Respondents noted in their January 2016 Wells Submission:

> An enforcement case would rest on the premise that the joint tenancy accounts are invalid under New York law. But virtually all of the case law on joint tenancies arises in the context of probate and estate disputes. . . . Were a case to be brought now, then, the SEC would in essence be putting itself in the place of New York courts to decide an issue of first impression under New York law. And it would necessarily be taking the position that its own interpretation of New York law is correct – and not only correct, but so clearly correct as to support the conclusion that Mr. Lathen engaged in fraud when he advanced a contrary interpretation.
>
> [I]t is important to underscore here that even if the Staff is correct in predicting how New York law should be applied, that would not be enough to support a fraud claim. The plain language of Section 675 of the New York banking law strongly applies in favor of Mr. Lathen's position that he was a surviving owner of a JTWROS, entitled to redeem the survivor's option instruments, *undermining the Staff's ability to prove that Mr. Lathen had the requisite level of scienter or made a statement that was at the time it was made false or misleading.*"

Respondents' Wells Submission at 16 (emphasis added)

Additionally, even if the Division were somehow able to win the joint tenancy "battle," it would still inevitably lose the scienter "battle" and, thus, the "war." The strong presumption accorded Mr. Lathen under New York law, coupled with his awareness of New York law and the evidence that Mr. Lathen established joint tenancies based upon extensive advice he received from his attorneys, would have made it impossible for the Division to prove scienter <u>even if</u> it had it prevailed on the joint tenancy issue. For that reason, the Division's decision to proceed to litigation with its tenuous and highly debatable joint tenancy position was not substantially justified.

E. The Division's Position with Respect to <u>the Custody Rule Was Wholly Unjustified</u>

Like its beneficial ownership position, the Division's Custody Rule position could not be reconciled with the written contracts. In particular, Mr. Lathen's contractual structure established that survivor's option securities were owned by the joint tenancy accounts that Mr. Lathen formed with Participants. The Fund provided financing to the joint accounts and owned <u>only</u> advances, loans and profit sharing rights from (depending on the vintage of the agreements) counterparties Mr. Lathen, David Jungbauer and Participants. The Division focused on alleged inconsistencies between Mr. Lathen's contractual structure and certain statements on EACM's Form ADV and other documents. The Court soundly rejected the Division's position, finding as follows:

> To determine whether there was a violation of the custody, I must consider the language of the side agreements. . . . The agreements do not demonstrate that the joint accounts should be considered client funds for purposes of the custody rule. . . . The fact that EACM's Forms ADV sometimes stated that the company had custody of the funds in the joint accounts does not mean it did. . . . The question is not whether the Eden Arc Respondents sometimes claimed the joint accounts were owned by the Partnership but whether they actually were.

The Division's custody rule position was untenable because, to be successful, it required this Court to completely ignore Mr. Lathen's written contracts. The Division's position at the outset therefore was not "justified to a degree that could satisfy a reasonable person."

F. The Division's Arguments Concerning <u>Substantial Justification Are Without Merit</u>

The Division's substantial justification arguments are comprised largely of a laundry list cut and pasted from the Division's proposed findings of fact, most of which the Eden Arc Respondents disputed or which were otherwise irrelevant.

<u>First,</u> the Division asserts that this case "presented novel and complex questions of law and fact concerning the types of disclosures that must be made to issuers of survivor's bonds about the relationship between the purported joint holders of the bonds and the scope of undisclosed limitations on the authority of one holder to exercise rights to the bonds to the validity of the joint tenancy," that the Eden Arc Respondents were "walking a fine line of legality" and that the Commission's EAJA rules specifically safeguard the government's ability to litigate cases involving "close calls" to "insure that the Government is not deterred from advancing in good faith the novel but credible extensions and interpretations of the law that underlie vigorous enforcement efforts." The Eden Arc Respondents acknowledge that the Division may have good policy reasons for pursuing certain "close call" cases. But we fail to see how the instant matter fits within that paradigm.[10]

---

[10] If the Division's purpose was to extend existing law, the *Staples* case would have been more fertile ground for the Division to advance such a policy objective. With the exception of the Custody Rule, the *Staples* case was legally on all fours with the instant matter. If anything, the Division had a much stronger set of facts against the Staples. For example, the Staples' Participant Agreement fully stripped economics and survivorship whereas Mr. Lathen's Participant Agreement did not. Likewise, issuers never saw or reviewed the Staples' side agreements, whereas Mr. Lathen provided his Participant Agreements to several issuers who

(continued ...)

The only close question was that involving the validity of Mr. Lathen's joint tenancies, which all parties knew would be a matter of first impression under New York law. A state law matter of first impression issue, though, seems hardly the province Congress had in mind when it created the "special circumstances" exception.[11] As discussed above, the remaining issues in this case, particularly Mr. Lathen's scienter, were not close calls.

The Division also argues that its position was substantially justified because Judge Grimes did not grant the Eden Arc Respondents' motion for summary disposition. As the Division knows, Commission motion practice strongly disfavors summary dispositions. Moreover, the Eden Arc Respondents' motion was narrowly focused on the question of joint tenancy validity, not scienter or any other aspect of the case. Thus, little, if any, insight regarding substantial justification can be gleaned from a denial of the Eden Arc Respondents' motion. Likewise, the Court's observation (in its October 18, 2016 Order denying the Division's motion to exclude the Eden Arc Respondents' evidence concerning the advice of counsel) that it remains to be seen "[w]hether The Eden Arc Respondents will be able to establish all the elements of the defense" is hardly a ringing endorsement of the Division's position.

(... continued)

subsequently agreed to redeem. Finally, the Staples had not sought legal advice before starting their business whereas Mr. Lathen did.

[11] While the Eden Arc Respondents dispute this case even remotely warrants "special circumstances" consideration, such a result may not be the panacea the Division imagines. *See Devine v. Sutermeister,* 733 F.2d 892, 895 (Fed. Cir. 1984) (finding that, while some of the government's argument might be characterized as "novel," "this characterization does not detract from the fact that its positions were simply insupportable given the great weight of statutory, regulatory, and judicial authority to the contrary"); *SEC v. Morelli*, No. 91 Civ. 3874 (LAP), 1995 WL 9387, at *4 (S.D.N.Y. Jan. 11, 1995) (stating that "[a]lthough it is true that the government can carry its burden [of establishing substantial justification] by showing that its position advanced a novel but credible extension of the law, it is important not to overlook the word 'credible' in this formulation").

Second, the Division takes offense at the Eden Arc Respondents' observation that "the Division was willfully blind to evidence that the vast majority of survivor's option bond and CD issuers viewed Mr. Lathen's investment strategy as a legitimate and legal exploitation of a contractual loophole." The Division then listed twenty-eight facts that it claimed would refute that statement. But those facts neither refute such statement nor are they even related to same.

In any event, the Court largely agreed with the Eden Arc Respondents, finding as follows in its Initial Decision dismissing all of the Division's claims: (1) "This proceeding concerns a novel investment strategy that was disclosed to investors, was profitable to them, and was dependent on a contractual loophole"; (2) "No precedent establishes that the strategy was illegal, and no standard of care was otherwise established to hold the Eden Arc Respondents liable for these arms-length transactions"; (3) "Lathen directed redemption requests to over 70 issuers"; (4) "Lathen did not space out his redemption requests so as to avoid scrutiny . . . [t]o the contrary, he submitted multiple redemption requests to the same issuer or trustee, with respect to multiple bonds . . . in multiple accounts with participants . . . in Lathen's name in connection with different people who did not share his last name"; (5) "Information on Lathen's background, his relationship to EACM, and the nature of the strategy was publicly available online . . . [a] minority of issuers refused to redeem, or did so only after an initial dispute . . . the vast majority of issuers redeemed the bonds and CDs without question"; (6) "In December 2015 . . . Lathen began disclosing . . . that he had entered into a separate written agreement with the participant related to the account and that the Partnership had provided the financing for the accounts . . . at least 30 issuers honored his redemption requests following the enhanced disclosures put in place . . . In response to Lathen's redemptions, several issuers changed the language in their offering documents"; and (7) "Lathen believed these changes to be an acknowledgement by issuers that their pre-existing governing documents did not foreclose his strategy."

Third, the Division offers up the FINRA *CL King* case as evidence that its position was substantially justified. Initially, it bears noting that CL King is appealing the panel decision in that matter and that that case has not yet been fully adjudicated, unlike the instant matter. Also, although the Eden Arc Respondents acknowledge that the FINRA panel reached different conclusions regarding the joint tenancies than did this Court, the depth of analysis of the joint tenancy case law in that Panel's decision was well below the level of analysis undertaken by this Court. In any event, the joint tenancy analysis is the only relevant overlap between the two cases. The FINRA panel made a determination on CL King's negligence (which CL King disputes and is appealing) under a broker-dealer standard of care. Its findings concerning negligence therefore cannot reasonably be compared to this Court's findings concerning negligence. For instance, because the Division failed to pursue standalone negligence at trial, the Division cannot offer up any comparisons between the standards of care in the two cases through which an objective inference could be drawn on the Division's negligence-based substantial justification. And, of course, the FINRA Panel's decision sheds no light whatsoever on Division's substantial justification with respect to scienter.

Fourth, the Division offers up the district court decision in the *Staples* case, wherein the Division survived a motion to dismiss, as objective evidence that its position herein was substantially justified. That decision – in a different venue involving different parties and a different set of facts – sheds very little, if any light, on the question of whether the Division was substantially justified in filing the OIP against the Eden Arc Respondents. Indeed, a ruling on a motion to dismiss is a very poor prism through which to evaluate substantial justification because facts pled in a complaint must be accepted as true and the law must be construed in a manner most favorable to the non-movant. One simply cannot compare alleged facts in a pleading to findings of fact and law in a fully adjudicated case.

The settlement of the *Staples* case, by contrast, has more objective relevance to the question of whether the Division was substantially justified in bringing its case against the Eden Arc Respondents. Settled in June 2016, two months before the OIP in this case, the settlement was overwhelmingly positive for the Staples (and negative for the Division). In particular, the Division dismissed its fraud charges against the Staples with prejudice and settled for pennies on the dollar on a neither-admit-nor-deny negligence charge. Against that backdrop, the Division's decision to bring charges against the Eden Arc Respondents was, at a minimum, highly suggestive of a lack of substantial justification.

The Eden Arc Respondents received several documents from the *Staples* case file that shed considerable light on why the Division effectively walked away from that case. In particular, the file contained not only the aforementioned FBI memorandum but also affirmations from several issuers who told the Division that they still would have redeemed the Staples' bonds even if they knew about the Staples' side agreements. In addition, that file contained a letter to the Division from Bank of New York, the largest bond trustee by far in the survivor's option market, stating that beneficial ownership was determined by the account title at the brokerage firm. Given the foregoing, it is not surprising that the Division abandoned the *Staples* case. It is, however, surprising that the Division brought charges against the Eden Arc Respondents after such an unfavorable outcome in the *Staples* case. [12]

---

12 From the timing of the two matters it is reasonable to ask whether the Division concluded from the *Staples* case that it was unlikely to be able to persuade a federal court of the validity of its position and therefore decided to bring it claims against Mr. Lathen in what it hoped would be a friendlier forum.

Fifth, with respect to the Custody Rule, the Division argues that its position was substantially justified because the facts were complicated, it hired an expert who agreed with Division staff and the Court's analysis of the IMA was "complex." As detailed above, the Division's Custody Rule analysis was deeply flawed for the simple reason that they decided to ignore Mr. Lathen's written contractual regime. Instead, the Division decided to build a mosaic of extraneous "complicated" facts which, they hoped, would convince this Court to also ignore Mr. Lathen's contractual structure. The Court rightly focused on the contracts.

The Court characterized its analysis of the DLA/PSA as "straightforward" – "Lathen borrowed money from the Partnership to establish joint accounts . . . Lathen and participants owned those accounts . . . The Partnership was entitled to profits from the accounts under the PSA, but the accounts themselves were not the property of the Partnership . . . The Partnership owned only a right to repayment of the loans . . . as well as a security interest . . . in the joint accounts . . . to say the accounts then belonged to the Partnership would ignore the contractual structure set up by The Eden Arc Respondents."

The Court's analysis under the IMA was "more complex" than its analysis of the DLA/PSA. Ultimately, the Court concluded "The Partnership did not consider the funds or securities in the joint accounts to be its money and it didn't want them to be . . . There is no indication that the Commission intended the current version of the [custody] rule to be so broad in scope to reach situations where *the client itself* privately contracts to have funds held in the name of third parties in furtherance of its investment model." The Court also noted that the "statutory basis of the custody rule does not support a finding of liability," thereby raising a reasonable policy question as to whether the Division ought to have brought this case even under the somewhat ambiguous IMA language. "The custody rule is promulgated under Section 206(4) of the Advisers Act, which prohibits fraudulent, deceptive, or manipulative acts . . . The investment model contemplated by The Eden Arc Respondents – that the joint accounts be held by Lathen and the participants – seems far from a fraudulent, deceptive or manipulative act by EACM against the client . . . A finding for the Division would subvert the client's contracted-for investment arrangement to an interpretation of the custody rule that usurps client judgement on how assets should be classified."

Finally, the Division wrongly suggests that the Court had to engage in a "thoughtful weighing of the evidence" to get to the bottom of "genuinely disputed questions of fact." By and large, most of the facts related to the Custody Rule were undisputed. Instead, the parties disagreed on which facts actually mattered. The Eden Arc Respondents believed the facts that mattered were the contacts. The Division thought the facts that mattered were everything else. In the end, the Court rightly focused on the contracts and reached the correct decision based on the contracts alone. Out of thoroughness, the Court acknowledged the Division's non-contract facts and found them to be irrelevant or not dispositive to its inquiry. In sum, the Division's custody rule position, like its position on beneficial ownership, was plainly refuted by the written contracts themselves. As such, its custody rule position was not substantially justified.

V.

THE FEES INCURRED BY THE EDEN ARC RESPONDENTS WERE FAIR AND REASONABLE

The Division argues that the Eden Arc Respondents should not be able to recover fees incurred during the investigative stage of the proceeding, may not recover fees at a higher hourly rate than $75, should not be allowed to recoup certain non-attorney related expenses and should only be entitled to a prorated recovery of fees because Mr. Lathen was a Respondent but not an applicant herein. The Division also asserts that the Eden Arc Respondents have not demonstrated the reasonableness of their fees. The Division is wrong on all accounts.

Before proceeding to why the Division is wrong on its core arguments, the Eden Arc Respondents acknowledge that the Division is right on two of their objections. First, the Division is correct that private litigation is non-reimbursable under EAJA. In preparing and filing its initial application, the Eden Arc Respondents failed to notice that Kevin Galbraith, Esq.'s time sheets contained some mixed-matter line-items. Following receipt of the Division's Response, the Eden Arc Respondents asked Mr. Galbraith to estimate the amount of time attributable to the SEC matter in each mixed matter line item. Following that review, Mr. Galbraith advised the Eden Arc Respondents that his time devoted to the instant case was estimated to be 108.2 hours, a reduction of 42.5 hours from the Eden Arc Respondents original application. *See* Exhibit 3 to March 1, 2018 Lathen Declaration. Second, the Division is correct that the Eden Arc Respondents appear to have inadvertently double-counted the On-Trial Associates invoice ($10,519.17) and Robert Flanders' travel expenses to the trial ($655.88). An adjustment for those expenses would reduce Applicants reimbursement request by $11,175.05.

The Division argues that costs incurred by the Eden Arc Respondents during the investigation portion of the proceeding are not reimbursable under EAJA. The Division misconstrues the statute and case law on this issue. The Division is correct that EAJA recoveries are not possible for investigations which do not lead to an adjudication and final order. *See Family Television, Inc. v. SEC,* 608 F.Supp. 882 (D.C. Dist. 1985) and *ITT v. Electrical Workers*, 419 U.S. 428 (1975). But that is not the same as saying that fees incurred by applicants in investigations which lead to an adjudication and final order should be excluded from recovery. As the Supreme Court noted in *ITT v Electrical Workers,* "[I]nvestigatory proceedings, no matter how formal, which do not lead to the issuance of an order containing the element of final disposition as required by the definition, do not constitute adjudication." The clear meaning of the Supreme Court's language is that investigations are part of the adjudicatory process so long as they lead to an order and final disposition. This is because the EAJA defines an "adversary adjudication" as an "adjudication under [5 U.S.C. 554]." Section 554 covers "adjudications" required by statute to be determined on the record after a hearing. In turn, these "adjudications" are defined as "the agency process for the formulation of an order, 5 U.S.C. § 551(7)." Thus, as recognized by the courts in *ITT* and *Family Television,* the relevant inquiry under the EAJA is whether the fees sought were incurred as part of "the agency process for the formulation of an order."

The Division's investigation led directly to the OIP which led directly into the administrative proceeding which then led directly to an order and final disposition of the instant matter. The investigation, together with the administrative proceeding itself, constituted the "agency process for formulation of an order." The Division, perhaps subconsciously, acknowledges this fact when it refers to the investigation as the "investigative phase." In other words, the investigation is part of the "overall process." There is simply no question that fees and expenses incurred by Respondents during the "investigative phase" are recoverable under EAJA.[13] The Eden Arc Respondents are not aware of any precedent, outside of Commission

[13] The House Report for the 1985 reauthorization of the EAJA issued by the Judiciary Committee repeatedly chastises the courts for taking a restrictive interpretation of the EAJA. H.R. Rep. No. 120, 99th Cong., 1st Sess., reprinted in 1985 U.S. Code Cong. & Admin. News 132. The Judiciary Committee instructs the courts and agencies to take the "expansive view" of the Act and apply "the broader meaning." The Report clarifies that the "position of the United States" relevant for purposes of the EAJA is "not limited to the government's litigation position *but [includes] the action -- including agency action -- which [leads] to the litigation.*" *Id.* (emphasis added).

ALJ Proceedings, in which have held that investigation-related expenses were excluded from an EAJA award when the proceeding advanced to a final order.[14]

The Division maintains that recoupment of legal fees should be subject to a $75 per hour cap as proscribed in the Commission's internal EAJA regulations. As Applicants indicated in their initial application, the Commission's internal EAJA regulations are woefully out of date. When it was enacted in 1980, the EAJA provided that legal fees would be reimbursed at market rate, but could not exceed $75 per hour. In 1996, the EAJA was amended to state in relevant part, "The amount of fees awarded under this section shall be based upon prevailing market rates for the kind and quality of the services furnished, except that .... attorney or agent fees shall not be awarded in excess of $ 125 per hour." P.L. 104-121, Title II, Subtitle C, § 231, 110 Stat. 862. For whatever reason, the Commission has not yet updated its EAJA regulations to conform to a statutory amendment enacted by Congress 22 years ago. Since the Commission's regulation that purports to cap legal fees at $75 hours is inconsistent with the text of the EAJA, it is invalid. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976) ("The rulemaking power granted to an administrative agency charged with the

---

[14] The Division cites to the ALJ's decision in *Brandt, Kelly and Simmons,* 2006 SEC LEXIS 292 (ALJ Feb. 2006) which itself cited the enactment of the original SEC internal EAJA regulation. Therein the Commission avers that EAJA is not intended to cover "Commission investigations." But one could just as easily interpret that as applying to investigations that do not lead to an on-the-record proceeding and the issuance of a final order. The Division also cites *Douglas W. Powell* which cites *Flanagan* which cites *Family Television.* Meanwhile, the Court in *In the Matter of Rita Villa*, Initial Decision No. 132, Sept. 23, 1998 (to which Respondents referred in their initial application) cited *Family Television* to reach the *opposite* conclusion and found that because the investigation led directly to the hearing, it was "part of the agency process for the formulation of an order," and therefore came within the definition of "adversary adjudications." While *Rita Villa* was overturned by the Commission for substantial justification reasons, the Commission did not address, much less overturn, the *Villa* Court's reasoning as relates recoverability of investigative phase fees and expenses. Respondents respectfully submit that the Commission and regulations are out of step with the current state of the law on the EAJA and this case offers an opportunity to correct that.

administration of a federal statute is not the power to make law. Rather, it is the power to adopt regulations to carry into effect the will of Congress as expressed by the statute"); *K Mart Corp. v. Cartier*, 486 U.S. 281, 294-95 (1988) (striking a regulation where it is in express conflict with the plain language of the statute).

When Congress raised the EAJA rate to $125 per hour 1996, it also recognized the need to provide for a cost of living adjustment to keep pace with inflation. It encouraged agencies to update their internal regulations to incorporate the revised rate of $125 per hour and also to provide for inflation adjustments. 5 U.S.C. § 504(B)(1)(A)(ii). Most, if not all, agencies followed the Congressional guidance. The SEC did not. To the Eden Arc Respondents' knowledge, no other federal agency still maintains a $75 hourly cap and refuses to factor inflation into its awards.

It is worth noting that, had this case been filed in federal district court, the Division and the Eden Arc Respondents would not be debating the hourly rate. The Eden Arc Respondents would receive the rates set out in their application, capped at an inflation adjusted rate of $192.68 for 2016 and $196.79 for 2017. *See* Statutory Maximum Rates Under the Equal Access to Justice, https://www.ca9.uscourts.gov/content/view.php?pk_id=0000000039. But because the Division brought this case in its own in-house court, it asks that the Eden Arc Respondents recover only about one-third of the rate they would be entitled to had they prevailed in federal district court, which itself is only a fraction of the actual market rate.[15] Insofar as this Court agrees that the Eden Arc Respondents are deserving of an award, they urge the Court to "push the envelope" and award them the recovery level that they could have received had this action been brought in federal court. The worst thing that could happen is that the Commission

[15] See Sara Randazzo, "Legal Fees Cross New Mark: $1,500 per Hour," *Wall Street Journal*, Feb. 9, 2016.

could reduce the hourly rate and then the Eden Arc Respondents would have an opportunity to overturn the Commission at the federal appellate court level. Such a result would serve the interest of greater justice. It is obvious that the current Commission EAJA regulatory regime is overwhelmingly unfair to small litigants who, in addition to having no say on the Division's venue selection on the merits proceeding, find themselves relegated to second-class citizenship (relative to the federal court system) if they win in an administrative proceeding and then pursue EAJA compensation.

The Division also argues that certain of the Eden Arc Respondents' expenses are ineligible for reimbursement. The Division asserts that these costs are "expressly disallowed by statute." Unfortunately, the Division cites the wrong statute. The Division's statutory citations cover the award of "court costs" in connection with federal district court proceedings wherein federal courts are permitted to impose upon the losers of the case certain court costs. The instant case is not in federal district court. It relates to an EAJA prevailing party's fees, expense and costs, not court costs in a federal court proceeding. The Division's statutory citations thus miss the mark entirely. The controlling statute in this case is 5 U.S.C. § 504, which provides that under the EAJA, a prevailing party is entitled to its legal fees and "other expenses incurred by [it] in connection with that proceeding." 5 U.S.C. § 504(a)(1). Nothing in this section nor in the SEC regulations places any restrictions on the expenses that are eligible, other than to state that the expense for a "study, analysis, engineering report, test, or project" is only recoverable if it was "necessary for the preparation of the party's case." 5 U.S.C. § 504(b)(1)(A). The Division's argument is thus unavailing. All expenses in this proceeding are eligible for reimbursement.

The Division argues that any fee award in this case should be prorated because Mr. Lathen was a respondent but not an applicant under the EAJA. This makes no sense. First, regardless of whether Mr. Lathen was a respondent, the fees expended by the Eden Arc

Respondents (and covered by the Fund through the indemnity) in this case would not have changed one iota. Mr. Lathen was the control person for each of the Eden Arc Respondents and also for the Fund. The Eden Arc Respondents and Mr. Lathen were represented by the same counsel, the work streams in the case were not respondent-specific, and their legal positions and potential liability in the case were indistinguishable from one another. For the Division to suggest that the litigation expenses in this case could somehow be carved up and apportioned in any rational way is simply preposterous.

Mr. Lathen decided not to join this proceeding principally because he did not want the details of his financial affairs to enter the public domain. Insofar as this Court may be seriously entertaining the Division's request for a proration of fees, Mr. Lathen respectfully requests that he be deemed to have joined the proceeding as an applicant to facilitate a maximum recovery for the Fund and its investors.

Finally, the Division's quibbling on individual expenses submitted in this case barely warrants a response. The Division seems unable or unwilling to make even obvious inferences from the materials that the Eden Arc Respondents provided. For instance, the Division states that it is mystified by basis for a $5,359.64 claim related to Mr. Lathen's accountant, Eric Rosenthal of Nigro Karlin, whom the Division interviewed in connection with this proceeding. It claims it cannot discern how the Eden Arc Respondents arrived at that figure and intimates nefarious reasons for its inability to do so. However, the first page of Nigro Karlin's invoice (submitted with the EAJA application) states "For professional services rendering in connection with the SEC investigation including emails, phone calls and meetings with the SEC: $5280.00" and "Travel Charges: NYC – 1/27/2017 for SEC Meeting: $79.64" Those two items added together total the $5,359.64. We would welcome the opportunity to assist the Division in understanding our materials and narrowing the scope of any differences prior to the Court's review.

CONCLUSION

Accordingly and for all of the foregoing reasons, as well as those set forth in all of their prior submissions, Eden Arc Capital Management, LLC and Eden Arc Capital Advisors, LLC respectfully request that this Court enter an Order: (1) directing the Division to pay $1,104,988.44 for the legal fees and expenses they have incurred as detailed in their prior submissions (adjusted as described herein); and (2) awarding them the legal fees and expenses that they have been incurring in connection with this EAJA proceeding.

Dated: New York, NY
March 1, 2018

Respectfully submitted,

PROTASS LAW PLLC

/s/
By: ______________________
Harlan Protass
260 Madison Avenue
New York, NY 10165
T. 212-455-0335
F. 646-607-0760
hprotass@protasslaw.com

Counsel for Respondents Donald F. Lathen, Jr., Eden Arc Capital Management, LLC and Eden Arc Capital Advisors, LLC

CERTIFICATE OF SERVICE

The undersigned attorney hereby certifies that on March 1, 2018 I caused a true and correct copy of the foregoing REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF THE APPLICATION OF EDEN ARC CAPITAL ADVISORS, LLC AND EDEN ARC CAPITAL MANAGEMENT, LLC FOR RECOVERY OF LEGAL FEES AND EXPENSES PURSUANT TO THE EQUAL ACCESS TO JUSTICE ACT, dated March 1, 2018, and the accompanying AFFIRMATION OF DONALD F. LATHEN IN SUPPORT OF THE APPLICATION OF EDEN ARC CAPITAL ADVISORS, LLC AND EDEN ARC CAPITAL MANAGEMENT, LLC FOR RECOVERY OF LEGAL FEES AND EXPENSES PURSUANT TO THE EQUAL ACCESS TO JUSTICE ACT ("EAJA"), dated March 1, 2018, to be served upon the parties listed below via e-mail and/or Federal Express Overnight Service:

Honorable Jason S. Patil
Administrative Law Judge
U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549-2557

Brent Fields, Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549-2557

Sarah H. Concannon, Esq.
U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549-2557

/s/

Harlan Protass

UNITED STATES OF AMERICA
Before the
U.S. SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17387

In the Matter of

DONALD F. LATHEN, JR.,
EDEN ARC CAPITAL MANAGEMENT, LLC,
EDEN ARC CAPITAL ADVISERS, LLC.

AFFIRMATION OF DONALD F. LATHEN IN SUPPORT OF THE APPLICATION OF EDEN ARC CAPITAL ADVISORS, LLC AND EDEN ARC CAPITAL MANAGEMENT, LLC FOR RECOVERY OF LEGAL FEES AND EXPENSES PURSUANT TO THE EQUAL ACCESS TO JUSTICE ACT ("EAJA")

DONALD F. LATHEN hereby affirms under the penalty of perjury that the following statements are true and correct:

1. I am a resident of the State of New York.

2. I submit this affirmation in support of the Application of Eden Arc Capital Advisors, LLC and Eden Arc Capital Management, LLC for Recovery of Legal Fees and Expenses Pursuant to the Equal Access to Justice Act, dated December 4, 2017 and further supplemented thereafter.

3. The statements contained in this affirmation are based on my personal knowledge, except as otherwise indicated.

General Background

4. This affirmation supplements may affirmation dated December 22, 2017 which was filed with the Court on December 29, 2017.

My Net Worth at the OIP Date

5. I have attached a statement of my net worth at the time of the OIP as Exhibit 1. At the time of the OIP, I estimate that my net worth was [redacted]

6. Exhibit 1 also contains a comparison of my net worth at the OIP date to my net worth at the trial date. My net worth statement at the trial date, along with supporting documentation related to same were submitted as exhibits to my December 22, 2017 affirmation. My net worth at the OIP date was approximately [redacted] higher than my net worth at the trial date.

7. The far right-hand column of Exhibit 1 contains further details on each line item in my net worth statement and where it can be found in the supporting documentation. For many items, there was no change between the OIP date and the trial date. For those items, back-up documentation is contained in the exhibits attached to my December 22nd Affirmation.

8. For line-items whose values changed between the OIP date and the trial, I have included additional documentation where necessary to support the OIP date valuations. The penultimate column of the schedule indicates whether new documentation is being provided with respect to each line-item. Exhibit 2 attached herein contains the new documentation which is being provided in support of the OIP date net worth statement.

9. I respectfully request that this affirmation and the attached Exhibits be sealed, consistent with this Court's earlier decisions in this EAJA proceeding. As a non-party to the EAJA proceeding, I would prefer that my personal financial information remain private.

Additional Documentation Related to EAJA Fee Request

10. In the Division's Response Brief submitted February 14, 2018, they stated at page 52 that "[n]o itemized invoices whatsoever were submitted for Empire Discovery." Upon review, I concede that the Empire Discovery invoice was inadvertently omitted from the vendor invoices provided in connection with the initial application on December 4, 2017. I regret the oversight. The Empire Discovery invoice is attached herein as Exhibit 3.

11. In Applicants' initial application dated December 4, 2017, I included time sheets provided by the Law Office of Kevin Galbraith pertaining to work he completed for Applicants during the merits proceeding. In preparing and filing the application, I failed to notice that Kevin Galbraith's time sheets contained some mixed matter line-items. Following receipt of the Division's Response highlighting this point, I asked Mr. Galbraith to estimate the amount of time attributable to the SEC matter in each mixed matter line item. Following that review, Mr. Galbraith advised Applicants that his time devoted to the SEC the matter was estimated to be 108.2 hours, a reduction of 42.5 hours from the initial application. I attach as Exhibit 4 herein an email I received from Kevin Galbraith containing the revised time estimate.

I hereby declare under penalty of perjury that the foregoing is true and correct

Executed on March 1, 2018, in New York, New York

Donald F. Lathen

DONALD F. LATHEN, JR., ET AL.

File No. 3-17387

Respondents' Reply Memorandum of Law in Further Support of Application for Recovery of Legal Fees and Expenses Pursuant to EAJA, Affirmation of Donald Lathen in Support, and Exhibits 1-4

Dated 3/1/2018
Filed 3/5/2018

EXHIBITS 1 AND 2 UNDER SEAL
PER AP-5638

EXHIBIT 1

EXHIBIT 2

EXHIBIT 3

EMPIRE DISCOVERY

148 Madison Avenue, 9th Floor, New York, NY 10016

INVOICE

Date	Invoice #
6/12/2015	INV007615

Bill To
Jay Lathen Eden Arc Capital One Penn Plaza Suite 3671 New York, NY 10119

Job #: ED7746

Client Ref. #	Terms	Rep	Ordered By
Eden Arc Production	Net 30	RRyan	Harlan Protass

Description	Qty	Rate	Amount
Imaging:Endorsing Branding/Endorsing of Bates Numbers	21885	$0.010	$218.85T
Imaging:OCR OCR - per page	21885	$0.010	$218.85T
Imaging:Scanning - Grade 2 Imaging Medium Litigation	21885	$0.080	$1,750.80T
Media:DVD Creation Creation of Original DVD	6	$2.000	$12.00T
Misc:Project Management Hours Billable hours for SEC production - prepare images, data and Concordance load files on CD/DVD	1	$125.000	$125.00T

Thank you for your business

Subtotal:	$2,325.50
Sales Tax(0.08875):	$206.39
Total:	$2,531.89

Customer Signature: *Date:*

Tax ID Number: [redacted]

Main Office: 212-480-9900

EXHIBIT 4

Jay Lathen

From: Kevin Galbraith <kevin@kevingalbraithlaw.com>
Sent: Friday, February 23, 2018 6:19 PM
To: Jay Lathen
Cc: hprotass@protasslaw.com
Subject: PRIVILEGED AND CONFIDENTIAL JOINT DEFENSE COMMUNICATION

Jay and Harlan,

As I discussed with Harlan this afternoon, because many of the time entries combine work on the SEC matter with work on other matters, I had to estimate the SEC portion, and I chose to err on the side of being conservative.

My best good-faith estimate of hours devoted specifically to the SEC matter is 108.2, which works out to $54,100.

Our high-speed scanner is powered down for the night, so if you want back-up of my calculations, just let me know and I'll send them over on Monday.

Thanks, and have a good weekend.

Kevin

KG THE LAW OFFICE OF KEVIN GALBRAITH LLC

236 West 30th Street, 5th Floor
New York, New York 10001

212.203.1249 (p)
646.390.5935 (f)
[redacted] (m)

kevin@galbraithlawfirm.com
www.kevingalbraithlaw.com

Protass Law PLLC

260 Madison Avenue
22nd Floor
New York, NY 10016

T: 212-455-0335
F: 646-607-0760
hprotass@protasslaw.com

March 2, 2018

VIA FEDERAL EXPRESS

Honorable Jason S. Patil
Administrative Law Judge
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: In the Matter of Donald F. Lathen, Jr., Eden Arc Capital Management, LLC and Eden Arc Capital Advisors, LLC, Admin. Proc. File No. 3-17387

Dear Judge Patil:

As the Court knows, this firm represents Eden Arc Capital Advisors, LLC ("EACA") and Eden Arc Capital Management, LLC ("EACM") in connection with their claims under the Equal Access to Justice Act related to the referenced matter. Pursuant to this Court's recent Orders, enclosed please find copies of: (1) the Reply Memorandum of Law in Further Support of the Application of Eden Arc Capital Advisors, LLC and Eden Arc Capital Management, LLC for Recovery of Legal Fees and Expenses Pursuant to the Equal Access to Justice Act, dated March 1, 2018; and (2) the Affirmation of Donald F. Lathen in Support of the Application of Eden Arc Capital Advisors, LLC and Eden Arc Capital Management, LLC for Recovery of Legal Fees and Expenses Pursuant to the Equal Access to Justice Act ("EAJA"), dated March 1, 2018.

Thank you for your consideration and attention to this matter.

Respectfully submitted,

Harlan Protass

cc: Sarah H. Concannon, Esq. (via Federal Express)
Brent Fields, Secretary (via Federal Express)