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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.	:	
	:	
-----	X	

**MEMORANDUM OF LAW IN SUPPORT OF RESPONDENTS' MOTION TO
PRECLUDE THE DIVISION'S WITNESS, MATTHEW MACH, FROM TESTIFYING
AND FOR EXPEDITED BRIEFING**

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October 11, 2016

Respondents Lynn Tilton, Patriarch Partners, LLC, Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC, and Patriarch Partners XV, LLC (collectively, “Respondents”), respectfully submit this brief in support of their motion to preclude the Securities and Exchange Commission’s (the “Commission”) Division of Enforcement (the “Division”) from eliciting testimony from its May Call Witness Matthew Mach, of Varde Partners, Inc. (“Varde”) during the hearing in this matter, or, in the alternative, to require that Varde immediately produce all documents responsive to Respondents’ subpoenas dated August 17, 2015 and August 30, 2016, in accordance with Your Honor’s Order of September 14, 2016. Respondents also respectfully request expedited briefing concerning the issues addressed herein, and oral argument, in light of the fact that the hearing is to commence in less than two weeks, with Varde’s witness expected to testify on the first day. Specifically, Respondents request that the Division’s brief in opposition be due Friday, October 14, and that Respondents’ reply be due Monday, October 17.

INTRODUCTION

The Division intends to call Matthew Mach of Varde on October 24, 2016, the first day that the hearing in this matter is set to commence. Yet Varde continues to refuse to produce documents that Your Honor—in denying Varde’s motion to quash 27 days ago—deemed “directly relevant to the Division’s proposed evidence and *necessary* for cross-examination.” *Tilton*, Administrative Proceedings Release No. 4153, at 2 (ALJ Sept. 14, 2016) (emphasis added). In a transparent attempt to wait out the clock with a mere 13 days left before the hearing, Varde continues to withhold documents from Respondents, citing concerns about its “proprietary” information, ignoring Your Honor’s rejection of these same confidentiality arguments in denying Varde’s motion to quash, as well as Respondents’ repeated offers to enter into the same protective order with Varde as they did with third party Rabobank when it was

reluctant to produce documents that might reveal proprietary information. As a result of Varde's bald refusal to follow Your Honor's Order of September 14, 2016 and provide documents "necessary for cross-examination"—as well as the fact that the Division never interviewed Mr. Mach on the record during its investigation of Respondents, nor did it subpoena Varde to produce documents—Respondents have no meaningful opportunity to prepare their cross-examination of Mr. Mach. He should therefore be precluded from testifying at the hearing.

BACKGROUND

I. Division Counsel's Impermissible Request for Documents from Varde Without an Investigatory Subpoena and Its Concealment of Such Request

During its nearly 5.5-year investigation of Respondents, the Division never once subpoenaed Varde for documents concerning Varde's investment in Zohar III,¹ and, as such, the Division's investigative file contains no documents from Varde. However, on June 9, 2015, the Division transmitted to Respondents two letters exchanged between Varde's counsel, on the one hand, and Patriarch Partners XV, LLC ("Patriarch"), on the other (collectively, the "Varde-Patriarch Correspondence"), stating, "Please see the attached documents, which were *voluntarily provided to us* by Varde Partners, Inc." Declaration of Mary Beth Maloney, dated October 10, 2016 ("Maloney Decl.") Ex. 1 (emphasis added).

As Your Honor knows, on July 27, 2016, Respondents submitted requests to issue two subpoenas to the Commission: One concerned the application of the Commission's amended Rules of Practice and the other called for communications between and among the Commission and various parties about Respondents or this proceeding. On September 1, 2016, Your Honor

¹ As used herein, the "Zohars" refers collectively to the entities Zohar I, Zohar II, and Zohar III. "Zohar I" refers to the aggregate of Zohar CDO 2003-1, Ltd., Zohar CDO 2003-1, Corp., and Zohar CDO 2003-1, LLC. "Zohar II" refers to the aggregate of Zohar II 2005-1, Ltd., Zohar II 2005-1, Corp., and Zohar II 2005-1, LLC. "Zohar III" refers to the aggregate of Zohar III, Ltd., Zohar III, Corp., and Zohar III, LLC. Varde invested in Zohar III but not Zohar I or Zohar II.

issued the two subpoenas (the “September 1, 2016 Commission Subpoenas”) and ordered the production of materials responsive to the September 1, 2016 Commission Subpoenas, as modified by Your Honor’s Order. Maloney Decl. Exs. 3-4.

On September 22, 2016, and in response to the September 1, 2016 Commission Subpoenas, the Commission produced Varde’s email and cover letter (the “Varde Cover Letter”) that had accompanied the Varde-Patriarch Correspondence when it was transmitted to the Division more than 15 months earlier. The Division withheld the Varde Cover letter when it provided the Varde-Patriarch Correspondence to Respondents on June 9, 2015. The previously unproduced Varde Cover Letter reveals that, contrary to the Division’s representation to Respondents in its June 9, 2015 email, Varde did not provide the Varde-Patriarch Correspondence voluntarily. Rather, Varde provided the Varde-Patriarch Correspondence to the Division at the request of Division attorney Amy Sumner more than two months *after* the filing of the March 30, 2015 institution of proceedings in this matter. Maloney Decl. Ex. 2.

In other words, acting without an investigatory subpoena, Division counsel obtained evidence relevant to the proceedings from a witness more than two months after the investigation leading to the institution of proceedings had concluded. Further, the Division concealed from Respondents the fact that Division counsel had improperly obtained evidence by withholding the Varde Cover Letter from Respondents until it was demanded through Respondents’ subpoena of September 1, 2016. Maloney Decl. ¶4.

II. Respondents’ 2015 and 2016 Varde Subpoenas

On August 17, 2015, Your Honor issued Respondents’ subpoena *duces tecum* to Varde, which requested several categories of documents related to the Zohar Funds, their valuation, and related communications with the Securities and Exchange Commission (“SEC” or

“Commission”) about the same (“2015 Subpoena”). Maloney Decl. Ex. 5. Following the lift of the September 17, 2015 stay of the proceedings, Varde moved to quash Respondents’ 2015 Subpoena on August 4, 2016, arguing, *inter alia*, that Respondents’ requests sought irrelevant documents and proprietary business materials.

On August 22, 2016, the Division stated on its Witness List that it may call Mr. Mach to testify about “Varde Partners’ investment in the Zohar Fund(s), communications regarding the investment, . . . their understanding of the investment, . . . and the monitoring or assessment of Varde Partners’ investment.” Maloney Decl. Ex. 12.

On August 30, 2016, Your Honor granted Respondents’ requests to issue a second subpoena to Varde (“2016 Subpoena”), along with subpoenas to Varde witnesses Matthew Mach and Jeremy Hedberg.² Counsel for Respondents and counsel for Varde began meeting and conferring over compliance with the 2016 Subpoena while awaiting Your Honor’s ruling on Varde’s motion to quash the 2015 Subpoena.

On September 14, 2016, Your Honor denied Varde’s motion to quash the 2015 Subpoena. Your Honor noted that the Division has stated it will call Mr. Mach regarding “Varde Partners’ investment in the Zohar Fund(s), communications regarding the investment, relationship with Patriarch, their understanding of the investment, any interaction with Tilton or other Patriarch employees, and the monitoring or assessment of Varde Partners’ investment.” *Tilton*, Administrative Proceedings Release No. 4153, at 2 (ALJ Sept. 14, 2016). Accordingly, Your Honor concluded that the information sought by Respondents from Varde, at least insofar as it relates to those topics, is “directly relevant to the Division’s proposed evidence and

² Maloney Decl. Exs. 13-15. The Division initially listed both Matthew Mach and Jeremy Hedberg on its “May Call” witness list, but later informed Respondents that it would not be calling Mr. Hedberg.

necessary for cross-examination.” *Id.* Your Honor also noted that Varde’s reasonable concerns regarding confidentiality could be addressed by entering into a protective order, which Respondents offered immediately to do. *Tilton*, Administrative Proceedings Release No. 4153, at 2 (ALJ Sept. 14, 2016) (“Varde and Respondents may propose the text of a protective order.”).

Counsel for both parties continued to meet and confer, ultimately agreeing to further narrow various requests in the 2016 Subpoena. Yesterday, Varde provided Respondents with a log titled “General Categories of Documents Withheld from Varde Partners Inc.’s Response to Two Subpoenas Served by Respondents Dated August 17, 2015 and August 30, 2016” (“Varde’s Withheld Documents Log”). Maloney Decl. Ex. 18. The Varde Withheld Documents Log contains several categories of information that Respondents need to properly cross-examine Mr. Mach at the upcoming hearing and mount a defense against the allegations in the Order Instituting Proceedings (“OIP”) in this matter. These categories are as follows:

- Trade tickets, confirmations, and counterparty risk reports for transactions in Zohar III Notes [Category 5];
- Client holding statements, profit & loss statements, and custody statements reflecting all client holdings including Zohar III Notes as well as the prices and values of those holdings [Category 6];
- Investment committee updates/meeting minutes, quarterly memoranda, and presentations containing confidential and proprietary business information reflecting the prices and values Varde placed on Zohar III Notes as well as the methods it employs to price, value, analyze, and monitor those investments [Category 7];
- Emails among Varde personnel and internal reports titled “Zohar III Update,” “Zohar III Opportunity Overview,” and “Zohar III Portfolio Exposures” reflecting Varde’s internal valuation and analysis of Zohar III Notes including the prices and values Varde placed on investments as well as the methods it employs to price, value, analyze, and monitor those investments [Category 8];
- Emails among Varde personnel evaluating bids, offers and marks for Zohar III Notes [Category 9];
- Emails between Varde personnel on the one hand and brokers and other third parties on the other relating to bids, offers and marks for Zohar III Notes [Category 10];
- Internal spreadsheets and analyses reflecting Varde’s proprietary models and internal analyses concerning Zohar III Notes [Category 11]; and
- Emails among Varde personnel concerning its strategy for negotiating a restructuring of the Zohar CDOs [Category 12].

These categories of documents contain the very information that the Division is calling Mr. Mach to testify about, *i.e.*, “Varde Partners’ investment in the Zohar Fund(s), communications regarding the investment, . . . their understanding of the investment, . . . and the monitoring or assessment of Varde Partners’ investment.”

Despite Respondents’ repeated offers to enter into a protective order, and despite Your Honor’s Order concerning the 2015 Subpoena, counsel for Varde continues to refuse to produce any documents responsive to either the 2015 or the 2016 Subpoena that fall into the twelve categories of documents on the Varde Withheld Documents Log. Respondents are now left without documents or information necessary to cross examine Mr. Mach. And now the Division has revealed that Mr. Mach will be called as a witness on Day One of the hearing. With just 13 days left before Mr. Mach takes the stand, Respondents have no choice but to ask Your Honor to preclude Mr. Mach from testifying.

LEGAL STANDARDS

If a non-party opposes the issuance of a subpoena, it must move to quash or modify the subpoena within 15 days of service, Rule 232(e)(1), and demonstrate that compliance would be “unreasonable, oppressive, or unduly burdensome,” Rule 232(b); Rule 232(e)(2); *Clean Energy Capital LLC*, Administrative Proceedings Release No. 1653, 2014 WL 11115572, at *1 (ALJ July 25, 2014). And where any person refuses to comply with a hearing officer’s order, that person may be excluded from the proceeding. Rule 180(a)(1) (“Contemptuous conduct by any person before the Commission or a hearing officer during any proceeding, including . . . any conference, . . . shall be grounds for the Commission or hearing officer to [] [e]xclude that person from such . . . hearing”). Pursuant to Rule 300, “[a]ll hearings shall be conducted in a fair, impartial, expeditious and orderly manner.”

ARGUMENT

I. The Documents At Issue Are, As Your Honor Has Stated, “Directly Relevant” And “Necessary For Cross Examination,” And Varde Was Obligated To Produce Them Pursuant To Your Honor’s Order.

The relevance of the documents requested in the 2015 and 2016 Subpoenas is no longer at issue: the documents are clearly relevant, as Your Honor has already held. Specifically, the Division has stated that it will call Mr. Mach—on day one of the hearing—regarding “Varde Partners’ investment in the Zohar Fund(s), communications regarding the investment, . . . their understanding of the investment, . . . and the monitoring or assessment of Varde Partners’ investment.” *Tilton*, Administrative Proceedings Release No. 4153, at 2 (ALJ Sept. 14, 2016). The Division’s decision to call Mr. Mach on the first day of the hearing reflects the fact that these issues are central to the Commission’s allegations, as contained in the OIP in this matter, which focus on investors’ subjective valuations of the Zohar funds. As Your Honor has explained, the information sought by Respondents from Varde about its investment in the Zohar Funds is “directly relevant to the Division’s proposed evidence and necessary for cross-examination.” *Tilton*, Administrative Proceedings Release No. 4153, at 2 (ALJ Sept. 14, 2016).

Yet Varde refuses to produce any documents responsive to the 2015 or 2016 Subpoenas that fall into the categories listed on the Varde Withheld Documents Log, such as the following: trading data for the Zohar III notes; valuation data for the Zohar III notes; investment committee minutes, memoranda, and presentations reflecting the prices and values Varde placed on investments, as well as the methods it employs to price, value, analyze, and monitor those investments; internal emails evaluating bids, offers, and marks for the Zohar III notes; external emails evaluating bids, offers, and marks for the Zohar III notes; internal spreadsheets and analyses reflecting Varde’s models and internal analyses concerning the Zohar III notes; and

internal emails concerning Varde's strategy for negotiating a restructuring of the Zohar CDOs. Maloney Decl. Ex. 18. Respondents need information about Varde's reasons for purchasing Zohar III notes, communications regarding about Varde's investment in the notes, Varde's understanding of the investment, and Varde's monitoring and assessment of its investment because the Division is going to call Mr. Mach to testify about all of those topics. And while Varde has produced some documents in this matter, none of those documents indicate how Varde valued the Zohar III notes on its books, nor do the documents provide any insight into how Varde analyzes the trustee reports and financial statements that it receives relating to Zohar III, issues that are directly relevant to the allegations in the OIP.

In other words, Varde refuses to produce the documents that Your Honor already rightly deemed "directly relevant" and "necessary for cross-examination" and ordered Varde to produce. Allowing Mr. Mach to testify without giving Respondents access to documents to rebut the allegations in the OIP would be fundamentally unfair to Respondents, who—due to Varde's refusal to produce any documents in its possession concerning numerous core areas of Mr. Mach's testimony and due to the utter lack of any other discovery record concerning these same core issues—have no way to effectively cross examine Mr. Mach. *See, e.g., United States v. Int'l Bus. Machs. Corp.*, 83 F.R.D. 97, 106 (S.D.N.Y. 1979) (granting discovery of documents related to witness's direct testimony for purpose of cross-examination, "the greatest legal engine ever invented for the discovery of truth," because "[a]n engine without fuel has neither power nor effect" (internal citation and quotations omitted)).³ Varde's contemptuous conduct is "grounds for the Commission or hearing officer to [] [e]xclude" Mr. Mach from the hearing,

³ Compounding the importance of the discovery requested via the 2015 Subpoena and the 2016 Subpoena is the fact that—unlike in federal court—the SEC's Rules of Practice prohibit Respondents from taking depositions. Document subpoenas like the two Respondents have issued are the primary method of obtaining information necessary to prepare for trial.

Rule 180(a)(1), much as it would be grounds for exclusion in federal court under both the Federal Rules of Civil Procedure and the “inherent authority” that “all courts” possess to manage cases in the face of contemptuous behavior on the part of parties or their witnesses, *see Advanced Analytics, Inc. v. Citigroup Global Markets, Inc.* 301 F.R.D. 31, 38 (S.D.N.Y. May 7, 2014) (internal citation and quotations omitted); *see also Valente v. J.C. Penney Corp.*, 437 F. App’x 858, 860 (11th Cir. 2011) (affirming sanctions order excluding all evidence from non-party where non-party failed to produce subpoenaed documents in violation of order directing compliance with subpoena).

II. Varde’s Excuse For Non-Production, Which Was Already Rejected By Your Honor, Remains Unfounded.

Varde’s refusal to disclose plainly relevant documents that it has been ordered to disclose hinges entirely on its alleged concern over revealing its “proprietary model.” But this excuse has already been rejected. In its briefing in support of its Motion to Quash the 2015 Subpoena, Varde fully argued its concerns related to the disclosure of proprietary material. Your Honor’s September 14, 2016 ruling made plain that those arguments failed to meet Varde’s burden. *See Tilton*, Administrative Proceedings Release No. 4153 (ALJ Sept. 14, 2016). Nor is it at all clear that there is any support for the privacy concerns Varde asserts. There is no direct competitive danger from Respondents, as Respondents are no longer registered investment advisers. *Cf. Official Unsecured Creditors Comm. of Media Vision Tech. v. Jain*, 215 F.R.D. 587, 589–90 (N.D. Cal. 2003) (noting absence of any evidence tending to prove disclosure would be harmful, and explaining that even if such evidence were present, disclosure would still have been ordered pursuant to protective order). Moreover, even if Varde’s argument had not already been rejected, and even if there were a direct competitive danger from Respondents, that danger would be outweighed by Respondents’ need for the requested information. *See Tilton*, Administrative

Proceedings Release No. 4153, at 2 (ALJ Sept. 14, 2016) (explaining that the requested information is “directly relevant” and “necessary for cross-examination”); *Datacard Sys., Inc. v. PacsGear, Inc.*, 2011 WL 2491366, at *2 (D. Minn. June 23, 2011) (“the evidentiary value of the information outweighs the potential damage”); *Vision Tech.*, 215 F.R.D. at 589 (noting “Plaintiffs’ need for the manuals outweigh[ed] any claim of injury”).

Moreover, as Respondents explained in their opposition to Varde’s motion to quash, and as Your Honor already implicitly accepted, if there were any remaining doubt that Varde was required to disclose the documents at issue, it would be eliminated by Respondents’ repeated offer to enter a protective order. *Tilton*, Administrative Proceedings Release No. 4153, at 2 (ALJ Sept. 14, 2016) (“Varde and Respondents may propose the text of a protective order.”); *see, e.g., Morgan Asset Mgmt., Inc.*, Administrative Proceedings Release No. 658, 2010 WL 7765367, at *2 (ALJ July 20, 2010) (denying motion to quash where, “to the extent that documents responsive to Request No. 4 may contain confidential business information relating to third parties, Respondents are willing to enter into a protective order restricting their use of the confidential business information. No more is required.”). Courts consistently recognize that protective orders are an effective safeguard of nonparties’ otherwise-confidential information. *See, e.g., Wal-Mart Stores, Inc. v. Tex. Alcoholic Beverage Comm’n*, 2016 WL 270486, at *2 (W.D. Tex. Jan. 21, 2016) (protective order would “readily address[]” any remaining “confidentiality concern[s]”); *Nutratch, Inc. v. Syntech (SSPF) Int’l, Inc.*, 242 F.R.D. 552, 555 (C.D. Cal. 2007) (explaining that protective orders allow courts to strike “a proper balance between the philosophy of full and fair disclosure of relevant information and the need for reasonable protection against harmful side effects” (internal citation and quotations omitted)). This is true whether the nonparty’s concern relates to disclosure to direct competitors (which, as

explained above, cannot be the case here), or instead to the “relatively remote potential for inadvertent disclosure” to other parties. *AFMS LLC v. United Parcel Serv. Co.*, 2012 WL 3112000, at *7 (S.D. Cal. July 30, 2012) (nonparty’s supposed “fear of disclosure to alleged competitive decisionmakers” deemed fully “alleviated by this protective order,” along with “any concerns regarding inadvertent disclosure of confidential and sensitive material . . . The relatively remote potential for inadvertent disclosure of confidential documents does not justify the withholding of discovery altogether.”) (quoting *Sierra Pac. Indus. v. Am. States Ins. Co.*, 2012 WL 117132, at *2 (E.D. Cal. Jan. 13 2012)).

With 13 days until the hearing, and the Division’s assertion that it plans to call Varde witness Matthew Mach on day one of the hearing to testify as to topics about which Varde refuses to produce any documents, in direct contravention of Your Honor’s Order, it would be fundamentally unfair to allow Mr. Mach to testify. Mr. Mach’s testimony should be precluded, and Varde should be sanctioned for its continuing intransigence. *See* Rule 180(a)(1) (“Contemptuous conduct by any person before the Commission or a hearing officer during any proceeding, including . . . any conference, . . . shall be grounds for the Commission or hearing officer to [] [e]xclude that person from such . . . hearing”).

III. Excluding Mr. Mach’s Testimony Would Not Unfairly Prejudice The Division.

The Division is largely responsible for Respondents’ lack of information concerning the subjects about which the Division proposes to question Mr. Mach, regardless of whether the Division took part in Varde’s contemptuous intransigence. During its nearly 5.5-year investigation of Respondents, the Division never once bothered to subpoena documents concerning Varde’s investment in Zohar III—*e.g.*, documents concerning how and why Varde decided to invest in Zohar III, what its valuation of Zohar III was, whether that valuation

changed over time, or what it did to monitor or assess Zohar III, including how Varde analyzed the trust reports and financial statements that it received relating to Zohar III. Indeed, it is unclear how the Division could have ever come to any conclusion (let alone a reliable one) about whether Varde was materially misled without having asked for this information.

Regardless of the Division's motivations, the practical effect is that a discoverable record of information relevant to Varde and Mr. Mach's testimony was not created and remains unavailable to Respondents. This prejudicial lack of discovery concerning the subjects of Mr. Mach's proposed testimony is the product not only of Varde's intransigence, but also of a years-long failure on the part of the Division to obtain and maintain the sort of investigative record normally expected of this type of matter and that would otherwise allow Respondents to prepare for cross-examination of the Division's witnesses. There is nothing unfair about excluding the Division's witness here. Indeed, even if the Division bore no responsibility whatsoever for Respondents' prejudicial lack of information, it would still be appropriate to exclude Mr. Mach's testimony, as courts commonly exclude evidence as a sanction for contemptuous conduct on the part of counsel and other nonparties even to the detriment of the litigant whose evidence is excluded. *See, e.g., Valente*, 437 F. App'x at 860; *cf.* Rule 180(a)(1).

Furthermore, the only documents that the Division has provided to Respondents after receiving them from Varde were impermissibly obtained after the filing of the OIP, and the Varde Cover Letter that transmitted those documents was withheld by the Division. Rule 230(g) directs hearing officers to prevent the Division from issuing investigatory subpoenas for the purpose of obtaining additional evidence following the institution of proceedings against a party. The purpose of this rule is "to assure that investigative subpoenas are not used for the purpose of gathering information for use in the proceeding." Rules of Practice, S.E.C. Release No. 35,833,

1995 WL 368865, at *55 (June 9, 1995). Law Judges have ruled that Rule 230(g) stands for a broader principle that the gathering of evidence by the Division must occur before the OIP, not after. *See Morgan Asset Mgmt.*, Administrative Proceedings Release No. 656, 2010 WL 3405823, at *2–4 (ALJ July 12, 2010) (barring Division from gathering additional evidence for use in proceeding where OIP had already been issued).

Ms. Sumner’s request to Varde to provide documents after the close of the Division’s investigation, after the filing of the OIP and without a subpoena, directly violates Rule 230(g). Mr. Mach’s testimony at the upcoming hearing should be excluded as a sanction for the Division’s impermissible conduct.⁴

⁴ Moreover, the Division’s misconduct here—concealing from Respondents the fact that Ms. Sumner had improperly obtained evidence by withholding the Varde Cover Letter—provides further grounds to support the Respondents’ request that Your Honor conduct an *in camera* review of the Division’s investigative files, *see* Rule 230(c), not merely rely on the Division’s assertions that it has complied with its obligations to produce *Brady* and Jencks Act materials, *see Brady v. Maryland*, 373 U.S. 83 (1963); 18 U.S.C. § 3500; Rule 231(a) (providing for inspection of Jencks Act materials).

CONCLUSION

For the foregoing reasons, Respondents respectfully request that Your Honor preclude the Division from eliciting testimony from the Division's witness, Matthew Mach, during the hearing in this matter, or, in the alternative, to require that Varde immediately produce all documents responsive to Respondents' 2015 and 2016 Subpoenas. Respondents also respectfully request oral argument and expedited briefing concerning the issues addressed herein.

Dated: New York, New York
October 11, 2016

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