

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of,	:	
	:	
LYNN TILTON,	:	Administrative Proceeding
PATRIARCH PARTNERS, LLC,	:	File No. 3-16462
PATRIARCH PARTNERS VIII, LLC,	:	
PATRIARCH PARTNERS XIV, LLC and	:	Judge Carol Fox Foelak
PATRIARCH PARTNERS XV, LLC	:	
	:	
Respondents.	:	
	:	
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**MEMORANDUM OF LAW IN SUPPORT OF RESPONDENTS'
MOTION *IN LIMINE* TO EXCLUDE THE *ZOHAR CDO 2003-1, LLC, ET AL., V.
PATRIARCH PARTNERS, LLC, ET AL.*, CASE NO. 12247-VCS (DEL. CH. AUG. 9 & 10,
2016) TRIAL TRANSCRIPTS MARKED DIVISION EXHIBITS 207 AND 208**

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September 2, 2016

Respondents Lynn Tilton, Patriarch Partners, LLC, Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC, and Patriarch Partners XV, LLC (collectively, “Patriarch” or “Respondents”), respectfully submit this memorandum of law in support of their motion *in limine* to exclude the attempted admission of the *Zohar CDO 2003-1, LLC, et al., v. Patriarch Partners, LLC, et al.*, Case No. 12247-VCS (Del. Ch. Aug. 9 & 10, 2016), trial transcripts marked as exhibits 207 and 208 by the Securities and Exchange Commission (“SEC”) Division of Enforcement (the “Division”). Respondents respectfully request oral argument on this motion.

INTRODUCTION

The Division’s August 22, 2016, amended exhibit list includes the entire 580-page trial transcript of *Zohar CDO 2003-1, LLC, et al., v. Patriarch Partners, LLC, et al.*, Case No. 12247-VCS (Del. Ch. Aug. 9 & 10, 2016) (the “Books and Records” trial)—a two-day proceeding in which the sole issue was whether Patriarch¹ had a contractual duty to turn over additional material to the successor Collateral Manager in 2016. *See* Division’s Amended Exhibit List, Aug. 22, 2016, Exs. 207-208. As with the Division’s attempted admission of the investigative testimony, this is in direct contravention of the well-established rule prohibiting admission of wholesale transcripts. *See, e.g.*, Hearing Transcript at 1494:18-24, *In re John J. Aesoph*, SEC Admin. Proceedings File No. 3-15168 (Oct. 28, 2013) (Foelak, ALJ). Moreover, because the Books and Records trial concerned allegations, time periods, parties, and witnesses that are unrelated to the instant action, the transcripts are replete with irrelevant and unreliable testimony. Accordingly, Respondents move to exclude Division Exhibits 207 and 208.

¹ Patriarch Partners, LLC, Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC, Patriarch Partners XV, LLC, and Patriarch Partners Agency Services, LLC are defendants in the Books and Records proceeding.

LEGAL STANDARD

The Administrative Procedure Act (“APA”) requires that any agency order that issues after a hearing must be based on evidence that is “reliable,” “probative,” and “substantial.” 5 U.S.C. § 556(d). SEC Amended Rule 320² mandates that “the hearing officer . . . shall exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unreliable.” Amended Rule 235(a) provides that prior sworn statements of witnesses who are available to testify are generally inadmissible. Rule 300 states that the hearing “shall be conducted in a fair, impartial, expeditious and orderly manner.”

ARGUMENT

Respondents respectfully move for exclusion of Division Exhibits 207 and 208, which mark the entirety of the Books and Records trial transcripts.

I. Wholesale Admission Of Witness Testimony Transcripts Is Improper.

As Your Honor has previously recognized, the wholesale admission of witness testimony transcripts is not permitted. *See* Hearing Transcript at 1478:7-10, *In re John J. Aesoph*, File No. 3-15168 (Oct. 28, 2013) (Foelak, ALJ); *see also Del Mar Fin. Services, Inc.*, Security Act Release No. 8314, 2003 WL 22425516, at *8-9 (Oct. 24, 2003) (Op. of the Comm’n) (upholding exclusion of entire investigative transcripts offered by the Division); *In re Martin B. Sloate*, Exchange Act Release No. 38373, 1997 WL 126707, at *2 (Mar. 7, 1997) (Op. of the Comm’n) (upholding exclusion of prior trial testimony offered by the Division where the witnesses were available to testify at the hearing).

² As used herein, “Amended Rule ___” refers to an SEC Rule of Practice, as amended in July 2016, *see* SEC, Amendments to the Commission’s Rules of Practice, 81 Fed. Reg. 50,212 (July 29, 2016); and “Rule ___” refers to an SEC Rule of Practice as codified, 17 C.F.R. pt. 201.

Division Exhibits 207 and 208 are the complete, 580-page Books and Records trial transcripts, including testimony from six fact witnesses and one proffered expert witness. Having failed to designate relevant, admissible portions of the trial transcripts, or explain the necessity of their admission, Division Exhibits 207 and 208 should be excluded in their entirety.

II. The Division Has Failed To Comply With Amended Rule 235(a).

Division Exhibits 207 and 208 do not comply with Amended Rule 235(a). Amended Rule 235(a) requires the party seeking to admit prior sworn statements of a non-party witness to file a motion setting forth the reasons for introducing each statement. The Division has filed no such motion for the six non-party witnesses whose testimony the Division seeks to admit in Exhibits 207 and 208. Your Honor should thus exclude this prior sworn testimony from the Division's case-in-chief. *See In re Lynn Tilton*, Admin. Proceedings Rulings Release No. 4118 (Sept. 1, 2016) (“[I]f the Division intends to use prior sworn testimony in its case-in-chief, it must comply with 17 C.F.R. § 201.235. . . .”).

Procedural missteps aside, if the Division were to properly file a motion under Amended Rule 235(a), that motion should be denied. An ALJ may grant a motion under Amended Rule 235(a) only if the motion demonstrates either that (1) the witness is unavailable for reasons specified in the Rule, or (2) the interests of justice weigh so strongly in favor of the hearsay statement's admission that they overcome “the presumption that the witness will testify orally in an open hearing.” Amended Rule 235(a). Here, the Division could have compelled the testimony of the six non-party witnesses, but apparently chose not to do so. In light of the fact that the non-party witnesses testified live at the Books and Records trial in Delaware less than a month ago, it is hard to imagine a situation in which the “interests of justice” would overcome the presumption in favor of live testimony.

III. Wholesale Admission Of Books And Records Trial Transcripts Would Taint The Record With Inadmissible And Objectionable Testimony.

Wholesale admission of the Books and Records trial transcripts is fundamentally unfair for the additional reason that the Books and Records trial testimony is largely—if not entirely—inadmissible.³

First, the testimony in the Books and Records trial is irrelevant and immaterial to the instant action in multiple respects. For one, the Books and Records trial concerned narrow issues and claims that do not implicate the allegations in the Order Instituting Proceedings (“OIP”).⁴ In the Books and Records Proceeding, the Zohar Fund⁵ plaintiffs sought a determination as to whether the Patriarch defendants had any contractual duty to turn over certain documents to the successor Collateral Manager after resigning as Collateral Manager. By contrast, in the instant action, the Division alleges that Respondents violated the antifraud provisions of the Investment Advisers Act of 1940 in its *operation* of the Zohar Funds by “reporting misleading values for the assets held by the funds and failing to disclose a conflict of interest” *In re Lynn Tilton*, Admin. Proceedings Rulings Release No. 4004 (July 20, 2016). Moreover, the Books and Records proceeding concerned events in 2016—nearly a year after the filing of the OIP. In the

³ Prior sworn statements of non-party witnesses offered under Amended Rule 235(a) must be “otherwise admissible in the proceeding.” In addition, “[a] *party* opposing the introduction or use of [the party’s prior sworn statements] may still object to their admission under amended Rule 320 to the extent such evidence is ‘irrelevant, immaterial, unduly repetitious, or unreliable.’” SEC, Amendments to the Commission’s Rules of Practice, 82 Fed. Reg. 50,212, 50,223 (July 29, 2016) (Rule 235 Final Rule) (emphasis added).

⁴ Vice Chancellor Slight also recognized the narrow scope of the Books and Records proceeding: “I don’t know what’s happening outside of this courtroom. . . . I don’t want this to become a predicate proceeding for some other proceeding. Let’s just focus on whether the records are called for in the documents and the contracts at issue.” *Zohar CDO 2003-1, LLC Trial Transcript* at 193:13-21 (Aug. 9, 2016).

⁵ Zohar CDO 2003-1, LLC, Zohar CDO 2003-1, Ltd., Zohar II 2005-1, LLC, Zohar II 2005-1 Ltd., Zohar III, LLC, and Zohar III, Ltd. are plaintiffs in the Books and Records proceeding.

instant action, the Division alleges—and Respondents vehemently deny—that the conduct at issue ran from 2003 through, at the very latest, 2014. It is thus not surprising that, aside from Ms. Tilton, *not one* of the witnesses who testified in the Books and Records trial is listed on the Division’s or Respondents’ amended witness lists.

Accordingly, because the Books and Records testimony has no bearing on whether Respondents should be found liable for the conduct alleged in the OIP, such testimony should be excluded from the hearing in this matter. *See, e.g., In re Gregory M. Dearlove*, Admin. Proceedings Rulings Release No. 315, 2006 WL 2080012, at *54 (ALJ July 27, 2006) (affirming exclusion of Division’s multi-page exhibit “when only a portion of the document was relevant to the issues in the OIP” and “[t]he Division made only a token effort to identify those parts of the exhibits that it viewed as relevant to the case”); *In re Richmark Capital Corp.*, Admin. Proceedings File No. 3-9954, 2002 WL 412145, at *24 (ALJ Mar. 18, 2002).

Second, assuming the Division is offering the Books and Records trial transcripts for the truth of the matter asserted, the transcripts constitute unreliable hearsay. Amended Rule 320 provides that hearsay is admissible only “if it is relevant, material, and bears satisfactory indicia of reliability so that its use is fair.” *See* Amended Rule 320(b). Indeed, “[m]ere uncorroborated hearsay” in an administrative hearing “does not constitute substantial evidence.” *Consol. Edison Co. v. NLRB*, 305 U.S. 197, 230 (1938); *see also* 5 U.S.C. § 556(d) (requiring that evidence in administrative proceedings be “reliable” and “probative”). In determining whether to admit hearsay evidence, hearing officers consider, among other things, “the motives or potential bias of the declarant; the availability and credibility of the declarant; whether the statements are contradicted or consistent with direct testimony; the type of hearsay (e.g., sworn, written, attributable to an identified person); the availability of the missing witness and any attempts to

compel witness testimony; and whether or not the hearsay is corroborated by other evidence in the record.” SEC, Amendments to the Commission’s Rules of Practice, 82 Fed. Reg. 50,212, 50,226-27 (July 29, 2016) (Rule 320 Final Rule).

For the reasons described above, the Books and Records trial transcripts are neither relevant nor material.

Even if the transcripts, or portions of the transcripts, were relevant and material, they do not “bear[] satisfactory indicia of reliability” such that their “use is fair.” Amended Rule 320. It is not appropriate to admit hearsay evidence, such as the Books and Records trial transcripts, when the witnesses are available to testify or will testify live in the instant action. As discussed above, the Division has failed to show that the non-party witnesses who testified in the Books and Records trial are unavailable. Their testimony should thus be excluded. *See Sloate*, Exchange Act Release No. 38373, 1997 WL 126707, at *2. Moreover, because Ms. Tilton will be testifying live at the hearing, admission of Ms. Tilton’s testimony in the Books and Records proceeding would be “unduly repetitious.” *See* Amended Rule 320.

In addition, portions of the Books and Records testimony are unreliable because certain witnesses are biased and lack credibility. Indeed, the entire Books and Records proceeding was brought as a fishing expedition by the successor Collateral Manager as a proxy for MBIA Insurance Corp., which has embarked on a multi-year, multi-proceeding litigation campaign against Respondents. Testimony from witnesses for the plaintiff in that proceeding is, unsurprisingly, self-interested and biased. Accordingly, as the fact finder, it is especially important that Your Honor hear live testimony in order to assess credibility. *See Sloate*, Exchange Act Release No. 38373, 1997 WL 126707, at *2 (“[ALJs] are entitled (and expected) to make [their] own conclusions regarding credibility of witnesses.”).

CONCLUSION

For the reasons set forth above, Respondents respectfully move for an order excluding Division Exhibits 207 and 208.

Dated: New York, New York
September 2, 2016

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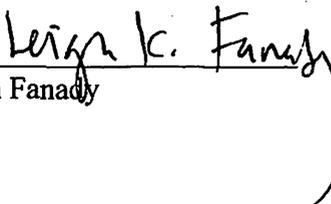
CERTIFICATE OF SERVICE

I hereby certify that I served true and correct copies of Respondents' Motion *In Limine* to Exclude the *Zohar CDO 2003-1, LLC, et al., v. Patriarch Partners, LLC, et al.*, Case No. 12247-VCS (Del. Ch. Aug. 9 & 10, 2016) Trial Transcripts Marked Division Exhibits 207 and 208, and Memorandum of Law in Support Thereof on this 2nd day of September, 2016, in the manner indicated below:

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