



*In the Matter of RD Legal Capital, LLC and Roni Dersovitz*

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SEC Administrative Proceeding, File No. 3-17342

Expert Report of

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## TABLE OF CONTENTS

I.	EXPERT QUALIFICATIONS .....	1
II.	SUMMARY OF OPINIONS .....	2
III.	BACKGROUND .....	4
A.	What is a Hedge Fund? .....	4
B.	Overview of RD Legal Entities.....	5
C.	Hedge Fund Service Providers.....	6
IV.	DISCUSSION .....	8
A.	Hedge Fund Marketing Materials and Investor Due Diligence .....	8
B.	The Funds' Broad Investment Mandate Is Consistent With Industry Standards.....	14
C.	RDLC Disclosed the Types of Investments in the Portfolio.....	16
D.	RDLC Accurately Reported the Concentration of Investments in the Funds.....	31
E.	RDLC's Valuation Procedures Were Reasonably Designed to Result in a Fair Valuation.....	37
V.	CONCLUSIONS.....	47

## **I. EXPERT QUALIFICATIONS**

1. I have 29 years of professional experience in the hedge fund industry, both in senior positions at an alternative investment firm and in academia. I have taught more than 30 graduate level courses on the regulation and operation of hedge funds at institutions including Columbia University, Cornell University, New York University, the University of Pennsylvania, Tel Aviv University, Yale University, and Yale Law School.
2. For 18 years, I was associated with the investment management firm of Paloma Partners Management Company (“Paloma”), which provides services to multi-strategy hedge funds. Most recently, I served as Paloma’s Vice Chairman and Chief Administrative Officer where I managed the administration of the firm and non-portfolio operations. At its peak while I was there, the assets under management at Paloma exceeded \$3 billion.
3. At Paloma, I co-headed the administration, chaired the audit, and served on the executive and valuation committees. I also advised on strategic issues such as acquiring or forming a bank in Germany; converting the company to an employee stock ownership plan; and operating the funds as a reinsurance company. Furthermore, I led industry initiatives for elective mark-to-market tax treatment for hedge funds and managed the firm’s relationship with government regulatory authorities and the media.
4. I have testified before Congress three times. The first time was shortly after one of the most renowned hedge funds in the world at the time, Long Term Capital Management, collapsed in 1998 and nearly caused severe dislocations in the world’s financial markets. The second time was in 2007, when Congress invited me to share my views about the carried interest of general partners of hedge funds. The third time was in 2009, when I appeared before Congress to share lessons from the Bernard Madoff Ponzi scheme.
5. I have appeared as an expert on valuations and other hedge fund matters before the U.S. Government Accountability Office (GAO); U.S. Commodities and Futures Trading Commission (CFTC); Department of Treasury; Internal Revenue Service (IRS); and the International Organization of Securities Commissions Standing Committee on Investment Management.
6. I have additionally lectured at the U.S. Securities and Exchange Commission (“SEC”) on key concepts and issues related to valuation of financial assets.
7. For 11 years (2004 and 2006-2015), I taught, at the aforementioned schools, graduate level courses that provided a multi-disciplinary, general management-focused overview of the challenges associated with launching and operating a hedge fund. My courses explored the impact of global macro current events on alternative investment managers, investors, and regulators.

8. I founded and chaired the Investment Management Committee of the New York State Society of CPAs, and served as a member of a Task Force on Alternative Investments of the American Institute of CPAs. I also served as a member of the Investor Risk Committee of the International Association of Financial Engineers (“IAFE”), and chair of the IAFE Advisory Board, through which I was the editor and one of the principal authors of a Valuation Concepts White Paper, which has led to more than 30 invitations to speak at conferences, seminars, and roundtables about the topic of valuation in the alternative investment management industry.
9. I have a master’s degree from Harvard Business School and a bachelor of science from the Wharton School at the University of Pennsylvania. A copy of my full curriculum vitae is attached hereto as Appendix A.
10. I am being compensated for my work in this matter at an hourly rate of \$[REDACTED]. My compensation does not depend upon the opinions that I deliver or the outcome of this matter. Members of the staff of Cornerstone Research and counsel, who worked under my direction, have assisted me.

## **II. SUMMARY OF OPINIONS**

11. I have been retained by Hughes Hubbard & Reed LLP, legal counsel to RD Legal Capital, LLC (“RDLC”) and Roni Dersovitz (“Dersovitz”) (together, “Respondents”), to review and provide an analysis of certain issues in an administrative proceeding brought by the Securities and Exchange Commission (the “Administrative Proceeding”). Specifically, I have been asked to review and offer expert analysis on the following subjects:
  - i. The role marketing materials play in the reasonable due diligence conducted by investors in private hedge funds.
  - ii. The degree to which it is customary in the hedge fund industry for the investment manager to be given discretion—under the governing documents of a fund—to seek out new investment opportunities without making updated disclosures about the nature of each investment, and whether the discretion given in the relevant funds’ offering memoranda for the manager to pursue new investment opportunities is consistent with those standards.
  - iii. Whether the investment strategy undertaken by RDLC fell within the stated investment strategy disclosed to investors in the funds’ offering memoranda and other documents made available to investors.
  - iv. Whether the investment manager accurately reported to investors the composition of the funds’ portfolios.

- v. Whether the procedures used by RDLC for valuing the assets in the funds' portfolios conformed to valuation principles and were reasonably designed to result in a fair valuation.
12. My opinions in this matter are based on an analysis of case documents and other publicly available documents, interpreted in light of my experience during the past 29 years as an active practitioner and adjunct professor specializing in hedge funds. Appendix B contains a list of the materials that either I, directly, or those working under my direction, considered in preparing this report.
13. In summary, my opinions are as follows:
- i. Reasonable accredited investors should have understood that the funds' marketing materials were meant to provide a brief summary of the investment opportunity only and did not purport to contain all relevant terms that may be of interest to prospective investors.
  - ii. Broad investment mandates are a common feature of the hedge fund industry and the investment strategy pursued by RDLC was consistent with the disclosures to investors in the funds' offering memoranda with respect to the types of investment strategies the funds' investment manager could employ, and the markets or instruments in which it could invest. Specifically, the flexibility provided to the funds' investment manager under the terms of the offering memoranda—which investors agreed to—included the ability to pursue investments in plaintiff and judgment-based legal receivables, as well as other receivables.
  - iii. The investment strategy undertaken by RDLC fell within the strategy disclosed to investors. Respondents did not misrepresent the type or diversification of assets under management in the funds. If the distinction between the various types of litigation-based receivables held by the funds was material to any particular investor—and I have not seen evidence to support such an assertion—the investor had access to that information.
  - iv. RDLC accurately reported to investors the composition of the funds' portfolios.
  - v. The procedures used by RDLC for valuation generally conformed to valuation principles and were reasonably designed to result in a fair valuation.

### III. BACKGROUND

#### A. What is a Hedge Fund?

14. A hedge fund is an investment vehicle typically structured in the United States as a limited partnership, limited liability company, or similar arrangement, and overseas as a corporation or similar arrangement.
15. Hedge fund investment managers pool capital from their investors and, based on an investment strategy, invest the proceeds.
16. Investment strategies vary widely, with some common types including directional trading (buying “long” an underpriced or selling “short” an overpriced financial instrument); arbitrage (exploiting the relative mispricing between two or more financial instruments by simultaneously taking partially offsetting long and short positions); macro (trades based upon forecasted economic trends and current economic events); and event-driven (exploiting the difference between the expected value to be received upon the successful consummation of an anticipated transaction or event and the current market price).
17. Hedge fund investment managers are typically compensated in part based upon the investment performance of the fund.
18. Hedge funds are not required to, and usually do not, register with the SEC. Fund managers, many of which register are, however, subject to the same antifraud provisions as other market participants, and owe a fiduciary duty to the funds they manage.<sup>1</sup>
19. Hedge funds are generally intended as investment options for wealthy and sophisticated investors who can assess their exposure to risk and who wish to diversify their portfolio of investments.<sup>2</sup>
20. Hedge funds organized under Section 3(c)(1) of the Investment Company Act of 1940 are limited to no more than 100 investors, of whom no more than 35 may be knowledgeable, non-accredited investors.<sup>3</sup>

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<sup>1</sup> SEC Investor Bulletin on Hedge Funds, SEC Pub. No. 139, February 2013.

<sup>2</sup> Edwards, Franklin R., “Hedge Funds and the Collapse of Long-Term Capital Management,” *Journal of Economic Perspectives*, 13(2), pp. 189-210.

<sup>3</sup> Accredited investors include, among others, a corporation or partnership with assets exceeding \$5 million; a natural person who has individual net worth, or a joint net worth together with his or her spouse, exceeding \$1 million at the time of the purchase, excluding the value of that person’s primary residence; and a natural person with income exceeding \$200,000 in each of the two most recent years, or joint income together with his or her spouse exceeding \$300,000 for those years, and a reasonable expectation of the same income level in the current year.

21. The accredited investor concept was developed to “identify persons who can bear the economic risk of an investment in unregistered securities, including the ability to hold unregistered (and therefore less-liquid) securities for an indefinite period and, if necessary, to afford a complete loss of such investment.”<sup>4</sup>

## B. Overview of RD Legal Entities

22. The two funds at issue in this proceeding are RD Legal Funding Partners, LP, a Delaware limited partnership (the “Domestic Fund”), and RD Legal Funding Offshore Fund, Ltd., a Cayman Islands exempted company (the “Offshore Fund”) (collectively, the “Funds”). The Domestic and Offshore Funds have similar investment objectives,<sup>5</sup> albeit they have earned slightly different returns. For purposes of this report, the issues and concepts extend equally to both Funds, unless indicated otherwise.
23. RDLC serves as the General Partner of the Domestic Fund and as the Investment Manager of the Offshore Fund.<sup>6</sup> Of note, RDLC does not receive any management fee for its operation of the Funds. The Funds do not follow any form of the “2 and 20” model<sup>7</sup> that is common in hedge fund industry. Moreover, RDLC pays for all overhead costs of the Funds, which is uncommon for a fund manager that does not receive a management fee.
24. RDLC since launching the Funds has, to say the least, generated attractive and stable returns while preserving capital. The Domestic Fund has provided investors with an impressive annualized return of at least 13.5 percent (the “hurdle rate”) since its inception in 2007. The Offshore Fund provided similar results from 2007 through 2013, and an 11.3 percent return in 2014.
25. In my experience, such a high hurdle rate is unique and very beneficial to investors. The tradeoff is that the manager keeps all of the profits above the

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Investment Company Act of 1940 Sections 2(a)(51) and 3(c)(1) (2012); Lhabitant, Francois-Serge (2006), *Handbook of Hedge Funds*, West Sussex, England: John Wiley & Sons Ltd, pp. 40-41.

<sup>4</sup> Net Worth Standard for Accredited Investors, 76 Fed. Reg. 81793, 81794 (Dec. 29, 2011), <https://www.gpo.gov/fdsys/pkg/FR-2011-12-29/pdf/2011-33333.pdf>.

<sup>5</sup> Compare Confidential Private Offering Memorandum of the Domestic Fund, December 2011, p. 1, with Confidential Explanatory Memorandum of the Offshore Fund, February 2011, p.1.

<sup>6</sup> For all practical purposes, RDLC serves the same role in its capacity as General Partner for the Domestic Fund and Investment Manager for the Offshore Fund. Therefore, I refer to RDLC generically as the “investment manager” for the Funds throughout this report.

<sup>7</sup> The “2 and 20” model is a common performance-based hedge fund compensation structure. Under the “2 and 20” model, the fund manager receives a flat 2 percent management fee based on the total value of assets under management, and an additional 20 percent of any profits earned. Here, by contrast, there is no management fee, performance fee, or origination fee for the Funds. RDLC receives no compensation or return of any kind until investors receive their full 13.5 percent annual target return.

hurdle rate. Also unique is that the investment manager receives no management fee, but bears all the overhead expenses of the Funds (employee salaries, payroll taxes, insurance, rent, etc.). This means the investment manager would have to find other sources to cover the Funds' expenses if the Funds did not earn more than the hurdle rate in any given year.

26. As shown in Appendix C, the Domestic Fund achieved above average returns relative to selected hedge fund and market indices. Moreover, there is very little correlation between the return earned by the Domestic Fund to those of major market equity and fixed income indices such as the S&P 500 and Barclays Aggregate Bond Indices. The combination of high risk-adjusted returns and low correlation make this an attractive investment. A technical explanation of terms such as Sharpe Ratio, Standard Deviation (volatility), and Annualized returns, as well as why I selected certain indices for comparison purposes, appears in Appendix C.

#### C. Hedge Fund Service Providers

27. Hedge funds rely on a network of key service providers, which many investors evaluate before they subscribe to a fund. These service providers partner with hedge funds to monitor and facilitate the hedge fund's operations and to communicate with investors, among other activities.
28. For the strategies described in the Funds' offering documents, three hedge fund service providers, in my view, stand out as playing particularly important roles in providing information or data to investors: (i) the Funds' independent auditor; (ii) the Funds' valuation agent; and (iii) the Funds' third-party administrator. Other service providers used by the Funds included a quarterly compliance review firm, legal counsel, and a bank.<sup>8</sup>
29. An independent auditor audits a hedge fund's financial statements and examines if the hedge fund complies with accounting practices and other applicable accounting requirements.<sup>9</sup> The independent auditor expresses an opinion on whether the fund's financial statements have been presented fairly and are free of material misstatement. The audit plan is based upon the auditor's assessment of the fund's internal controls. The auditor's report and audited financial statements are generally provided to fund investors several months after year-end.<sup>10</sup>

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<sup>8</sup> August 2012 Alpha Generation & Process Presentation p. 13.

<sup>9</sup> Lhabitant, Francois-Serge (2006), Handbook of Hedge Funds, West Sussex, England: John Wiley & Sons Ltd, 105.

<sup>10</sup> AU-C Section 700, "Forming an Opinion and Reporting on Financial Statements."

30. From 2009 to 2011, the Funds' auditors were Rothstein, Kass & Company, P.C. ("Rothstein").<sup>11</sup> Since 2011, Marcum LLP ("Marcum") has provided this service. I am familiar with both firms. I was affiliated with a hedge fund that was a client of Rothstein, and I worked with the Domestic Funds' current tax partner at Marcum when he was a principal at Rothstein. I would not hesitate to recommend either of these firms to an investment manager who was seeking an auditor for funds under his or her management.
31. Valuation agents are independent experts who value complex and illiquid assets.
32. In 2011, RDLC engaged Pluris Valuation Advisors, LLC ("Pluris") to provide valuation services to the Funds. Pluris provides the Funds with periodic valuations of portfolios of purchase agreements and monthly valuation summary reports.
33. A hedge fund administrator provides back-office support and administrative services to the fund. This may include "operations, administrative, accounting and valuation services," as well as calculating the net asset value of the fund.<sup>12</sup> Hedge funds can be self-administered or independently administered. As the SEC staff has observed, however, some investors may be reticent to invest in a private alternative investment fund if the fund does not have an independent third-party administrator.<sup>13</sup> This is because of the belief that independent administrators may "mitigate certain investment and operational risks, such as the misappropriation of investor assets," and ensure "segregation of duties."<sup>14</sup>
34. The Funds appointed Woodfield Fund Administration, LLC ("Woodfield") to serve as their independent, third-party administrator. According to their June 2009 services agreement, Woodfield's responsibilities included monthly fund accounting; distributing investor statements; audit assistance; preparing the initial draft of financial statements for the annual audit; distributing offering materials; processing subscriptions, capital calls and redemptions; AML compliance; and third party control on movement of funds.<sup>15</sup>

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<sup>11</sup> In 2014, KPMG LLP agreed to buy Rothstein.

<sup>12</sup> Lhabitant, Francois-Serge (2006), *Handbook of Hedge Funds*, West Sussex, England: John Wiley & Sons Ltd., 99.

<sup>13</sup> SEC Risk Alert, *Investment Advisor Due Diligence Processes for Selecting Alternative Investments and Their Respective Managers* (Jan. 28, 2014), available at <https://www.sec.gov/about/offices/ocie/adviser-due-diligence-alternative-investments.pdf>.

<sup>14</sup> See above.

<sup>15</sup> June 2009 Fund Administration Service Agreement.

## IV. DISCUSSION

### A. Hedge Fund Marketing Materials and Investor Due Diligence

35. Marketing a hedge fund is analogous to seeking a job—the role of the cover letter is to persuade its reader to look at the resume, which will convince that person to invite the candidate to an interview. A successful first interview can lead to a second and third meeting, and ultimately a job. Hedge fund marketing documents are typically snapshots of information that the investment manager believes provide a general overview of the fund’s basic strategy and whets the appetite of an investor to seek out more information about the fund. As such, the initial documents—by their very nature and brevity—provide only summary information. Accordingly, they necessarily will *not* include all of the relevant information a prospective investor would need to make an informed decision about investing in the fund. Typically, disclaimers appear either in the beginning or end of informal hedge fund marketing documents,<sup>16</sup> and many of these documents will, on every page, refer readers to the disclaimers.
36. For example, a due diligence questionnaire (“DDQ”) generally should be nothing more than a snapshot of information regarding the fund and the investment manager, and may include background about principals, contact information and service providers, a summary of key terms of the fund, historical performance, strategies, and key risks.
37. Market practice is that hedge funds provide more in-depth written information to their serious prospective investors in the form of a private offering memorandum or private placement memorandum (“PPM”).<sup>17</sup> A hedge fund typically prepares an offering memorandum, or PPM, that describes the fund’s investment strategy and objectives, risk factors, a summary of partnership terms, regulatory compliance requirements, and additional information.
38. The SEC notes that the “information disclosed in PPMs varies from adviser to adviser, however, and often is **general** in scope. PPMs generally discuss in **broad terms** the fund’s investment strategies and practices. They also typically disclose that the hedge fund’s investment adviser may invest fund assets in illiquid, difficult-to-value securities and that the adviser reserves the discretion to value such securities as it believes appropriate under the circumstances. The PPM

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<sup>16</sup> Contrast that to formal documents, e.g., the private placement memorandum, limited partnership or limited liability company agreement, and subscription agreement.

<sup>17</sup> “Implications of the Growth of Hedge Funds,” Staff Report to the United States Securities and Exchange Commission, September 2003, p. 46.

also may disclose that the adviser may exercise its **discretion to invest fund assets outside the stated strategy or strategies** (Emphasis added).<sup>18</sup>

39. In addition to the PPM, many funds choose to distribute other materials to prospective investors, including, *inter alia*, fund performance spreadsheets and audited financial statements. Some prospective investors may even be invited to conduct on-site due diligence, and some prospective investors may visit service providers to the fund. In addition, prospective investors may request other documents, such as a written valuations policy, compliance manual, redacted valuations report, and redacted portfolio-holdings report, which the fund will share provided such prospect will sign a non-disclosure agreement (“NDA”).
40. An independent third party prepares audited financial statements and therefore the information that appears in them should be considered more reliable than what appears in documents not independently prepared. In this case, RDLC made audited financial statements and other documents concerning the Funds available to prospective investors before they invested. This was made explicit in the PPMs. For example, the 2012 PPM for the Domestic Fund states: “Prospective limited partners are invited to **review any documents that the General Partner possesses regarding the Partnership**, the operation of the Partnership and any other matters regarding this Memorandum (Emphasis added).”
41. During the course of due diligence, many hedge fund managers do not like to disclose to prospective investors the specific positions held by the fund. A 2014 SEC Risk Alert observed that “while some managers were willing to provide additional transparency, others were reluctant to share detailed information about their alternative investments. In particular, these managers were sensitive to sharing position-level information, which they felt may compromise their ability to execute their strategies.”<sup>19</sup>
42. In this case, Respondents offered total position transparency to prospective and current investors. Upon signing an NDA, investors would receive access to a Lotus Notes database that contained *all* of the underlying documents for the positions held in the Funds. This degree of position transparency, while not unprecedented, is, in my experience, highly unusual and beneficial to investors.
43. When an investor seems ready to commit, an onshore hedge fund will typically supply the investor with a governing document such as a limited partnership agreement or limited liability company agreement. The investor at this time will

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<sup>18</sup> “Implications of the Growth of Hedge Funds,” Staff Report to the United States Securities and Exchange Commission, September 2003, pp. 47-48 (Emphasis added and footnotes omitted).

<sup>19</sup> <https://www.sec.gov/about/offices/ocie/adviser-due-diligence-alternative-investments.pdf>.

also usually receive a subscription agreement, which, among other things, contains representations about income, net worth, total assets, and investments.

44. In looking at the facts of this case, one must consider that investments in the Funds were *not* open to retail investors. Only sophisticated, accredited investors—each of whom represented to RDLC that he or she had the requisite knowledge and expertise in financial and business matters could become investors in the Funds.
45. The Domestic Fund’s offering documents, for example, state that “[i]nterests in the Partnership generally will be sold only to persons who are both ‘**accredited investors**’ as defined in Regulation D of the Securities Act of 1933 and ‘**qualified clients**’ within the meaning of Rule 205-3 under the Investment Advisers Act of 1940.”<sup>20</sup>
46. Indeed, the Subscription Agreement for the Offshore Fund (by example) required investors to affirm that they have: (i) “the **knowledge, expertise and experience in financial matters** to evaluate the risks of investing in the Fund, and (ii) [are] aware of the risks inherent in investing in the securities and the method by which the assets of the Fund are held and/or traded, and (iii) can bear the risk of loss of its entire investment.”<sup>21</sup>
47. Further, the Domestic Fund’s Subscription Agreement, for example, states as follows:

“Subscriber confirms that the Partnership has made available to Subscriber the opportunity to ask questions of, and receive answers from, the Partnership concerning the Partnership and the terms and conditions of this offering, and to obtain any additional non-proprietary information which the Partnership has in its possession or was able to acquire without unreasonable effort or expense that was necessary to verify the accuracy of the information in the Memorandum. . . .

In deciding to invest in the Partnership, Subscriber has relied solely upon the information in the Memorandum and nothing else. *Subscriber acknowledges that no person is authorized to give any information or to make any statement not contained in the Memorandum, and that any information or statement not contained in the*

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<sup>20</sup> December 2011 Confidential Private Offering Memorandum (Emphasis added).

<sup>21</sup> SECLIT-EPROD-000005328 (Emphasis added).

*Memorandum must not be relied upon as having been authorized by the Partnership.”<sup>22</sup>*

48. It is reasonable for an investment manager to expect that an investor—who claims to have such knowledge and experience in financial and business matters—will be capable of evaluating the merits and risks of a prospective investment and will read disclaimers and disclosures. Moreover, it is reasonable for a fund to rely on such certifications absent a suspicion that the investor is being deceitful or is just plain ignorant about the subject.
49. In October 2012, the SEC staff issued an investor bulletin detailing the information investors should evaluate to better understand the risks of hedge fund investing.<sup>23</sup> Excerpts follow:
- i. **“Read a fund’s offering memorandum and related materials.** The hedge fund’s offering documents and agreements contain important information about investing in the fund, including the investment strategies of the fund, whether the fund is based in the United States or abroad, the risks of the investment, fees earned by the hedge fund manager, expenses charged to the hedge fund and the hedge fund manager’s potential conflicts of interest. **It is important that you read all the documents before making your decision to invest in a hedge fund.** You should consider consulting an independent financial advisor before investing in a hedge fund.”
  - ii. **“Understand the fund’s investment strategy.** There are [sic] a wide variety of hedge funds with many different investment strategies. Some hedge funds will be diversified among many strategies, managers and investments, while others may take highly concentrated positions or may only use a single strategy. Make sure you understand the level of risk involved in the fund’s investment strategies and ensure that they are suitable to your personal investing goals, time horizons and risk tolerance. As with any investment, generally the higher the potential returns, the higher the risks you must assume.”
  - iii. **“Understand how a fund’s assets are valued.** Hedge funds may invest in highly illiquid securities that may be difficult to value. Moreover, many hedge funds give themselves significant discretion in valuing illiquid securities. You should understand a fund’s valuation process and know the extent to which a fund’s securities are valued by independent sources. Valuations of fund assets will affect the fees that the manager charges.”

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<sup>22</sup> RDLC-SEC 593374, RDLC-SEC 593375 (Emphasis added).

<sup>23</sup> SEC Investor Bulletin: Hedge Funds (Oct. 2012).

- iv. “Understand how a fund’s performance is determined. Hedge funds do not need to follow any standard methodology when calculating performance, and they may invest in securities that are relatively illiquid and difficult to value. By contrast, federal securities laws dictate how mutual funds can advertise their performance by requiring specific ways to calculate current yield, tax equivalent yield, average annual total return and after-tax return, as well as having detailed requirements for the types of disclosure that must accompany any performance data. If you are provided with performance data for the hedge fund, ask whether it reflects cash or assets actually received by the fund as opposed to the manager’s estimate of the change in value of fund assets and whether the data includes deductions for fees.”
  - v. “Don’t be afraid to **ask questions**. You are entrusting your money to someone else. You should know where your money is going, who is managing it, how it is being invested, how you can get it back, what protections apply to your investment and what your rights are as an investor (Emphasis added).”
50. Thus, the SEC’s own guidance to investors places little weight on marketing materials and highlights that some funds may take concentrated positions; give their managers significant discretion in valuing illiquid securities; and may invest in securities that are relatively illiquid and difficult to value. And, the SEC emphasizes that investors should ask questions and assume the risk of their investment.
51. The investors in the Funds should not be held to a different standard.
52. Indeed, when dealing with accredited investors, a hedge fund manager can reasonably expect that prospective investors will conduct a level of due diligence that is appropriate to their circumstances. A thorough due diligence process would generally include reviewing all information made available by the fund. Simply put, due diligence requires investors to do their homework. And, if investors find inconsistencies between documents, they should inquire.
53. Scrutiny of an accredited investor’s due diligence process may undermine a claim by that investor that he or she was misled by information that was made available by the fund’s manager regarding the investment opportunity. Discussing the investment opportunity with friends or family, or basing one’s investment decision on the past performance of the fund, would not constitute adequate due diligence. For example, the only investor Respondents have deposed, Arthur Sinensky, testified that before investing in the Offshore Fund he did “Arthur’s

version of due diligence,” which typically includes discussions with his wife and colleagues,<sup>24</sup> but rarely includes review of the PPM.<sup>25</sup>

54. Consistent with established industry practice, reasonable accredited investors would have understood that the Funds’ marketing materials—in this case, the 2011 marketing presentation and subsequent “Alpha Generation and Process” presentations, Due Diligence Questionnaires (“DDQ”), and Frequently Asked Questions (“FAQs”) documents—were meant to provide a brief summary of the investment opportunity only, and did not purport to contain all relevant terms that may be of interest to prospective investors.<sup>26</sup>
55. Such investors would also have understood that marketing materials are only the “first step” in any investment in a private fund, and are no substitute for due diligence. Accordingly, a reasonable accredited investor would not deem information provided in informal marketing documents to be material. He or she would look to the totality of information made available by the investment manager during the due diligence process and in the offering documents.
56. Marketing materials, by their nature, are meant to give prospective investors a brief overview of a fund’s strategy and provide contact information for possible future dialogue between the investor and the fund’s manager. As is understood throughout the industry, marketing materials are not intended to be relied upon as a substitute for basic due diligence, or the fund’s offering memoranda.
57. The examples that the SEC cites in non-critical marketing documents must be read in the context of the critical documents. The SEC should not “cherry pick” language from less-important documents, and then ignore the critical ones.<sup>27</sup>
58. In my opinion, the SEC’s allegations fail to show that RDLC made any materially false statement or omission in connection with the sale of partnership interests in the Funds.<sup>28</sup> I do not believe that the disclosure of any of the alleged misstated or

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<sup>24</sup> A. Sinensky Test. (Jan. 17, 2017) 25:17-23.

<sup>25</sup> A. Sinensky Test. (Jan. 17, 2017) 37:20-21.

<sup>26</sup> The last page of the DDQ and the page after the cover of the Alpha Generation Process emphasized that not every **material** fact was represented (Emphasis added). On the top of the first page, the FAQ stated, “Potential investors should read carefully the disclosures set forth in RDLC’s disclosure brochure, a copy of which is available upon request, and the terms and conditions contained in the applicable fund’s offering documents before making any investment decision.” On every page, in regular-sized font, these three documents informed its readers to study the disclosures on a specific page.

<sup>27</sup> I consider the PPM and Limited Partnership and Subscription Agreements as critical documents. The others are, to use a metaphor, “appetizers” to pique investor interest in the Fund.

<sup>28</sup> In the context of applying materiality thresholds to the preparation of financial statements filed with the Commission, and the performance of audits of those financial statements, the SEC has written, “[a] matter is ‘material’ if there is a substantial likelihood that a reasonable person would consider it important.”

omitted facts in non-critical marketing documents would have been viewed by the reasonable investor as having significantly changed the total mix of information that was otherwise made available to investors.

**B. The Funds' Broad Investment Mandate Is Consistent With Industry Standards**

59. Broad investment mandates are a common feature of hedge funds and give hedge fund managers the ability to employ alternative strategies to generate returns for the fund if the original strategy is no longer lucrative, other opportunities are more compelling, or managers feel that diversifying into additional strategies is in the investors' best interests.

60. Consistent with common industry practice, RDLC, as investment manager for the Funds, enjoyed a broad investment mandate under the governing documents to pursue attractive investment opportunities. For example, the offering documents for the Domestic Fund stated:

“The Partnership will not be limited with respect to the types of investment strategies it may employ or the markets or instruments in which it may invest. Over time markets change, and the General Partner will seek to capitalize on attractive opportunities, wherever they might be. Depending on conditions and trends in securities markets and the economy generally, the General Partner may pursue other objectives or employ other techniques it considers appropriate and in the best interest of the Partnership.”<sup>29</sup>

61. The Funds were not unique in providing for broad investment flexibility in the Funds' offering documents. I am aware of similar language in other hedge fund offering documents that provided for a similarly broad investment mandate and flexibility of the investment manager.<sup>30</sup> At least as early as 1987, around the time at which my association with the hedge-fund industry began, hedge fund PPMs often gave managers broad investment discretion and allowed them the flexibility to change investment focus.

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<https://www.sec.gov/interps/account/sab99.htm#body2>, accessed January 8, 2017. Furthermore, the FASB has said, “[t]he omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.” FASB, Statement of Financial Accounting Concepts No. 2, Qualitative Characteristics of Accounting Information (“Concepts Statement No. 2”), 132 (1980). See also Concepts Statement No. 2, Glossary of Terms - Materiality.

<sup>29</sup> RDLC-SEC 940003, RDLC-SEC 065720, SECLIT-EPROD-000706122, SECLIT-EPROD-000717805, SECLIT-EPROD-000714321, SECLIT-EPROD-000719598, RDLC-SEC 057167.

<sup>30</sup> Confidential Private Placement Memorandum of Amaranth Partners LLC, January 2006, pp. 24, 29, [http://lib.law.virginia.edu/hedge\\_funds/pdf/ppm/Amaranth\\_2006.pdf](http://lib.law.virginia.edu/hedge_funds/pdf/ppm/Amaranth_2006.pdf), accessed December 27, 2016.

62. There is evidence in the hedge fund industry that broad investment mandates can be advantageous in certain circumstances. For instance, a 2003 SEC Staff report cites the flexibility provided by broad investment mandates as a benefit of hedge fund investing, and indicates that most hedge-fund advisers find the broad investment flexibility “necessary in order to effectuate their absolute return strategies.”<sup>31</sup>
63. The SEC contrasts RDLC’s marketing of the Funds with the marketing of another investment opportunity, a special purpose vehicle, and asserts that evidences RDLC’s deception of investors. Simply put, these were very different funds with many distinct investment terms. These differences can be seen in the chart below:

<b>Difference in 2013PPM</b>	<b>Domestic Fund</b>	<b>SPV-Onshore</b>
i. Minimum initial commitment	\$1 million	\$10 million
ii. Minimum subsequent commitment	\$100,000	\$1 million
iii. 1983 bombing	Not limited to	Limited to
iv. Investment mandate	Unlimited	Limited to 1983 bombing
v. Investment committee	No	Yes
vi. Withdrawals	Permitted	Not permitted
vii. Reports	Monthly performance	Quarterly reports regarding turnover liquidation
viii. Counsel	Seward & Kissel LLP	Reed Smith LLP
ix. Flexibility	Broad	None
x. Hurdle rate	13.5%	None
xi. Incentive compensation	Everything above 13.5% hurdle rate	30% to GP after full return of capital to LPs

64. In my experience, fund managers launch new, but similar funds, all the time. A fund that has a broad investment mandate is not the same as a fund that has an extremely limited investment mandate. Although investments made by a fund with a broad investment mandate may significantly overlap with the investments

<sup>31</sup> See “Implications of the Growth of Hedge Funds,” Staff Report to the United States Securities and Exchange Commission, September 2003, pp. 33, n.118, 111, n.359, 36, 87.

made by a fund with a more limited mandate, when the positions are closed out, the former can remain in business while the latter will close.

65. Since the Funds' offering documents disclosed that the investment manager may exercise its discretion to invest in a broad range of assets or strategies, investors, who were concerned with such a broad mandate, could have simply declined to invest. After all, not every hedge fund will appeal to every investor.
66. Consistent with the flexibility that the offering memoranda disclosed with respect to the types of investment strategies the Funds' investment manager could employ, or the markets in which it could invest, RDLC invested the Funds' money according to its discretion in settled cases, as well as in cases where no settlement agreement had been entered, including in plaintiff and judgment-based-legal receivables, as well as other legal receivables.

#### C. RDLC Disclosed the Types of Investments in the Portfolio

67. The SEC claims that the Funds' PPMs "failed to disclose that the Funds had substantial investments in ongoing litigation for which there was no settlement or judgment" and "failed to capture the significant distinction between a judgment obtained after full litigation and a default judgment."<sup>32</sup>
68. In my opinion, this assertion is plainly wrong on several accounts. First, RDLC provided investors an extraordinary level of transparency into the Funds and the portfolio. Potential investors were, after signing NDAs, given access to a password-protected non-public website with copies of all historical financial statements, investor communications, and agreed upon accounting procedures ("AUPs"). Prospective investors, who requested it, and current investors, were granted access to the entire Lotus Notes database containing *all* of the underlying documentation for each position in the portfolio. If desired, investors could come to the Funds' offices and have an employee walk them through the Lotus Notes database and examine any aspect of the portfolio they chose. The SEC is grievously mistaken that the nature of these receivables was hidden from, or misrepresented to, investors, much less that this was done with an intent to deceive.
69. Second, had I been an investor in the Funds, I would have considered non-appealable judgments, where a corpus of money has been identified, a perfectly acceptable derivative of the principal strategy of investments in legal receivables related to settlements, and, therefore, the difference between them to be immaterial. This includes the Funds' investments in receivables related to the *Peterson* case, which had a dedicated government-restrained pool of money set aside to satisfy the judgments.

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<sup>32</sup> SEC Order in Administrative Proceeding.

70. Below are excerpts from every version of the PPM for the Domestic Fund from July 2007 to June 2013 (Emphasis will be added).

<b>Date: July 2007</b>
<b><u>Investment Objective and Strategy:</u></b> The Partnership will (i) purchase from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, <b>judgments</b> and settlements (“Legal Fee Receivables”), and (ii) provide loans to such Law Firms through secured line of credit facilities (“Lines of Credit”).
<b><u>Other Advances to Law Firms:</u></b> Periodically, the Partnership may be presented with opportunities to provide capital to Law Firms which does not lend itself to the constraints of either the Factoring or Line of Credit products. In these instances, the Partnership may provide capital to client Law Firms based upon the specific needs associated with the credit request.
<b><u>Flexibility:</u></b> The Partnership will not be limited with respect to the types of investment strategies it may employ or the markets or instruments in which it may invest. Over time markets change, and the General Partner will seek to capitalize on attractive opportunities, wherever they might be.
<b><u>Investment Concentration:</u></b> The Partnership intends to invest the assets of the Partnership in either Legal Fee Receivables or Lines of Credit. By investing solely in these instruments, the assets of the Partnership will be exposed entirely to the risks of such investment without the protections against loss afforded by diversification.

<b>Date: October 2008</b>
<b><u>Investment Objective and Strategy:</u></b> The Partnership will (i) purchase from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, <b>judgments</b> and settlements (“Legal Fee Receivables”), and (ii) provide loans to such Law Firms through secured line of credit facilities (“Lines of Credit”).
<b><u>Other Advances to Law Firms:</u></b> Periodically, the Partnership may be presented with opportunities to provide capital to Law Firms which does not lend itself to the constraints of either the Factoring or Line of Credit products. In these instances, the Partnership may provide capital to client Law Firms based upon the specific needs associated with the credit request.

**Date:** October 2008

**Flexibility:** The Partnership will not be limited with respect to the types of investment strategies it may employ or the markets or instruments in which it may invest. Over time markets change, and the General Partner will seek to capitalize on attractive opportunities, wherever they might be.

**Investment Concentration:** The Partnership intends to invest the assets of the Partnership in either Legal Fee Receivables or Lines of Credit. By investing solely in these instruments, the assets of the Partnership will be exposed entirely to the risks of such investment without the protections against loss afforded by diversification.

**Date:** August 2009

**Investment Objective and Strategy:** The Partnership will (i) purchase from law firms and attorneys (collectively, the "Law Firms") certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, **judgments** and settlements ("Legal Fee Receivables"), and (ii) provide loans to such Law Firms through secured line of credit facilities ("Lines of Credit").

**Other Advances to Law Firms:** The Partnership may be presented with opportunities to provide capital to Law Firms which does not lend itself to the constraints of either the Factoring or Line of Credit products. In these instances, the Partnership may provide capital to client Law Firms based upon the specific needs associated with the credit request.

**Flexibility:** The Partnership will not be limited with respect to the types of investment strategies it may employ or the markets or instruments in which it may invest. Over time markets change, and the General Partner will seek to capitalize on attractive opportunities, wherever they might be.

**Investment Concentration:** The Partnership intends to invest the assets of the Partnership in either Legal Fee Receivables or Lines of Credit. By investing solely in these instruments, the assets of the Partnership will be exposed entirely to the risks of such investment without the protections against loss afforded by diversification.

**Date:** February 2011

**Investment Objective and Strategy:** The Partnership will (i) purchase from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, **judgments** and settlements (“Legal Fee Receivables”), and (ii) provide loans to such Law Firms through secured line of credit facilities (“Lines of Credit”).

**Other Advances to Law Firms:** The Partnership may be presented with opportunities to provide capital to Law Firms which does not lend itself to the constraints of either the Factoring or Line of Credit products (“Other Advances”). In these instances, the Partnership may provide capital to client Law Firms based upon the specific needs associated with the credit request.

**Flexibility:** The Partnership will not be limited with respect to the types of investment strategies it may employ or the markets or instruments in which it may invest. Over time markets change, and the General Partner will seek to capitalize on attractive opportunities, wherever they might be.

**Investment Concentration:** The Partnership intends to invest the assets of the Partnership in either Legal Fee Receivables, Lines of Credit or Other Advances to Law Firms. By investing solely in these instruments, the assets of the Partnership will be exposed entirely to the risks of such investment without the protections against loss afforded by diversification.

**Date:** August 2011

**Investment Objective and Strategy:** The Partnership will (i) purchase from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, **judgments** and settlements (“Legal Fee Receivables”), and (ii) provide loans to such Law Firms through secured line of credit facilities (“Lines of Credit”).

**Other Advances to Law Firms:** Periodically, the Partnership may be presented with opportunities to provide capital to Law Firms which does not lend itself to the constraints of either the Factoring or Line of Credit products (“Other Advances”). In these instances, the Partnership may provide capital to client Law Firms based upon the specific needs associated with the credit request.

**Date:** August 2011

**Flexibility:** The Partnership will not be limited with respect to the types of investment strategies it may employ or the markets or instruments in which it may invest. Over time markets change, and the General Partner will seek to capitalize on attractive opportunities, wherever they might be.

**Investment Concentration:** The Partnership intends to invest the assets of the Partnership in either Legal Fee Receivables, Lines of Credit or Other Advances to Law Firms. By investing solely in these instruments, the assets of the Partnership will be exposed entirely to the risks of such investment without the protections against loss afforded by diversification.

**Date:** December 2011

**Investment Objective and Strategy:** The Partnership will (i) purchase from law firms and attorneys (collectively, the "Law Firms") certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, **judgments** and settlements ("Legal Fee Receivables"), and (ii) provide loans to such Law Firms through secured line of credit facilities ("Lines of Credit").

**Other Advances to Law Firms:** Periodically, the Partnership may be presented with opportunities to provide capital to Law Firms which does not lend itself to the constraints of either the Factoring or Line of Credit products ("Other Advances"). In these instances, the Partnership may provide capital to client Law Firms based upon the specific needs associated with the credit request.

**Flexibility:** The Partnership will not be limited with respect to the types of investment strategies it may employ or the markets or instruments in which it may invest. Over time markets change, and the General Partner will seek to capitalize on attractive opportunities, wherever they might be.

**Investment Concentration:** The Partnership intends to invest the assets of the Partnership in either Legal Fee Receivables, Lines of Credit or Other Advances to Law Firms. By investing solely in these instruments, the assets of the Partnership will be exposed entirely to the risks of such investment without the protections against loss afforded by diversification.

**Date:** April 2012

**Investment Objective and Strategy:** The Partnership will (i) purchase from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, **judgments** and settlements (“Legal Fee Receivables”), and (ii) provide loans to such Law Firms through secured line of credit facilities (“Lines of Credit”).

**Other Advances to Law Firms:** Periodically, the Partnership may be presented with opportunities to provide capital to Law Firms which does not lend itself to the constraints of either the Factoring or Line of Credit products (“Other Advances”). In these instances, the Partnership may provide capital to client Law Firms based upon the specific needs associated with the credit request.

**Flexibility:** The Partnership will not be limited with respect to the types of investment strategies it may employ or the markets or instruments in which it may invest. Over time markets change, and the General Partner will seek to capitalize on attractive opportunities, wherever they might be.

**Investment Concentration:** The Partnership intends to invest the assets of the Partnership in either Legal Fee Receivables, Lines of Credit or Other Advances to Law Firms. By investing solely in these instruments, the assets of the Partnership will be exposed entirely to the risks of such investment without the protections against loss afforded by diversification.

**Date:** June 2013

**Investment Objective and Strategy:** The Partnership will (i) purchase from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, **judgments** and settlements (“Legal Fee Receivables”), (ii) purchase from certain **plaintiffs** accounts receivable representing the plaintiff’s portion of proceeds arising from final judgment awards or settlements (“Plaintiff Receivables”, together with the Legal Fee Receivables, the “Receivables”), (iii) provide loans to such Law Firms through secured line of credit facilities (“Lines of Credit”) and (iv) provide capital to Law Firms through opportunities that do not lend themselves to the constraints of either the Receivables or Lines of Credit products (“Other Advances”).

**Date:** June 2013

Other Advances to Law Firms: Periodically, the Partnership may be presented with opportunities to provide capital to Law Firms. Such opportunities do not lend themselves to the constraints of either the Factoring or Line of Credit products. In these instances, the Partnership may provide capital to Law Firms based upon the specific needs associated with the credit request.

Flexibility: The Partnership will not be limited with respect to the types of investment strategies it may employ or the markets or instruments in which it may invest. Over time markets change, and the General Partner will seek to capitalize on attractive opportunities, wherever they might be.

Investment Concentration: The Partnership intends to invest the assets of the Partnership in either Receivables, Lines of Credit or Other Advances to Law Firms. By investing solely in these instruments, the assets of the Partnership will be exposed entirely to the risks of such investment without the protections against loss afforded by diversification.

71. Based on these excerpts, I make the following observations. First, every version of the PPM clearly identified legal judgments as being one of the “Legal Fee Receivables” purchased by the Funds’ investment manager, as part of the Funds’ “Investment Objective and Strategy.” Second, every version of the PPM identified an additional strategy that the Funds would pursue—they would “provide capital to client Law Firms based upon the specific needs associated with the credit request.” Third, every version contained a “Flexibility” clause signaling that the Funds would pursue strategies beyond those clearly enumerated in the documents, and “capitalize on attractive opportunities, wherever they might be.”
72. The SEC asserts, “From at least [December] 2011, the Funds’ offering documents falsely noted that “[a]ll of the Legal Fee Receivables purchased by the Partnership arise out of litigation in which a binding settlement agreement or memorandum of understanding has been reached between the parties.””
73. This statement is plainly wrong. As noted directly above, the offering documents for the Funds defined “Legal Fee Receivables” to include “judgments,” and the offering documents did not misrepresent the Funds’ investment strategy.
74. Moreover, the Funds’ PPMs always made it quite clear that the investment manager would not be wedded to any particular strategy. Even the early versions of the PPMs described three specific strategies that may be employed by the Funds’ investment manager: (i) legal fee factoring; (ii) lines of credit; and

(iii) other advances to law firms.<sup>33</sup> Plainly, it was disclosed to investors that some of the Funds' investments did not involve settled cases.

75. Indeed, legal fee receivables arising out of a non-appealable default judgment could also fall within the third specific strategy, "other advances to law firms." The PPMs describe "other advances to law firms" as opportunities to provide capital to law firms that do not lend themselves to the constraints of the factoring strategy. In these instances, the Fund may provide working capital to law firms based upon the specific needs associated with the credit request but subject to certain parameters, including that the borrower is either an attorney or law firm; and the repayment source is realistic within twelve months or less. Notably, a settled case is not one of the parameters. Indeed, RDLC's publicly available April 27, 2011, Form ADV-Part 2A ("Form ADV") states, "Except for some of the 'other advances' provided to law firms, all of the legal fee receivables purchased by the funds arise out of litigation in which a settlement agreement or memorandum of understanding among the parties has been reached."<sup>34</sup>
76. I understand that all the parameters were met. Therefore, I believe that all of the *Peterson* legal-fees-receivables fell under the category, "other advances to law firms," which was specified in each of the 2011 PPMs. In addition, by June 2013 the Funds' offering documents were amended and the clause relied upon by the SEC was replaced with the following: "All of the Receivables purchased by the Fund arise out of litigation in which a settlement agreement or memorandum of understanding among the parties has been reached, or a judgment has been entered against a judgment debtor." (Although I do not think such an amendment was necessary, I applaud the voluntary effort to increase transparency by highlighting this strategy.)
77. Additionally, the 2009, 2010, and 2011 audited financial statements for the Domestic Fund, which are dated June 24, 2010, November 8, 2011, and April 27, 2012, respectively, each state: "[The Funds'] Legal Fees Receivables have been purchased from contingency fee attorneys across the United States which **typically** arise out of litigation in which a binding settlement agreement or memorandum of understanding among the parties has been reached **and the final payment of the settlement amount is subject to certain delays.** (Emphasis added)."
78. The term, "typically," implies what is expected, but does not guarantee that there will be no deviation. If, for the sake of argument, a once-in-a-lifetime investment opportunity appears, it may not be what is expected, but it still may be a

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<sup>33</sup> See, for example, April 2012 Domestic Fund PPM.

<sup>34</sup> SECLIT-EPROD-000012995.

permissible investment. Moreover, anytime a payment is subject to delays, there is collection risk, whether or not there is ongoing litigation.

79. The SEC states that “the 2012 Due Diligence Questionnaire [set] forth in unequivocal terms that 95% of the Funds’ portfolio consisted of law firm receivables in cases where a settlement had been reached.”<sup>35</sup> That is one way of interpreting the DDQ, but is not an accurate quotation from the DDQ. The 2012 Due Diligence Questionnaire actually states: “Fee Acceleration (Factoring) – this is RDLFP’s primary investment product and represents approximately ninety-five (95) per cent of assets under management.” Thus, while the SEC offers one interpretation of the DDQ, another way to interpret it is that it uses settlements as an example of a fee acceleration: “[a] fee acceleration investment is the purchase of a legal fee at a discount from a law firm, once a settlement has been reached and the legal fee is earned.” But not that *every* fee acceleration investment requires that a settlement had been reached. Indeed, I have seen a hedge fund describe, by way of illustration, a convertible-bond arbitrage strategy when the fund in practice engaged in multiple hedge fund strategies and, over time, such arbitrage played a lesser role than other strategies.<sup>36</sup>
80. In response to the question appearing in the March 2012 DDQ, “What is your trading philosophy? . . . How do you think these market inefficiencies will change over time?” RDLC responded, “In fact, we believe that the inefficiencies will grow and morph allowing us to further use our skill set in a number of **different receivable secured strategies** (Emphasis added).”<sup>37</sup> This certainly signaled that the focus was on broad-based receivable-secured strategies, and could include accounting and claim aggregator firms. Moreover, any DDQ, which is a snapshot at a specific time, may contain stale information the day after it is published.
81. Litigation is subject to collection risk because the cases are ongoing; default judgments—even when they cannot be appealed—are subject to collection risk; and even settlements are subject to default, as Note 7 to the 2012 Domestic Fund audited financial statements makes clear: “**Other than the default risk associated with any single payer of the settlement** associated with the purchased legal fee or judgment, no economic interdependency is apparent among the individual legal fees or judgments purchased (Emphasis added).”<sup>38</sup>

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<sup>35</sup> SEC Order in Administrative Proceeding, paragraph 40.

<sup>36</sup> The goal of presenting that strategy was to provide a simple example of hedging for those investors who were unfamiliar with its economics.

<sup>37</sup> March 2012 DDQ, p. 12.

<sup>38</sup> 2012 Domestic Fund Audited Financial Statement, at Note 7 (Emphasis added).

82. RDLC's Form ADV similarly disclosed that the strategy was to "purchase from law firms and attorneys certain of their accounts receivable representing legal fees derived by the law firms and attorneys from litigation, **judgments and settlements.**"<sup>39</sup>
83. It is natural for people to conflate awards and settlements into one litigation outcome. For tax purposes, for example, judgments and settlements are treated the same.
84. When analyzing the assets held by the Funds, we should look at economic substance rather than legal form. Settlement is by contract and a judgment is enforced by law. A judgment obtained after full litigation is subject to the risk of bankruptcy of the losing party or theft from the attorney escrow account. On the other hand, courts can overturn settlements and a party to a settlement can also file for bankruptcy.<sup>40</sup> In fact, to enforce a settlement agreement, parties will often need to obtain a judgment. In short, where a corpus of money has been identified to satisfy a judgment, and the judgment is no longer appealable, there is no meaningful difference between a settlement and a judgment in terms of fee acceleration—the economic substance is the same.
85. On December 15, 2008, investors were notified that the Funds intended to invest, without any formal limitations, in plaintiffs' proceeds receivable that were subject to the same underwriting standards used in the legal fee factoring strategy. Any investor who did not want such exposure was invited to contact the investment manager.<sup>41</sup> If investors chose to remain in the Funds with this notice, they are deemed to have ratified this strategy. Investors with access to RDLC's investor website would have been able to see this document after the fact.
86. In addition to the affirmative notification of December 15, 2008, the flexibility language of the PPM allowed the Funds to pursue investments in plaintiffs' proceeds receivable.
87. I have reviewed the audited financial statements of the Domestic Fund from 2007 to 2015. I provide the following summaries.

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<sup>39</sup> SECLIT-EPROD-000012989.

<sup>40</sup> <http://www.nysd.uscourts.gov/cases/show.php?db=special&id=138>.

<sup>41</sup> Temporary\_Concentration\_Limit\_Changes\_and\_policy\_changes\_RE\_plaintiff\_funding\_12.15.08.pdf.

<b>Year:</b> 2007
<b>Date:</b> August 27, 2008
<b>Nature of Operations:</b> The Fund was organized for the principal purpose of purchasing factored legal fees and making advances pursuant to revolving credit facilities provided to attorneys.
<b>Legal Fees Receivable:</b> The Fund purchases from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, <u>judgments</u> and settlements (“Legal Fees Receivable”).
<b>Credit Risk:</b> % of fair value of legal fees receivable due from number of law firms not stated.

<b>Year:</b> 2008
<b>Date:</b> May 18, 2009
<b>Nature of Operations:</b> The Fund was organized for the principal purpose of purchasing factored legal fees and making advances pursuant to revolving credit facilities provided to attorneys.
<b>Valuation Techniques:</b> The Fund purchases from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, <u>judgments</u> and settlements (“Legal Fees Receivable”).
<b>Credit Risk:</b> 59% of fair value of legal fees receivable due from three law firms.

<b>Year:</b> 2009
<b>Date:</b> June 24, 2010
<b>Nature of Operations:</b> The Fund was organized for the principal purpose of purchasing factored legal fees and making advances pursuant to revolving credit facilities provided to attorneys.
<b>Valuation Techniques:</b> The Fund purchases from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, <u>judgments</u> and settlements (“Legal Fees Receivable”).
<b>Credit Risk:</b> 76% of fair value of legal fees receivable due from five law firms.

<b>Year:</b> 2010
<b>Date:</b> November 8, 2011
<b>Nature of Operations:</b> The Fund was organized for the principal purpose of purchasing factored legal fees and making advances pursuant to revolving credit facilities provided to attorneys.
<b>Valuation Techniques:</b> The Fund purchases from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, <u>judgments</u> and settlements (“Legal Fees Receivable”).
<b>Credit Risk:</b> 72% of fair value of legal fees receivable due from four law firms.

<b>Year:</b> 2011
<b>Date:</b> April 27, 2012
<b>Nature of Operations:</b> The Fund was organized for the principal purpose of purchasing factored legal fees and making advances pursuant to revolving credit facilities provided to attorneys.
<b>Valuation Techniques:</b> The Fund purchases from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, <u>judgments</u> and settlements (“Legal Fees Receivable”).
<b>Credit Risk:</b> 70% of fair value of legal fees receivable due from four law firms.

<b>Year:</b> 2012
<b>Date:</b> April 15, 2013
<b>Nature of Operations:</b> The Fund was organized for the principal purpose of purchasing factored legal fees (“Legal Fees Receivable”), plaintiff’s judgment awards or settlements (“Judgment Receivables”) and making advances pursuant to revolving credit facilities provided to attorneys.
<b>Valuation Techniques:</b> The Fund purchases from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, <u>judgments</u> and settlements (“Legal Fees Receivable”).
<b>Credit Risk:</b> 60% of fair value of legal fees receivable due from four law firms.

<b>Year:</b> 2013
<b>Date:</b> March 12, 2014
<b>Nature of Operations:</b> The Fund was organized for the principal purpose of purchasing factored legal fees (“Legal Fees Receivable”), plaintiff’s <u>judgment</u> awards or settlements (“Judgment Receivables”) and making advances pursuant to revolving credit facilities provided to attorneys.
<b>Valuation Techniques:</b> The Fund purchases from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, <u>judgments</u> and settlements (“Legal Fees Receivable”).
<b>Credit Risk:</b> 65% of fair value of legal fees receivable due from four law firms.

<b>Year:</b> 2014
<b>Date:</b> April 15, 2015
<b>Nature of Operations:</b> The Fund was organized for the principal purpose of purchasing factored legal fees (“Legal Fees Receivable”), plaintiff’s <u>judgment</u> awards or settlements (“Judgment Receivables”) and making advances, pursuant to revolving credit facilities provided to attorneys.
<b>Valuation Techniques:</b> The Fund purchases from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived by the Law Firms from litigation, <u>judgments</u> and settlements (“Legal Fees Receivable”). The Fund also purchases judgments and settlements due plaintiffs (“Judgment Receivables”).
<b>Credit Risk:</b> 65% of fair value of legal fees receivable due from four law firms.

<b>Year:</b> 2015
<b>Date:</b> November 18, 2016
<b>Nature of Operations:</b> The Fund was organized for the principal purpose of purchasing factored legal fees (“Legal Fees Receivable”), plaintiff’s <u>judgment</u> awards or settlements (“Judgment Receivables”) and making advances, pursuant to revolving credit facilities provided to attorneys.
<b>Valuation Techniques:</b> The Fund purchases from law firms and attorneys (collectively, the “Law Firms”) certain of their accounts receivable representing legal fees derived from litigation, judgments and settlements (“Legal Fees Receivable”) due to the Law Firms. The Fund also purchases <u>judgments</u> and settlements due plaintiffs (“Judgment Receivables”) from the Law Firms.
<b>Credit Risk:</b> 53% of fair value of legal fees receivable due from three law firms.

88. Based on my review of the audited financial statements, I make the following observations. First, as of on or shortly after August 27, 2008, current and prospective investors knew or should have known from the financial statements that the Domestic Fund purchased legal fees deriving from litigation, judgments, and settlements. Second, as of on or shortly after April 15, 2013, current and prospective investors knew or should have known from the financial statements that that Domestic Fund purchased plaintiff’s judgment awards or settlements.
89. The first legal receivable associated with a *Peterson* attorney was purchased on September 1, 2010, and first legal receivable associated with a *Peterson* plaintiff was purchased on September 13, 2012.<sup>42</sup>
90. Because the investment manager had the right to change how it invested at any time, and because both current and prospective investors had access to financial statements, I consider the Funds’ audited financial statements to have provided timely notice to investors of these events.

<sup>42</sup> Source: *Peterson* cash flows” spreadsheet, sheet “Data,” rows 19 and 50.

D. RDLC Accurately Reported the Concentration of Investments in the Funds

91. The SEC asserts that, “Respondents also made numerous misrepresentations concerning the concentration of investments in the Funds.”
92. It is important to remember that the Funds’ PPMs specifically disclosed that the Funds may be concentrated, and the investment manager did not purport to offer “a broadly diversified portfolio.” For example, the 2011 PPM for the Domestic Fund stated as follows:

“The Partnership **intends** to invest the assets of the Partnership in either Legal Fee Receivables, Lines of Credit, or Other Advances to Law Firms. By investing solely in these instruments, the assets of the Partnership will be exposed entirely to the risks of such investment **without the protections against loss afforded by diversification**. Concentration in a certain type of investment has the effect of exposing a significant portion of invested capital to the same or similar risks, as well as return or other characteristics, and thereby increases investment risk as well as the portfolio volatility. Accordingly, the value of a Partnership investment may fluctuate more widely given this **concentration**, as compared with the fluctuation expected in a broadly diversified portfolio.” (Emphasis added.)

93. This language should be a clear notice to investors that the Fund intends **not** to be diversified. And, as I have seen from my experience in the industry, the term “intends” allows fund managers discretion to change their strategies as circumstances present opportunities to improve returns or to avoid losses.
94. Moreover, the audited financial statements—which were made available to investors and prospective investors—disclosed concentration levels of investments in the Funds. Below is the year-end percentage, as reported by the audited financial statements, of investments in *Peterson*.

Portfolio composition	2010	2011	2012	2013	2014	2015
US Government /Qualified Settlement Trust	5,403,518	21,691,789	65,464,555	96,888,446	115,379,722	65,869,122
Total assets	68,042,167	85,597,356	144,564,68	159,955,90	180,074,470	96,265,010
Percentage	7.94%	25.34%	45.28%	60.57%	64.07%	68.42%

95. At times, the Funds' audited financial statements referred to the *Peterson* amounts receivable as, "Funds under control of the US Government."<sup>43</sup> The SEC takes issue with this captioning, arguing "[t]he possible sources of payment in the *Peterson* Case . . . were not under the control of the U.S. government."<sup>44</sup>
96. According to the AICPA Audit and Accounting Guide for Investment Companies, With Conforming Changes as of May 1, 2004 (the "AICPA Guide"), nonregistered investment partnerships should categorize investments by type, country or geographic region, and industry. To wit: "Type (such as common stocks, preferred stocks, convertible securities, fixed-income securities, government securities, options purchased, options written, warrants, futures, loan participations, short sales, other investment companies, and so forth)." I believe that the nomenclature used by the Funds was consistent with the AICPA Guide.
97. The Form ADV also warned readers of investment concentration risk: "The funds managed by RD Legal intend to invest their assets in legal fee receivables, lines of credit and other advances to law firms. By investing solely in these instruments, the assets of the funds will be exposed entirely to the risks of such investment without the protections against loss afforded by diversification. Concentration in a certain type of investment has the effect of exposing a significant portion of invested capital to the same or similar risks, as well as return or other characteristics, and thereby increases investment risk as well as the portfolio volatility. Accordingly, the value of a fund investment may fluctuate more widely given this concentration, as compared with the fluctuation expected in a broadly diversified portfolio."<sup>45</sup>

<sup>43</sup> Condensed Schedule of Investments of the 2012 Domestic Fund Audited Financial Statements.

<sup>44</sup> SEC Order in Administrative Proceeding.

<sup>45</sup> SECLIT-EPROD-000012996.

98. Clearly, the *Peterson* amounts receivable are not government securities. But, they were under the control of the US government. On February 5, 2012, the President of the United States issued Executive Order 13599, declaring “[a]ll property and interests in property of” Iran or Bank Markazi held in the United States or by a “United States person” “blocked” pursuant to the President’s authority under the International Emergency Economic Powers Act.<sup>46</sup> Pursuant to Executive Order 13599, the government blocked \$1.75 billion in **registered federal government** bonds that were held by Citibank in a custodial omnibus account.<sup>47</sup> An omnibus account is held by an investment firm with a third party in which client assets are held in aggregate, rather than in individually designated accounts by client, but which nevertheless ensures that the assets are segregated from those of the firm.
99. On March 13, 2013, a United States District Court granted partial summary judgment to the *Peterson* plaintiffs and ordered turnover of about \$1.75 billion blocked assets held at Citibank, N.A.<sup>48</sup>
100. Moreover, on July 9, 2013, a judge ruled, “The Investment Advisor [to the *Peterson* Fund] shall invest and reinvest the principal and income of the Fund and keep the Fund invested in **United States Treasury or Agency securities** and one or more money market accounts which shall be treated as a single fund without distinction between principal and income. For purposes of this paragraph, ‘money market account’ shall mean a money fund whose objectives are current income consistent with liquidity and low risk, the maintenance of a portfolio of high quality, short-term money market instruments, and maintenance of a constant \$1.00 net asset value per share (Emphasis added).”<sup>49</sup>
101. If the *Peterson* amounts receivable were not funds under the control of the US Government, under whose control were they?
102. According to the United States Supreme Court, “Article III of the Constitution establishes an independent Judiciary, a Third Branch of Government with the ‘province and duty . . . to say what the law is’ in particular cases and controversies.”<sup>50</sup> On July 9, 2013, the District Court ordered the establishment and funding of the *Peterson* 26 U.S.C. § 468B Qualified Settlement Fund (the “QSF”) and “that the Court shall retain continuing jurisdiction over the QSF.”<sup>51</sup>

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<sup>46</sup> <https://www.gpo.gov/fdsys/pkg/FR-2012-02-08/pdf/2012-3097.pdf>.

<sup>47</sup> [http://www.americanbar.org/content/dam/aba/publications/supreme\\_court\\_preview/briefs\\_2015\\_2016/14-770\\_amicus\\_resp\\_NatlSecurityLawProfs.pdf](http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/briefs_2015_2016/14-770_amicus_resp_NatlSecurityLawProfs.pdf).

<sup>48</sup> *Peterson v. Islamic Republic of Iran*, CA 10-4518 (KBF), 2013 U.S. Dist. LEXIS 40470 (S.D.N.Y. Feb.28, 2013).

<sup>49</sup> Section 4.1 of AGREEMENT FOR THE *PETERSON* §4688 FUND PURSUANT TO 26 U.S.C. §4688.

<sup>50</sup> *Bank Markazi v. Peterson*, 136 S. Ct. 1310, 1315 (2016).

<sup>51</sup> [www.beirutbombinglawsuit.com/files/2016/08/Order-Approving-QSF.pdf](http://www.beirutbombinglawsuit.com/files/2016/08/Order-Approving-QSF.pdf), accessed January 8, 2017.

103. After the establishment of the QSF, the audited financials were changed to identify the obligor of the *Peterson* receivables as the QSF.
104. Even though the PPMs clearly warn that the Funds may be concentrated and may not offer a diversified portfolio, the March 2012 DDQ states, “The portfolio is constructed with diversification in mind, and as such is made-up of many litigants, many law firms, and a variety of different claims.”<sup>52</sup> Furthermore, 95 percent of assets under management are invested in factoring, while 5 percent is in credit lines.
105. These two statements are not inconsistent; they are referring to different ways of understanding diversification. The DDQ is stating that the strategy is concentrated but suggests that within the strategy there is diversification.
106. “Diversification” is a word that can mean many things to different people, and without a definition attached to it, it is another term that provides discretion and judgment to the investment manager.

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<sup>52</sup> March 2012 DDQ, p. 11.

107. The following table sets forth the diversification stated in various DDQs:

DDQ Date	As of Date	Positions	Cases	Attorneys/ Plaintiffs
Mar. 2012 <sup>53</sup>	Not mentioned	Not mentioned	“Variety of different Claims”	“Many”
Dec. 2012 <sup>54</sup>	Dec. 31, 2013 [sic] <sup>55</sup>	243	63	117
Jun. 2013 <sup>56</sup>	Apr. 30, 2013	276	65	132
Jul. 2013 <sup>57</sup>	Apr. 30, 2013	276	65	132
Jan. 2014 <sup>58</sup>	Dec. 31, 2013	416	68	200
May 2014 <sup>59</sup>	Apr. 30, 2014	439	75	213
Jun. 2014 <sup>60</sup>	May 31, 2014	454	72	213
Jul. 2014 <sup>61</sup>	Jun. 30, 2014	436	67	193

108. Even the Commission acknowledges, “The *Peterson* Receivables were assets in which Dersovitz invested fund monies that involved the pursuit, by numerous plaintiffs.”<sup>62</sup> If there were a perceived conflict between the language in the PPM and DDQ, an investor should have either asked the fund manager to explain the seeming contradiction, or looked at the Lotus Notes database to verify if the DDQ was correct.

<sup>53</sup> RDLC-SEC 7 45349.

<sup>54</sup> RDLC-SEC 642277.

<sup>55</sup> I suspect that 2013 is a typo and that it should be December 31, 2012, the same date of the DDQ. I note, however, that all other instances that included an As of Date, such date preceded the DDQ Date.

<sup>56</sup> RDLC-SEC 591571.

<sup>57</sup> RDLC-SEC 638230.

<sup>58</sup> RDLC-SEC 642105.

<sup>59</sup> RDLC-SEC 631007.

<sup>60</sup> RDLC-SEC 592112.

<sup>61</sup> RDLC-SEC 645069.

<sup>62</sup> SEC Order in Administrative Proceeding, paragraph 21.

109. When prompted by a question in the March 2012 DDQ to describe what portfolio data the Funds can provide (electronically) in terms of position concentration, the DDQ stated, “We can provide monthly payor concentration as a per cent of the total AUM.”<sup>63</sup> This, of course, would be available to any investor who asked for the information, notwithstanding that the raw data was available in Lotus Notes.
110. When prompted by a question in the March 2012 DDQ to discuss the depth of diversification in the Funds, the DDQ stated, “As with portfolio risk, diversification is managed by limiting the level of portfolio exposure based on the obligor’s (the financial party responsible for the payment of the settlement) credit worthiness.”<sup>64</sup> This suggests that if the obligor has very high creditworthiness that there will be less diversification, because there is less concern for the portfolio’s overall risk of loss.
111. I understand there were multiple sources of payment following the *Peterson* judgments. Ignoring turnover risk, it is my opinion that these sources of payment removed any meaningful credit risk as to repayment on the assets held in the Funds. If the purpose of diversification is to minimize the risk of loss, the credit risk did not need to be diversified. I do not hold myself out to be an expert on turnover risk. Nevertheless, Mr. Dersovitz has impressive credentials, experience assessing these assets, and an enviable record of highly attractive risk-adjusted performance. In light of that, were I an investor in the Domestic Fund, if the judgment of Mr. Dersovitz were that the turnover risk were virtually nil, I would have confidence in his judgment and not fret about the lack of diversification of turnover risk. After all, if I invested in the fund, I am investing in the skill that he brings to the table; if I thought that I knew more than he about the strategy, I would not ask him to manage my money.
112. In my opinion, diversification is the application of common sense. In this case, the *Peterson* default judgments could not be overturned—only the turnover was at risk—but I understand that the federal government essentially provided a backstop of payment through Congressional and Presidential action and set aside pools of money in trusts to satisfy the judgments. Thus, in my opinion, creating a large concentration in the *Peterson* assets after July 2013 was akin to buying nearly risk-free U.S. Treasury securities that were extremely safe through the government backstop, but also had high rates of returns. Investing in the *Peterson* positions reduced the overall portfolio risk of the Domestic Fund and was very prudent and reflected the “alpha,” or added value that the investment manager brought to the table.

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<sup>63</sup> March 2012 DDQ, p. 14.

<sup>64</sup> March 2012 DDQ, p. 13.

113. Espen Robak (“Robak”), president of Pluris testified that his assessment of the relative risk between attorney receivable claims and plaintiffs judgments are “equivalent.”<sup>65</sup> Robak said they were similar because they both are investments in duration risk—not litigation risk. When asked about appeals, he responded that appeals risk was part of the discount rate.
114. The SEC’s allegations reflect a fundamental misunderstanding of diversification in the context of investing. The SEC complains about exposures but does not quantify what it believes is a safe exposure level. It attributes no importance to correlation between assets or reduction in volatility.
115. Although “prudent investing ordinarily requires diversification,” “[c]ircumstances can, however, overcome the duty to diversify.”<sup>66</sup> It is my strong opinion that the circumstances involving the *Peterson* positions with essentially a government guarantee of repayment, made the decision to invest a large portion of the portfolio into *Peterson* prudent and wise.
116. Thus, it is also my opinion that those, such as investors in the Domestic Fund, who essentially can invest in cash while earning 13.5 percent, net, per annum, on their investment, receive the best of both worlds—the benefits of diversification and an enviable return. In this instance, the reward is much greater than the risk suggests it should be.

E. RDLC’s Valuation Procedures Were Reasonably Designed to Result in a Fair Valuation.

117. The SEC alleges that the Respondents withdrew money from the Funds using valuations based on “unreasonable assumptions,” thereby draining the Funds of liquidity at the expense of investors.
118. As an industry professional with significant expertise in the principles of asset valuation, I find the SEC’s allegations to be wholly contradicted by the facts.
119. The procedures used by RDLC for valuation generally conformed to valuation principles and were reasonably designed to result in a fair valuation.
120. The Funds’ legal fee receivable assets are “Level 3” assets, which means the inputs are unobservable because they trade infrequently or not at all.<sup>67</sup> To the extent that an asset is valued based upon models or inputs that are unobservable in the market, the determination of fair value of that asset requires more judgment than would be required for assets with observable market inputs.

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<sup>65</sup> Source: meeting with Espen Robak on Nov 17 2016, at offices of Counsel in New York City.

<sup>66</sup> [http://lpdirect.net/casb/crs/15-1\\_1-103.html](http://lpdirect.net/casb/crs/15-1_1-103.html).

<sup>67</sup> See Note 3 to 2011 Audited Financial Statements of the Domestic Fund.

121. Valuation of Level 3 assets and liabilities requires good judgment. Experience can lead to better judgment, but judgment is not precise.<sup>68</sup> As long as Respondents acted in good faith, the inputs provided to Pluris to help it arrive at a discount rate should stand. Given that what constitutes a fair value is a matter of *judgment*, pronouncing a value does not amount to a mischaracterization of reality, notwithstanding a majority opinion to the contrary—which, in this case, did not exist.
122. Any investor that invests in a fund that holds essentially all of its positions in Level 3 assets necessarily accepts the risk that the investment manager’s valuation may be imprecise, even if the investment manager acts in good faith. Indeed, this was disclosed to investors in the Funds.<sup>69</sup>
123. In 2011, the Funds engaged Pluris, a nationally recognized valuation firm,<sup>70</sup> to provide periodic valuations of portfolios of purchase agreements, and to provide the Funds with monthly valuation summary reports.
124. According to the retainer agreement, each month Pluris prepares a written summary valuation report that expresses the fair value for a portfolio of purchase agreements, as of a mutually agreed-upon date. These reports serve as a valuation basis for financial reporting and related purposes.
125. The agreement between Respondents and Pluris, such that the reports shall serve as a valuation basis, implies that the investment manager maintains the ultimate authority, which is consistent with the industry standard from at least 2011 to 2015.<sup>71</sup> Pluris has had about 100 hedge fund clients since its inception and has never been the ultimate decider of the valuations for its clients.<sup>72</sup>

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<sup>68</sup> Indeed, it is even plausible for two counterparties, which are audited by the same accounting firm, to arrive at different fair values for the same position. Anecdotally, at a CFTC Roundtable at which I moderated a panel on valuations and which took place on April 6, 2005, I asked Joel Press (“Press”), then-Senior Partner, Global Hedge Fund Practice, Ernst & Young, “Under what conditions is it acceptable for two or more funds that hold the identical instrument to use different valuations?” He responded, “Very often, in a complex instrument... there are different pricing sources that people rely on, let alone their own models. People only use bids; some will use means; some will use average, and in large block positions, those differentials can be significant to the P&L of an organization depending on its assets and its P&L.” [www.cftc.gov/files/ac/ac-transcript0406.pdf](http://www.cftc.gov/files/ac/ac-transcript0406.pdf), p. 169. In other words, Press acknowledged that values fall within an acceptable range and that there is no “one size fits all” when it comes to valuations.

<sup>69</sup> For example, see June 2013 PPM for Domestic Fund, p. 16.

<sup>70</sup> Pluris is recognized by its peers. For example, Interactive Data Corporation (IDC), a supplier of financial market data, relies on valuations determined by Pluris. Source: meeting with Epsen Robak on Nov 17 2016, at offices of Counsel in New York City.

<sup>71</sup> The SEC observes “that a hedge fund investment adviser generally has complete discretion with respect to the valuations used to price the fund’s securities... For example, some hedge funds may value the securities of non-publicly traded companies at cost and may not revalue them until a public trading market for the securities develops

126. I note that the independent auditors reviewed the valuation analysis prepared by Pluris and concluded that the value was reasonable. The independent auditors also determined that there are no comparable investments in the public market, and the methodology used to develop the discount rate was logical.
127. According to the RD Legal Capital Valuation Policy, “The Funds initially value investments in the Receivable that it acquires at the purchase price of the asset. When evidence supports a change to the carrying value from the purchase price, plus accrued income, adjustments are made to reflect the expected fair value under current market conditions.”<sup>73</sup>
128. In determining fair value, the Funds use their own market assumptions (unobservable inputs) about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. Therefore, the Funds’ own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date.
129. Those estimated values do not necessarily represent the amounts that may be ultimately realized because of the occurrence of future circumstances that cannot be reasonably determined at the time the asset or liability is fair valued. Because of the inherent uncertainty of valuation, estimated values may be materially higher or lower than the values that would have been used had a ready market for the investments existed.
130. The Funds’ investment manager continually evaluates the collectability of the investments within the Funds’ portfolio and considers whether they still can realize the return anticipated when the investment was first made. Immediately upon identifying any single investment that is likely to be at risk of not returning both the initial investment and the anticipated return, an evaluation of the current value and probable yield for those assets is undertaken.
131. Should it be determined that any material diminution of the asset value is likely, the Funds would, based upon the recommendation of the investment manager, write down the specific assets that were adversely impacted in amounts reflecting the fair value of the asset, based upon the circumstance.

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or the issuer engages in a subsequent round of equity financing. See “Implications of the Growth of Hedge Funds,” Staff Report to the United States Securities and Exchange Commission, September 2003, pp. 64-65.

<sup>72</sup> Source: Meeting with Espen Robak on November 17, 2016 at offices of counsel in New York City.

<sup>73</sup> RDLC Valuation Policy, SECLIT-EPROD-000035707.

132. The future cash flows of legal receivables are discounted at interest rates that vary and are higher for the higher-risk situations and based upon the underlying contractual agreements. No organized market for the Funds' investments exists.
- i. RDLC'S valuation procedures satisfy my key valuation principles
133. In 2004, I was the editor and a principal author of the whitepaper, "Valuation Concepts for Investment Companies and Financial Institutions and Their Stakeholders" published on behalf of the Investor Risk Committee of the then-International Association of Financial Engineers (subsequently renamed the International Association for Quantitative Finance) (the "IAFE").
134. In the whitepaper, we identify 29 valuation principles, the majority of which apply to the Funds' valuation process. While I did not test the fair value of the investments made by the Funds and therefore cannot opine about their reliability, I do conclude that the Funds' valuation procedures generally conformed to the IAFE valuation principles as explained in the chart below.

Valuation Principles	Application to Funds' Valuation Procedures
1. Valuations should be determined in good faith.	<b>Principle satisfied.</b> According to the SEC, "In our view, a board [of an investment company] acts in good faith when its fair value determination is the result of a sincere and honest assessment of the amount that the fund might reasonably expect to receive for a security upon its current sale, based upon all of the appropriate factors that are available to the fund. Furthermore, we believe that a board acts in good faith when it continuously review[s] the appropriateness of the method used" in determining the fair value of the fund's portfolio securities. Compliance with the good faith standard generally reflects the directors' faithfulness to the duties of care and loyalty that they owe to the fund." <sup>74</sup> I believe that the Respondents have determined valuations in good faith, consistent with the guidance that the SEC has offered.
2. All investors—whether they are contributors or redeemers of capital, or continuing ones—should be treated equitably and non-discriminatorily, with regard to valuations.	<b>Principle satisfied.</b> Because the valuations of the assets of the Funds are reported at fair value, all investors are treated equitably.

<sup>74</sup> Division of Investment Management: April 2001 Letter to the ICI Regarding Valuation Issues, April 30, 2001. (Footnotes omitted).

Valuation Principles	Application to Funds' Valuation Procedures
<p>3. Valuations should be done at the appropriate intervals consistent with key activities; e.g., periodic investor reporting, internal control, margin, and times of contributions and redemptions.</p>	<p><b>Principle satisfied.</b> The Funds' valuations are performed monthly. According to the Domestic Fund's 2011 Limited Partnership Agreement, "[w]ith the consent of the General Partner, additional Limited Partners may be admitted to the Partnership on the first day of each month and at such other times as the General Partner, in its sole discretion, permits."<sup>75</sup> Moreover, "A new fiscal period ('Fiscal Period') will commence on the first day of each month, on each date of any capital contribution to the Partnership and on each date next following the date of any withdrawal of capital or retirement from the Partnership, and the prior Fiscal Period will end on the date immediately preceding such date of commencement of a new Fiscal Period."<sup>76</sup> Thus, valuations were done at the appropriate intervals.</p>
<p>4. For purposes of capital contributions and withdrawals, valuations based upon forward pricing is preferred to those based upon backward pricing.</p>	<p><b>Principle satisfied.</b> According to the 2011 Domestic Fund audited financial statements, "The Fund uses prices and inputs that are current as of the measurement date, including periods of market dislocation." Thus, valuations are based upon forward pricing at the "Measurement Date."<sup>77</sup></p>
<p>5. A firm should disclose its valuation policy and process to all investors.</p>	<p><b>Principle satisfied.</b> According to the Domestic Fund's 2011 Limited Partnership Agreement, "All investments not freely marketable (including factoring contracts), whether on account of legal restrictions, lack of a current liquid market or otherwise, will be valued at their fair value or on such other basis as the General Partner determines is reasonably representative of fair value."<sup>78</sup> Thus, contractually, the General Partner ultimately determines the fair value all of non-freely marketable investments. The Domestic Fund's audited financial statements from 2008 (in 2007, an independent review—not an audit took place) through 2015 include a section entitled, "Valuation Techniques," which typically says, "The Fund initially values investments in Legal Fees Receivables it acquires at the purchase price that is a discount to the legal fee that is anticipated to be collected. When evidence supports a change to the carrying value from the purchase price, plus accrued income, adjustments are made to reflect expected exit values under</p>

<sup>75</sup> RDLC-SEC 665123.

<sup>76</sup> RDLC-SEC 665122.

<sup>77</sup> RDLC-SEC 665130

<sup>78</sup> RDLC-SEC 665128.

Valuation Principles	Application to Funds' Valuation Procedures
	current market conditions. Due to the absence of a readily observable market price, the Fund values investments in Legal Fee Receivables at fair value determined by the Fund's management through a [proprietary Pluris] valuation model." The audited financial statements clearly state the policy and process. Furthermore, I know that at least one investor sought additional valuation information, which she received.
6. Valuations should conform to the firm's valuation policy and process.	<b>Principle satisfied.</b> According to the deposition testimony of Dennis Schall, assurance engagement partner at Marcum, he said, "[w]e design our audit procedures to give reasonable assurance that the valuation of the investment transactions are reasonably stated." <sup>79</sup> The opinions of the Funds' audited financial statements from 2011 through 2015 do not suggest that valuations did not conform to policy and process. The Funds had a written valuation policy since at least 2011 and which was provided to at least one investor who had requested to see it.
7. Valuations should be verifiable.	<b>Principle satisfied.</b> The Funds used Pluris as its independent valuation agent. According to internal memoranda produced by Marcum's advisory group relating to the valuation of RD Legal's investments at year ends 2012-15, "As a result of all the factors presented in the report the value [sic] conclusion is reasonable." <sup>80</sup>
8. Unless a change is beneficial with regard to accuracy, valuation methods should be applied consistently from period to period.	<b>Principle satisfied.</b> Robak stated that the basic valuation framework never changes—only the judgments change. <sup>81</sup>
9. Material changes in valuation methods should be communicated to appropriate stakeholders.	<b>Principle satisfied.</b> Robak stated that the basic framework never changes—only the judgments change.
10. The market price is the basic reference for building valuations.	<b>Principle satisfied.</b> Because of the absence of a readily observable market price, the Funds value investments in legal fee receivables at fair value determined by the Funds' management by way of a proprietary Pluris valuation model.

<sup>79</sup> (Rough) Transcript, In the Matter of: RD LEGAL CAPITAL, LLC; Witness: Dennis Schall; File Number: 3-17342; Date: January 11, 2017; Location: New York, NY; p. 45, lines 1-3.

<sup>80</sup> SECLIT-EPROD-000033007; SECLIT-EPROD-000032931; SECLIT-EPROD-000032951; SECLIT-EPROD-000029307.

<sup>81</sup> Source: meeting with Epsen Robak on Nov 17 2016, at offices of Counsel in New York City.

Valuation Principles	Application to Funds' Valuation Procedures
	Thus, market price does not apply to building valuations for the Funds. According to internal memoranda produced by Marcum's advisory group relating to the valuation of RD Legal's investments at years-end 2012-15, "there are no comparable investments in the public market." <sup>82</sup>
11. Actual (traded) prices are the best indicators of the market price	<b>Principle, when it applies, satisfied.</b> The Domestic Fund sold plaintiff receivables to Cedar's Funding and SPV Onshore at fair value. <sup>83</sup> The Master Participation Agreement between the Domestic Fund and Constant Cash Yield ("CCY") specified that both the "Purchase Price" and "Repurchase Price" mean cost basis plus certain accreted income. The fact that the Domestic Fund could buy back at book value the receivables it sold at book value, suggests that this was a special exception, perhaps something akin to a repo agreement, which is a financing transaction, and thus the book value did not reflect fair value. Therefore, this principle does not apply to the transactions with CCY, but was satisfied with regard to the transactions with Cedar's Funding and SPV Onshore. In his deposition, Robak testified that "we generally consider these transactions where an actual outside buyer has purchased the receivable. We think that's a better reflection of fair value." <sup>84</sup>
12. Actual fair value should be used rather than projected fair value.	<b>Principle satisfied.</b> When market assumptions are not readily available, the Funds' own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. The Funds use prices and inputs that are current as of the measurement date, including periods of market dislocation. Thus, the Funds use actual fair value.

<sup>82</sup> SECLIT-EPROD-000033007; SECLIT-EPROD-000032930; SECLIT-EPROD-000032951; SECLIT-EPROD-000029307.

<sup>83</sup> RDLC-SEC 046195.

<sup>84</sup> In the Matter of: RD LEGAL CAPITAL, LLC, 4 Witness: Espen Robak, File Number: NY-09278-A, Date: March 2, 2016, Location: New York, NY, proceedings before the U.S. Securities and Exchange Commission, page 168, lines 5-8.

Valuation Principles	Application to Funds' Valuation Procedures
12. Liquidity issues and transactions costs mitigate the law of one price.	<b>Principle does not apply.</b> According to Paul Krugman, "The law of one price states that in competitive markets free of transportation costs and official barriers to trade (such as tariffs), identical goods sold in different countries must sell for the same price when their prices are expressed in terms of the same currency." <sup>85</sup> If prices differ, arbitrageurs will cause the prices to converge, unless low liquidity prevents simultaneous buying and selling of such securities. Because the assets held by Domestic Fund do not trade in multiple markets, this principle does not apply.
14. Price is the amount at which two consenting parties agree to transact at arm's length.	<b>Principle does not apply.</b> Because of the absence of a readily observable market price, the Funds value investments in legal fee receivables at fair value determined by the Funds' management by way of a proprietary Pluris valuation model. Thus, market price does not apply to building valuations for the Funds. Nevertheless, Robak believes that the fair value falls within the range of prices that two consenting parties transacting at arm's length would agree. <sup>86</sup>
15. Supply and demand influence valuation.	<b>Principle does not apply.</b> Discounted cash flows influence valuations more than supply and demand because the assets held by the Domestic Fund are unique. I note that Cedar's Funding and SPC Onshore purchased participations in receivables owned by the Domestic Fund, and relied on the same proprietary Pluris valuations model, as did the Domestic Fund. As mentioned above, the transaction between the Domestic Fund and CCY seems to be unique. In any case, it is difficult to assert that there is meaningful supply and demand for these receivables.
16. All prices are not created equally (e.g., large block vs. odd lot, and two or more different dealers).	<b>Principle does not apply.</b> Robak says there are no such adjustments.
17. Compelling circumstances, e.g., large blocks, may merit different valuations of the same instrument in different portfolios.	<b>Principle does not apply.</b> There are no compelling circumstances that would cause different valuations of the same assets held by the Domestic Fund in different portfolios.

<sup>85</sup> [http://bookfree.ca/files/International\\_Economics\\_Theory\\_and\\_Policy\\_9th.pdf](http://bookfree.ca/files/International_Economics_Theory_and_Policy_9th.pdf), p.385.

<sup>86</sup> Source: meeting with Epsen Robak on Nov 17 2016, at offices of Counsel in New York City.

<b>Valuation Principles</b>	<b>Application to Funds' Valuation Procedures</b>
18. One must consider all relevant components (e.g., transactions costs) in the selection of arbitrage pricing vs. present-value pricing.	<b>Principle satisfied.</b> Fair value is determined by discounted cash flows, which is present-value pricing.
19. Greater independence in performing valuations, both process and sources, is preferred to lesser.	<b>Principle satisfied.</b> Pluris is an independent valuation agent.
20. Greater knowledge and sophistication in determining valuations is preferred to lesser.	<b>Principle satisfied.</b> Pluris, of which the RD Legal family is its only legal-receivables client, relies on information it receives from the fund manager to arrive at the discount rate. The manager is in a much better position to anticipate the risk of non-repayment (collectability), the value of collateral, the timing of repayment, and the legal risk, e.g., appeal. In addition, Pluris had conversations with Steven Perles to assess collectability of the Iran receivables and the expected repayment date. <sup>87</sup> On the other hand, Pluris is a better judge of market interest rates and liquidity discounts. Pluris treats each holding as part of a portfolio of zero-coupon fixed-income instruments. With regard to the estimated due date of certain receivables, Leo Zatta testified Dersovitz is "the most knowledgeable. He's the one, and he has the direct conversations with the parties involved and has the most knowledge as to those particular matters." <sup>88</sup>
21. Prices from frequently traded instruments generally provide better building blocks for fair value	<b>Principle does not apply.</b> None of the assets held by the Domestic Fund is frequently traded.
22. Prices from frequently quoted instruments generally provide better building blocks for fair value	<b>Principle does not apply.</b> None of the assets held by the Domestic Fund is frequently quoted.

<sup>87</sup> In the Matter of: RD LEGAL CAPITAL, LLC, 4 Witness: Espen Robak, File Number: NY-09278-A, Date: March 2, 2016, Location: New York, NY, proceedings before the U.S. Securities and Exchange Commission, page 60, lines 18-25; page 7, lines 4-7; page 197, lines 4-17; page 199, lines 9-22; page 260, lines 14-page 261, line 12; page 262, lines 11-page 264, line 2; page 278, lines 15-17; page 305, line 7-9 and 18-20; page 306, lines 3-6; page 307, line 15-page 309, line 12; page 311, line 24-page 312, line 1; page 325, lines 13-19; page 353, line 10-17

<sup>88</sup> Leo Zatta deposition, p. 117, lines 3-12.

Valuation Principles	Application to Funds' Valuation Procedures
23. Two-sided markets generally provide better evidence of fair value than one-sided ones	<b>Principle does not apply.</b> There are no markets for the assets held by the Funds.
24. Quotations based upon trades from liquid markets generally are better evidence of fair value than those from thin ones.	<b>Principle does not apply.</b> There are no liquid markets for the assets held by the Funds. Leo Zatta testified that thinly-traded debt obligations was the asset type that the Domestic Fund found closest to legal fee receivables. <sup>89</sup>
25. Quotations that are closer to the normal time for valuation, which may vary by market, generally provide better evidence of fair valuation than those further.	<b>Principle does not apply.</b> There is no market for the assets held by the Funds.
26. Prices of contracts that trade at the normal time for valuation are better evidence of fair value than underlying stale prices.	<b>Principle does not apply.</b> The assets held by the Funds do not trade.
27. More-robust pricing procedures generally are preferred to less-robust ones.	<b>Principle satisfied.</b> The deposition testimony of Robak suggests that the pricing procedures were quite robust for the nature of the positions in the portfolio.
28. A particular country's generally accepted accounting practices do not necessarily reflect the best fair value.	<b>Principle satisfied.</b> The valuations of assets held by the Domestic Fund conform to US-based generally accepted accounting principles (GAAP).
29. The first principle "valuations should be determined in good faith," should be used to resolve any conflicts in the interpretation of these Valuation Principles.	<b>Principle satisfied.</b> There were no conflicts between any of the principles. Any potential conflict between the principles of independence and knowledge was resolved by Pluris' proprietary valuation model relying on certain inputs from the Domestic Fund..

135. Thus, the Funds' valuation procedures generally conformed to my model principles for valuation.

<sup>89</sup> Leo Zatta deposition, p. 82, lines 16-25.

136. I note that Marcum, the independent auditors, reviewed the valuation analysis prepared by Pluris, the independent valuation agent, and concluded that the value was reasonable, and determined, that although there are no comparable investments in the public market, the methodology used to develop the discount rate makes logical sense.
137. In sum, the SEC has not demonstrated a failure by Respondents to value the Funds at fair value and to follow valuation procedures, that generally conform to the IAFE principles.

## V. CONCLUSIONS

138. Hedge fund marketing documents are one piece of a mosaic that must be considered in the context of all of the information made available to investors by the fund's investment manager.
139. Consistent with industry standards, under the terms of the Funds' offering memoranda, RDLC was given a broad investment mandate that included the ability to pursue investments in plaintiff and judgment-based legal receivables, as well as other legal receivables.
140. The actual investment strategy undertaken by RDLC fell within the strategy disclosed to investors in the offering memoranda and other documents made available to investors.
141. RDLC used valuation procedures consistent with industry best practices that were reasonably designed to result in a fair valuation.
142. RDLC accurately reported to investors the composition of the Funds' portfolios.
143. In short, it is my opinion that the SEC has failed to establish that Roni Dersovitz or RDLC, in connection with the sale of partnership interests in the Domestic Fund and shares in the Offshore Fund, made a materially false statement or omitted a material fact, with scienter or even negligently. I also do not believe that there was a substantial likelihood that the disclosure of an omitted fact in non-critical marketing documents would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.

By: Leon M. Metzger  
Leon M. Metzger  
Dated: January 27, 2017

# **APPENDIX A**

## Expert Testimony Activity of

**LEON M. METZGER**

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Bronx, NY 10471-3911

(718) 601 9918

[leon.metzger@gmail.com](mailto:leon.metzger@gmail.com)

### Summary

- 42 opportunities to testify, mediate, or render judgment on testimony
- 4 times invited as expert by government agencies
- Authority in asset management, in general, and hedge funds, in particular
- Normally principal author of decisions for the arbitrations on which served as panelist

### Areas of Expertise

- Hedge funds
- Operational controls and infrastructure
- Incentive compensation practices and management fees
- Diversification
- Asset classes
- Operational due diligence
- Disclosure documents
- Taxation and accounting
- Valuations
- Lessons learned from Amaranth and Madoff
- Selecting pooled investments
- Standard business practices
- History and theory of alternative investments
- Transparency issues
- Service providers to asset managers
- Benchmarks
- Bylaws
- Compliance policies, processes, and procedures

### Expert Testimony (13 times)

#### Litigation Support (5 times)

- Ropes & Gray LLP, Boston, MA (2014-15) (co-counsel)
- Skadden, Arps, Slate, Meagher & Flom, Washington, DC. (2014-15) (co-counsel)
  - *Russian Recovery Fund Limited, Russian Recovery Advisors, L.L.C. vs. the United States*, Case No. 1:06-cv-00030-EGB, 1:06-cv-00035-EGB, consolidated.
  - Expert consultant and witness in connection with a dispute between hedge-fund taxpayer and the United States regarding taxpayer's request for readjustment of partnership items.

## Expert Testimony Activity of Leon M. Metzger

- Submitted expert rebuttal report to refute assertions about the hedge-fund industry and the characteristics of hedge funds in the late 1990s, which were claimed in three expert reports. Deposed about such report.
- Testified at trial. U.S. Court of Federal Claims Judge Eric G. Bruggink: “We have no reservations about [Metzger’s] qualifications to speak about the management of hedge funds... [W]e do not rely on most of the points [two expert witnesses for defendant] made concerning RRF, except as considered below. Thus, it is unnecessary to lay out Mr. Metzger’s responses.” [https://ecf.cofc.uscourts.gov/cgi-bin/show\\_public\\_doc?2006cv0030-384-0](https://ecf.cofc.uscourts.gov/cgi-bin/show_public_doc?2006cv0030-384-0).
- Research support provided by staff of Analysis Group, Inc.
- English & Gloven, A Professional Corporation, San Diego, CA. (2014)
  - *Jones v. Societe Generale*, Superior Court of the State of California, County of San Diego, Case No. 37-2008-00058449-CU-FR-CTL.
  - Expert consultant and witness in connection with a dispute between an investor and a group of related financial institutions regarding a structured investment in a hedge fund.
  - Deposed about the management of the fund and general hedge-fund issues.
  - Case settled twelve days after deposition.
- Akin Gump Strauss Hauer & Feld LLP, Philadelphia, PA. (2013-14)
  - *Kamian Schwartzman v. Morningstar, Inc.*, Civil Action No. 2:12-cv-01647-BMS.
  - Expert consultant and witness in connection with a dispute between a receiver, in control of several defunct hedge funds, asserting claims of contribution under Section 10(b), and common law aiding and abetting, from a judgment obtained by the SEC against the defunct hedge funds, which were deceived in a Ponzi scheme, and an investment research company that provided data about investment offerings such as hedge funds, including the one used in the fraud.
  - Submitted expert rebuttal report on: overview of what is a hedge fund; roles of hedge fund service providers; hedge-fund regulatory environment; and performance data. Deposed about such report.
  - Testified at trial. U.S. District Court Judge Berle M. Schiller: “The Court finds more persuasive the testimony by... Leon Metzger... The Court believes that Metzger has greater expertise on hedge funds... The Court credits the three possible explanations that Metzger offered.” Testimony cited thirteen times in Court Memorandum. <http://lifegoodfundsreceivership.com/12-cv-01647%20-%20111.pdf>.

## **Expert Testimony Activity of Leon M. Metzger**

- Trial verdict on all claims.
- Research support provided by staff of Cornerstone Research.
- **Williams & Connolly LLP, Washington, DC. (2009)**
  - Expert consultant and witness in connection with a dispute between a hedge-fund management company and a former employee of it.
  - Submitted expert report and opinion.
  - At arbitration hearing, testified for respondent about similarities and differences between hedge and mutual funds, and socially responsible investing.
  - American Arbitration Association-administered dispute resolution.
  - Research support provided by staff of global economic consulting firm (currently at Charles River Associates).
- **Arkin Rice Kaplan LLP, New York, NY. (2006-07)**
  - Expert consultant and witness in connection with a dispute between former members of a management company whose hedge fund had been dissolved.
  - Submitted expert report and opinion.
  - At arbitration hearing, testified for respondent about hedge-fund-industry practices.
  - American Arbitration Association-administered dispute resolution.

### **U. S. House of Representatives (3 times)**

- Testified before Committee on Financial Services, Open Meeting on Assessing the Madoff Ponzi and the Need for Regulatory Reform, 2009.
- Testified before Committee on Ways and Means, Hearing on Fair and Equitable Tax Policy for America's Working Families, 2007.
- Testified before Committee on Banking and Financial Services, Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises, The Operations of Hedge Funds and Their Role in the Financial System, 1999.

### **Internal Revenue Service and U.S. Treasury (5 times)**

## Expert Testimony Activity of Leon M. Metzger

- Testified about Proposed Treasury Regulation §1.475(a)-4, Safe Harbor for Valuation under Section 475, Washington, DC, 2005.
- Testified about Proposed Treasury Regulations §1.475(e)-1; §1.475 (f)-1; and §1.475 (f)-2, Mark-to-Market Accounting for Traders, Washington, DC, 1999.
- Testified about Proposed Treasury Regulation §1.864(b)-1, Trading in Derivatives, Washington, DC, 1998.
- Testified about Proposed Treasury Regulation §1.7704-3, Qualifying Income, Washington, DC, 1998.
- Testified about Proposed Treasury Regulation §1.7704-1, Publicly Traded Partnerships, Washington, DC, 1995.

### Arbitration (28 cases)

Beth Din of America, New York, NY. Impartial neutral.

- Arbitrator in dispute regarding failure to pay royalties under clothing licensing agreement. Parties settled after closing of proceedings.
- Arbitrator in dispute regarding quality of printing work performed under contract.
- Arbitrator in dispute regarding whether board of trustees of not-for-profit organization acted in accordance with its by-laws.
- Arbitrator in dispute regarding whether contract executed by individual without express authority to bind entity had "implied" or "apparent" authority.
- Arbitrator in dispute regarding termination of business relationship between caterer and institution for which there was no contract.
- Arbitrator in dispute regarding parenting and financial arrangements between divorcing couple.
- Arbitrator in dispute regarding termination of letter of intent regarding purchase of interests in real estate partnership.
- Arbitrator in dispute regarding election of officers of not-for-profit organization and sale of its principal asset.
- Arbitrator in dispute regarding a risky loan made by unsophisticated investors to a limited liability company that managed hedge funds.
- Arbitrator in dispute regarding election of a board of directors of a not-for-profit organization; transparency of its accounting and governance practices; and termination of employment of key employee.
- Arbitrator in dispute regarding employment contract of key employee at not-for-profit organization.
- Arbitrator in dispute regarding accounts receivable owed by health-care facility to vendor. See [http://bethdin.org/docs/Decision\\_8.pdf](http://bethdin.org/docs/Decision_8.pdf) (The names, dates, places, and other identifying information have been changed, and the parties to this case consented to the release of the decision).

## Expert Testimony Activity of Leon M. Metzger

- Arbitrator in dispute regarding claim against dissolved limited liability company vendor. Claimant withdrew from case after proceedings had commenced.
- Arbitrator in dispute regarding "term sheet" agreement concerning whether investment was made in telecom company, and if so, what was value of company.
- Arbitrator in dispute regarding operating control of real estate partnership.
- Arbitrator in dispute regarding joint venture where one party was to contribute patent-pending home-improvement fixtures and other party was to contribute marketing database and administrative support. Adopted settlement agreement between parties after closing of proceedings.
- Arbitrator in dispute between lender and borrower, whereby borrower did not dispute his overdue liability but claimed not to have current financial resources to repay the debt.
- Arbitrator in dispute between a building contractor and non-profit organization whereby tenant of organization executed unauthorized contract and contractor demanded payment from organization.
- Arbitrator in dispute regarding a factoring arrangement.
- Arbitrator in dispute between company and former employee regarding employee's right to compete with company.
- Arbitrator in dispute between former employee and employer regarding claims for back wages, unemployment benefits, and damages from data wiping.
- Arbitrator in dispute regarding assets and liabilities of a divorcing couple.
- Arbitrator in dispute regarding potential and actual liabilities of individual acting as nominee for charitable organization.
- Appointed by appeals arbitrator as expert to review mathematical calculation regarding certain mortgage payments. Advised arbitrators to modify award.
- Appointed as expert to mediate dispute between couple regarding home budgeting in an effort to avoid arbitration.

### Ad Hoc Arbitration, New York, NY

- Appointed by arbitration panel as expert in dispute between former partners of an accounting firm that had unwound.

### Beis Din Nesivos Chaim, Jerusalem, Israel

- Appointed by arbitrator as independent expert regarding a dispute between investors in a fund that turned out to be a Ponzi scheme and employees of an affiliated entity of the funds over the conducting of due diligence.
- Appointed by arbitrator as an independent expert regarding a dispute revolving around a New York-formed limited liability company, which lacked a written operating agreement.

## Expert Testimony Activity of Leon M. Metzger

### Mediator (1 time)

Financial Industry Regulatory Authority, Inc. /JAMS, Inc., New York, NY.

- Dispute between a hedge fund and one of its managing partners, who claimed that the hedge fund wrongfully terminated him; principal issues involved liability and quantification of damages.

### Invited as expert by government agencies (4 times)

- U.S. Government Accountability Office, 2007
  - Conducted all-day seminar on hedge funds and lessons learned from Amaranth
- U.S. Commodities Futures Trade Commission, 2005
  - Moderator of roundtable discussion about hedge-fund industry, especially, valuation practices
- International Organization of Securities Commissioners, 2005
  - Participant in roundtable on valuations
- U.S. Securities and Exchange Commission, 2004
  - Invited to address entire agency staff on valuations

### Qualifications

Adjunct faculty, 31 semesters of graduate-level multi-disciplinary, general-management-focused courses that provide an overview of the challenges of launching and operating a hedge fund, and that explore the impact of global macro current events on alternative-investment managers, investors, and regulators, at:

- Columbia University School of Engineering
- Cornell University Financial Engineering
- New York University—Stern School of Business
- Tel Aviv University Recanati school of Business
- University of Pennsylvania, Wharton School
- Yale University Law School
  - Course satisfied the legal ethics/professional responsibility requirement for graduation
- Yale University School of Management

18 years as consultant to and hedge-fund executive at Paloma Partners Management Company, Greenwich, CT

Previous experience at:

- Yeshiva University, New York, NY, adjunct assistant professor of economics
- Skadden, Arps, Slate Meagher & Flom, New York, NY, treasury manager

## Expert Testimony Activity of Leon M. Metzger

- IBM Corporation, East Fishkill, NY, financial analyst
- Arthur Andersen & Co., New York, NY, tax division

### Publications

- Associate Editor, *Judaism and Economics* (Oxford University Press, 2010)
- Editor, International Association of Financial Engineers White Paper on Valuations, 2004

### Licenses

- Certified Public Accountant (since Feb 1982), New York
- Held National Commodity Futures Examination Series 3 securities license while working in hedge-fund industry

### Past Leadership

- New York State Society of Certified Public Accountants
  - Founding Chair, Investment Management Committee
  - Chair, Taxation of Financial Institutions and Products Committee
- International Association for Quantitative Finance
  - Chair, Advisory Board
- American Institute of Certified Public Accountants
  - Member, Alternative Investments Task Force

### Education

- Harvard University Graduate School of Business Administration, MBA
- The Wharton School, University of Pennsylvania, BS in Economics

**Panelist and speaker** about hedge funds, compliance, and valuations at many conferences, seminars, roundtables, and other programs hosted by organizations including:

- American Bar Association
- Association of the Bar of the City of New York
- Bloomberg LP
- Borsa Italiana
- Boston University School of Law
- Columbia University School of Law
- Darden Graduate School of Business Administration, University of Virginia
- Ernst & Young LLP
- Financial Innovation Study Committee, Virginia Polytechnic Institute and State University
- Fordham University School of Law
- Harvard Business School Club of Connecticut
- International Association of Financial Engineers
- New York State Society of CPAs
- Owen School of Management, Vanderbilt University
- Women in Housing and Finance

# **APPENDIX B**

## List of Materials Considered

Document	Doc ID
RDLFP 2014 Financial Statements	RDLC-SEC 008555
RDLFP LPA (August 2015)	RDLC-SEC 183830
RD Legal Capital Fund Overview	RDLC-SEC 088568
Alpha Generation and Process Presentation (December 2012)	RDLC-SEC 088569
RD Legal Capital, FAQ	RDLC-SEC 088590
RD Legal Capital, DDQ (March 2012)	RDLC-SEC 665141
RD Legal Capital, DDQ (2015)	RDLC-SEC 032239
RDLFP Subscription Documents (December 2014)	RDLC-SEC 593372
RDLFP Offering Memorandum (December 2011)	RDLC-SEC 000566
RDLFP Offering Memorandum (April 2012)	RDLC-SEC 084034
RDLFP Offering Memorandum (June 2013)	RDLC-SEC 047236
RDLFP & RDLFOF Presentation (August 31, 2011)	RDLC-SEC 172458
RDLFP 2008 Financial Statements	RDLC-SEC 066031
RDLFP 2009 Financial Statements	RDLC-SEC 065983
RDLFP 2011 Financial Statements	RDLC-SEC 002179
RDLFP 2013 Financial Statements	RDLC-SEC 004474
RDLFP Offering Memorandum (July 2007)	RDLC-SEC 939989
RDLFP Offering Memorandum (October 2008)	RDLC-SEC 065705
RDLFP Offering Memorandum (August 2009)	SECLIT-EPROD-000721099
Reed Smith – Analysis of the <i>Peterson v. Islamic Republic of Iran</i> Order and Opinion – DRAFT	RDLC-SEC 639682
Reed Smith – Analysis of the <i>Peterson v. Islamic Republic of Iran</i> Turnover Litigation	RDLC-SEC 624656
Reed Smith - Analysis of the Priority of Claimants in the <i>Peterson v. Islamic Republic of Iran</i> Turnover Litigation	RDLC-SEC 654801
RDLFP 2012 Financial Statements	RDLC-SEC 002257
Independent Accountant’s Report on Applying Agreed Upon Procedures 1Q2012	RDLC-SEC 928422
Independent Accountant’s Report on Applying Agreed Upon Procedures 2Q2012	RDLC-SEC 109718
Independent Accountant’s Report on Applying Agreed Upon Procedures 3Q2012	RDLC-SEC 045635
Independent Accountant’s Report on Applying Agreed Upon Procedures 1Q2013	RDLC-SEC 336684
Independent Accountant’s Report on Applying Agreed Upon Procedures 2Q2013	RDLC-SEC 045658
Independent Accountant’s Report on Applying Agreed Upon Procedures 3Q2013	RDLC-SEC 045669
Independent Accountant’s Report on Applying Agreed Upon Procedures 1Q2014	RDLC-SEC 040158
Independent Accountant’s Report on Applying Agreed Upon Procedures 2Q2014	RDLC-SEC 054559

Independent Accountant's Report on Applying Agreed Upon Procedures 3Q2014	RDLC-SEC 046179
Leo Zatta Deposition Transcript	SECLIT-EPROD-000026252
Plaintiff Receivables Sold at Fair Value	RDLC-SEC 046195
Espen Robak Deposition Transcript	SECLIT-EPROD-000005462
Yuanguo "Eric" Liu Deposition Transcript	SECLIT-EPROD-000026390
Reed Smith – Analysis of January 22, 2014 Clearstream – Treasury Department Settlement	RDLC-SEC 111141
Reed Smith – Analysis of the <i>Peterson v. Islamic Republic of Iran</i> Turnover Litigation	RDLC-SEC 624656
Reed Smith – Analysis of the <i>Peterson v. Islamic Republic of Iran</i> Order and Opinion	RDLC-SEC 638137
Reed Smith – Analysis of the Priority of Claimants in the <i>Peterson v. Islamic Republic of Iran</i> Turnover Litigation	RDLC-SEC 638182
Reed Smith – Analysis of the Appellees' Brief in <i>Peterson v. Islamic Republic of Iran</i>	RDLC-SEC 640922
Reed Smith – <i>Peterson v. Islamic Republic of Iran</i> Litigation – Appeal	RDLC-SEC 654780
Reed Smith – Update on <i>Peterson</i> Turnover Litigation and Implementation of the Iran Threat Reduction and Syria Human Rights Act of 2012	RDLC-SEC 654806
Reed Smith – Analysis of the Appellees' Brief in <i>Peterson v. Islamic Republic of Iran</i>	RDLC-SEC 716213
Alpha Generation and Process Presentation (December 2012)	SECLIT-EPROD-000000879
RDLC FAQ (January 2013)	SECLIT-EPROD-000000869
Fund Presentation (August 2011)	SECLIT-EPROD-000000869
Special Purpose Vehicle, Summary of Investment Opportunity (August 2012)	SECLIT-EPROD-000000869
Alpha Generation and Process Presentation (July 2014)	SECLIT-EPROD-000022476
Fund DDQ (September 2011)	SECLIT-EPROD-000007806
Special Opportunities Memorandum of Terms	SECLIT-EPROD-000007821
Special Purpose Vehicle, Summary of Investment Opportunity (August 2013)	SECLIT-EPROD-000022522
SPV Marketing Deck from Kat (September 2013)	SECLIT-EPROD-000000510
RDLC FAQ (July 2014)	SECLIT-EPROD-000007878
RDSL SOP Offering Memorandum (September 2013)	RDLC-SEC 000868
RDSL OOF Offering Memorandum (September 2013)	RDLC-SEC 075942
Pluris Portfolio Valuation Report (April 2015)	RDLC-SEC 190039
Pluris Portfolio Valuation Report (September 2014)	RDLC-SEC 193511
Pluris Portfolio Valuation Report (January 2014)	RDLC-SEC 201589
Pluris Portfolio Valuation Report (February 2013)	RDLC-SEC 205386
Pluris Portfolio Valuation Report (March 2013)	RDLC-SEC 205396
Pluris Portfolio Valuation Report (September 2013)	RDLC-SEC 205455
Pluris Portfolio Valuation Report (October 2013)	RDLC-SEC 205465
Order Instituting Proceedings	N/A

Response of RD Legal Capital	N/A
RDLC DDQ (December 2012)	RDLC-SEC 642268
RDLC DDQ (January 2014)	RDLC-SEC 642098
RDLC DDQ (July 2013)	RDLC-SEC 638220
RDLC DDQ (July 2014)	RDLC-SEC 645061
RDLC DDQ (June 2013)	RDLC-SEC 591561
RDLC DDQ (June 2014)	RDLC-SEC 592105
RDLC DDQ (March 2012)	RDLC-SEC 745339
RDLC DDQ (May 2014)	RDLC-SEC 631000
RDL Special Investments DDQ (2015)	RDLC-SEC 591779
RDLFP 2012 Subscription Agreement	RDLC-SEC 665109
RDLFP 2014 Financial Statements	RDLC-SEC 008555
RDLFP 2012 Financial Statements	RDLC-SEC 002257
RDLFP 2010 Financial Statements	RDLC-SEC 052879
RDLFP 2015 Financial Statements (Draft)	RDLC-SEC 269236
RDLFOF Administration Services Agreement (November 2015)	RDLC-SEC 940020
RDLFP Administration Services Agreement (November 2015)	RDLC-SEC 940027
RD Legal Capital, LLC Compliance Manual	SECLIT-EPROD-000003238
Roni Dersovitz Deposition Transcript (March 15, 2016)	SECLIT-EPROD-000019474
Roni Dersovitz Deposition Transcript (January 29, 2016)	SECLIT-EPROD-000026155
RDLFOF Offering Memorandum	RDLC-SEC 000868
RDLFP 2007 Financial Statements	RDLC-SEC 066018
RDLFOF 2007 Financial Statements	RDLC-SEC 065969
RDLC 2014 Consolidated Financial Statements	RDLC-SEC 014998
RDLFP 2015 Financial Statements (Audited)	RDLC-SEC 940034
Letter from R. Dillon re RDLF Policy & Procedure Changes (December 2008)	RDLC-SEC 943440
RDLFP Offering Memorandum (August 2015)	RDLC-SEC 700176
Markovic Testimony Transcript	SECLIT-EPROD-000013764
Pluris Retainer Agreement (June 2011)	RDLC-SEC 293882
RDLFP LPA (September 2011)	RDLC-SEC 665122
Fund Administration Services Agreement with Woodfield (June 2009)	SECLIT-EPROD-000854191
RDLC Valuation Policy (January 2016)	SECLIT-EPROD-000035707
Amy Hirsch Testimony Transcript	N/A
Nathan Anderson Testimony Transcript	N/A
Arthur Sinensky Testimony Transcript (Rough Draft)	N/A
Roni Dersovitz Testimony Transcript (Rough Draft)	N/A
Memorandum from Marcum re RD Legal Funding Partners, LP – Value of Loan Portfolio as of December 31, 2015	SECLIT-EPROD-000029304
Memorandum from Marcum re RD Legal Funding Partners, LP – Value of Loan Portfolio as of December 31, 2013	SECLIT-EPROD-000032928
Memorandum from Marcum re RD Legal Funding Partners, LP – Value of Loan Portfolio as of December 31, 2014	SECLIT-EPROD-000032948
Memorandum from Marcum re RD Legal Funding Partners, LP –	SECLIT-EPROD-000033005

Value of Loan Portfolio as of December 31, 2012	
Agreement for the Peterson §468B Fund Pursuant to 26 U.S.C. §468B	RDLC-SEC 937119
RD Legal Capital Valuation Policy (2014)	RDLC-SEC 056925
Plaintiff Receivables Sold at Fair Value	RDLC-SEC 046195
Email from L. Zatta to P. Wisard	RDLC-SEC 089657
Contracts with CCY and Cedars	RDLC-SEC 097816 – RDLC-SEC 098117
Barbara Laraia Testimony Transcript	N/A
Dennis Schall Testimony Transcript	N/A
Form ADV – Part 2A (April 2011)	SECLIT-EPROD-000012956

# APPENDIX C

## Annual Return Comparison – RDLFPLP vs. Selected Indices

### Oct 2007 – Dec 2016

Year	RDLFPLP <sup>[1]</sup>	Selected Hedge-Fund Indices <sup>[2]</sup>			Selected Market Indices <sup>[3]</sup>	
		HFRI Fund Weighted Composite Index	HFRI RV: Fixed Income-Asset Backed Index	HFRI ED: Distressed/Restructuring Index	S&P 500	Barclays Aggregate Bond Index
Oct 2007 – Dec 2007	3.22%	1.97%	-0.84%	-0.58%	-5.09%	2.89%
2008	13.50%	-21.37%	-3.42%	-25.20%	-37.58%	4.56%
2009	13.50%	11.47%	23.92%	28.14%	19.67%	6.49%
2010	13.50%	5.70%	12.95%	12.12%	11.00%	6.40%
2011	13.50%	-5.72%	6.01%	-1.79%	-1.12%	7.93%
2012	13.50%	4.79%	17.12%	10.12%	11.68%	4.45%
2013	13.50%	8.96%	9.91%	14.05%	26.39%	-1.81%
2014	13.50%	3.37%	8.69%	-1.39%	12.39%	5.89%
2015	13.50%	-0.27%	2.07%	-8.06%	-0.69%	0.32%
2016 <sup>[4]</sup>	13.50%	0.48%	4.94%	13.42%	11.24%	2.53%
Annualized Return	13.50%	0.56%	8.51%	3.34%	3.41%	4.25%
Total Cumulative Return	222.64%	5.35%	112.93%	35.51%	36.35%	46.96%
Standard Deviation <sup>[5]</sup>	0.00	0.10	0.08	0.16	0.18	0.03
Sharpe Ratio <sup>[6]</sup>		0.05	1.08	0.27	0.30	1.18
Market Index Correlation with RDLFPLP					0.20	0.12

Sources: RDLFPLP Financial Statements and Independent Accountants' Review Report, 2007–2015; Hedge Fund Research, Inc.; Datastream; Bloomberg

Note:

[1] RDLFPLP returns are net of non-overhead expenses and incentive-allocation compensation. The 2007–2015 RDLFPLP annual returns are based upon compounding 1.0609% monthly returns.

[2] Returns of HFRI indices are net of all fees.

[3] Returns of S&P 500 and Barclays Aggregate Bond Index are total returns.

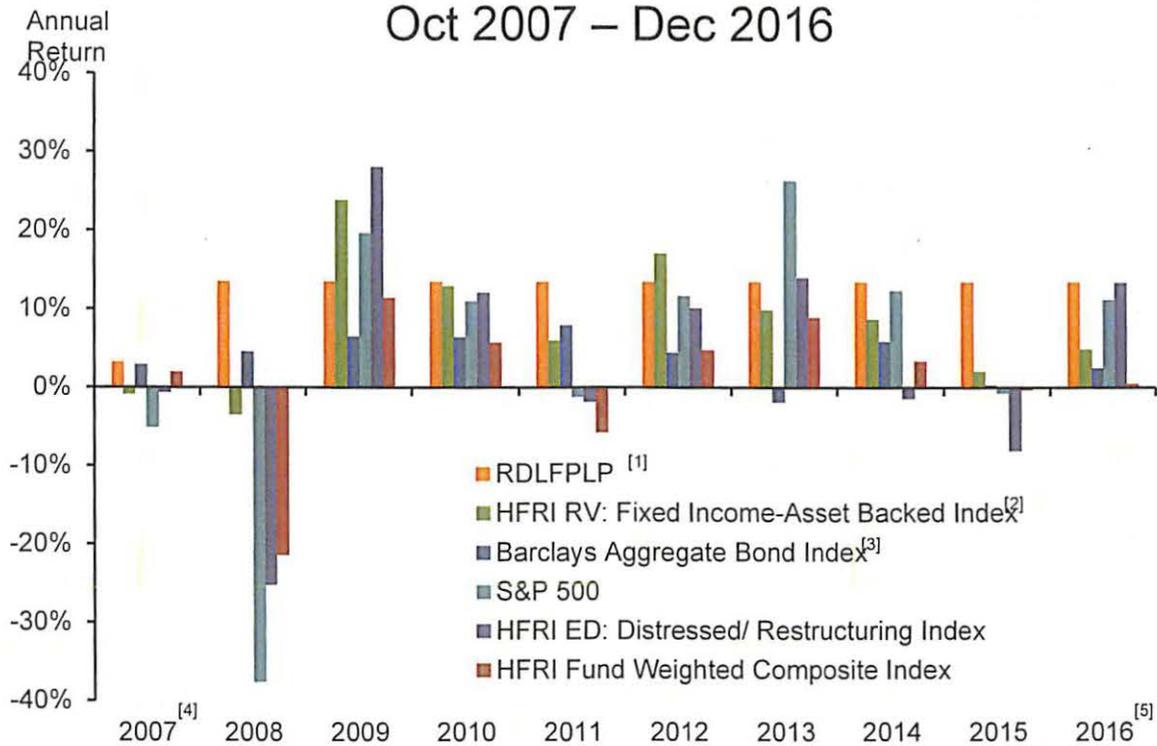
[4] 2016 RDLFPLP return based on client representation. 2016 index returns are estimates as of January 10, 2017.

[5] 2007 RDLFPLP and index returns are not included in standard deviation or Sharpe Ratio calculations.

[6] Sharpe Ratio equals average excess returns divided by the standard deviation of the excess returns. Excess returns are the difference between an index's annual returns and the average return for a 3-month treasury bill over the time period.

## Annual Return Comparison — RDLFPLP vs. Selected Indices

Oct 2007 – Dec 2016



Sources: RDLFPLP Financial Statements and Independent Accountants' Review Report, 2007–2015; Hedge Fund Research, Inc.; Datastream; Bloomberg

**Note:**

[1] RDLFPLP returns are net of non-overhead expenses and incentive-allocation compensation. The 2007–2015 RDLFPLP annual returns are based upon compounding 1.0609% monthly returns.

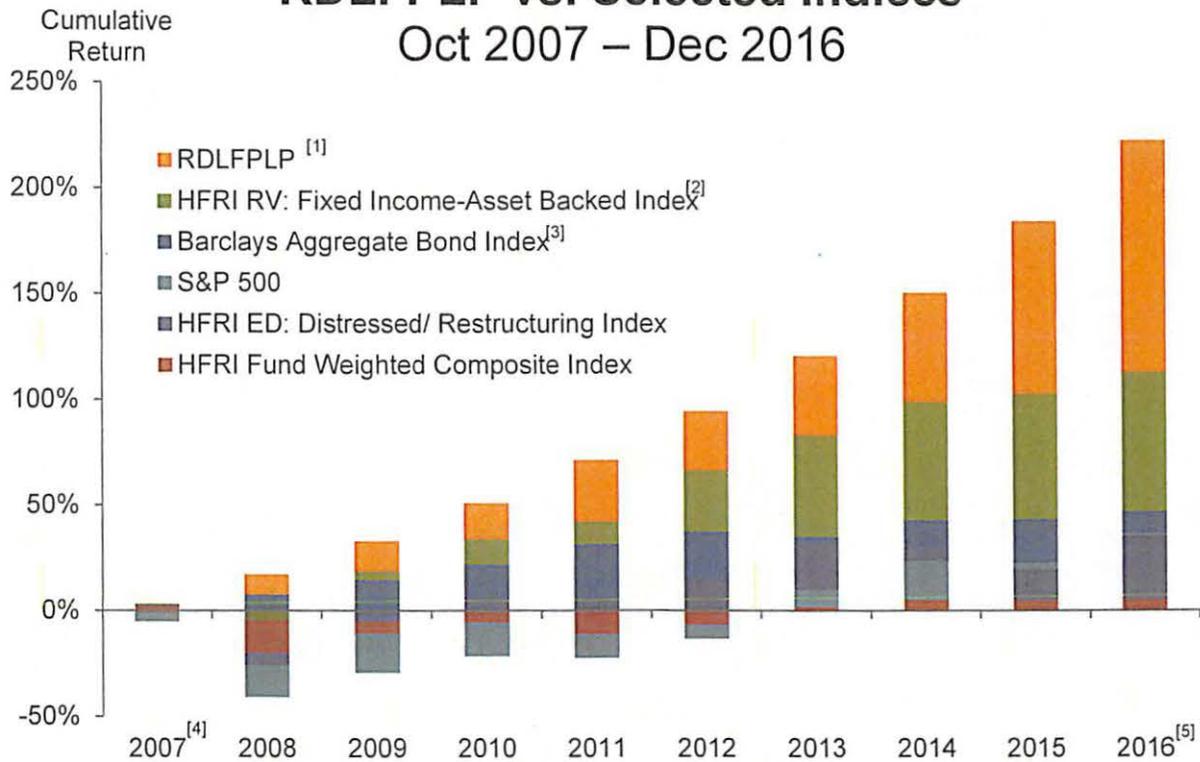
[2] Returns of HFRI indices are net of all fees.

[3] Returns of S&P 500 and Barclays Aggregate Bond Index are total returns.

[4] Only October through December 2007 data are included.

[5] 2016 RDLFPLP return based on client representation. 2016 index returns are estimates as of January 10, 2017.

## Annual Cumulative Return Comparison — RDLFPLP vs. Selected Indices Oct 2007 – Dec 2016



Sources: RDLFPLP Financial Statements and Independent Accountants' Review Report, 2007–2015; Hedge Fund Research, Inc.; Datastream; Bloomberg

**Note:**

[1] RDLFPLP returns are net of non-overhead expenses and incentive-allocation compensation. The 2007–2015 RDLFPLP annual returns are based upon compounding 1.0609% monthly returns.

[2] Returns of HFRI indices are net of all fees.

[3] Returns of S&P 500 and Barclays Aggregate Bond Index are total returns.

[4] Only October through December 2007 data are included.

[5] 2016 RDLFPLP return based on client representation. 2016 index returns are estimates as of January 10, 2017.

**CERTIFICATE OF SERVICE**

The undersigned certifies that the foregoing Expert Report of Leon M. Metzger was served on this 27<sup>th</sup> day of January 2017 by U.S. Postal Service on the Office of the Secretary and by electronic mail and U.S. Postal Service on the following counsel of record:

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