

Tilton, Patriarch Beat SEC Fraud Claims Over Zohar Funds

By Jack Newsham

Law360, New York (September 27, 2017, 5:03 PM EDT) -- Investment manager Lynn Tilton and her companies on Wednesday won dismissal of the U.S. Securities and Exchange Commission's allegations that they defrauded investors in several commercial debt funds, with an administrative law judge ruling the SEC failed to show alleged misconduct by Tilton and her company Patriarch Partners rose to the level of fraud.

The government accused Tilton of hiding the poor performance of three funds she ran, known as the Zohar funds, that invested in high-risk corporate debt so she could rake in \$208 million in ill-gotten gains. The SEC said she failed to disclose conflicts of interest and issued misleading financials, but Judge Carol Fox Foelak said Tilton didn't hide anything from the sophisticated banks and insurers that invested with her.

"While respondents did not maximize the ease of finding it, they also did not conceal — omit to state — material information such as the amount of interest actually being paid and the interest rate and principal on the portfolio companies' loans," the judge wrote.

The SEC accused Tilton and four of her companies in 2015 of violating the Investment Advisers Act by overvaluing the loans in the Zohar funds so they could rake in higher fees. The private, mid-sized companies in financial trouble whose loan payments were supposed to flow to Zohar investors often missed payments, but they were still categorized as performing, the feds said.

Tilton defended the practice, however, noting that the agreements that bound her and her firms gave her broad authority to adjust the terms of the loans. But even assuming that assets were miscategorized, Judge Foelak said, the true loan performance was available in reports given to Zohar investors. The relevant information might have been on different pages, but "the total mix" didn't omit or misrepresent any material facts, the judge found.

The securities watchdog had also accused the respondents of issuing financial statements that didn't comply with generally accepted accounting principles, but that in and of itself wasn't fraud, the judge found. The SEC would have had to show evidence of recklessness or knowledge of wrongdoing, which it didn't, the decision said.

Tilton had vigorously contested the legitimacy of the ALJ proceeding on constitutional grounds, filing her own suit against the SEC a month after it initiated proceedings against her claiming that its system of in-

house judges was unconstitutional. Although similar cases have resulted in clashing opinions from different appeals courts and appear headed for the U.S. Supreme Court, the high court declined to hear Tilton's case earlier this year.

A couple of decisions cut in the government's favor. The judge discarded Tilton's defense that she relied on her accountants, and snubbed her request to reconsider dozens of previous decisions. But with the court ultimately ruling in her favor, the famed investor and her lawyers hailed the decision and ripped the SEC in their statements.

"I have never been one to accept injustice or cower in the face of challenging obstacles, and I knew the truth would ultimately prevail," Tilton said. "I can only hope that this vindication will deter the future abuse of power that comes with government overreach."

"I am thrilled that she has now been fully cleared," said Susan Brune of Brune Law, who represents Tilton.

"We said all along that Lynn Tilton was innocent of these charges and had been wrongly accused and we'd prove it at trial, and that's exactly what we did," Randy Mastro of Gibson Dunn & Crutcher LLP, who also represents Tilton, told Law360. He said his client "has been through eight years of hell" but was vindicated by the decision.

A spokeswoman for the SEC declined to comment.

The commission is represented by its own Dugan Bliss, Nicholas Heinke, Amy Sumner and Mark L. Williams.

Tilton and the Patriarch companies are represented by Randy M. Mastro, Lawrence J. Zweifach, Barry Goldsmith, Caitlin J. Halligan, Reed Brodsky, Monica K. Loseman, Mark A. Kirsch and Lisa H. Rubin of Gibson Dunn & Crutcher LLP and Susan E. Brune of Brune Law PC.

The case is In the matter of Lynn Tilton et al., administrative file number 3-16462, with the U.S. Securities and Exchange Commission.

--Editing by Jack Karp.