UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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| SECURITIES AND EXCHANGE COMMISSION, Plaintiff, -against- YORKVILLE ADVISORS, LLC, MARK ANGELO and EDWARD SCHINIK, Defendants. | : | Civil Action No. 12 CIV 7728 (GBD) ECF CASE |

# MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS YORKVILLE ADVISORS, LLC, MARK ANGELO, AND EDWARD SCHINIK'S MOTION FOR SUMMARY JUDGMENT

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**TABLE OF CONTENTS**

**TABLE OF CONTENTS**
(continued)

**Page**

# TABLE OF AUTHORITIES

**Page(s)**

**CASES**

**STATUTES**



**OTHER AUTHORITIES**

# PRELIMINARY STATEMENT

After nine years of investigation and litigation, it is crystal clear that there is no fraud in this case. Defendants properly employed a highly subjective, judgment-laden process in valuing YA Global Investment L.P.'s ("YA Global" or the "Fund") unique, complicated distressed assets for which no market existed. Nevertheless, the SEC seeks to substitute its own erroneous judgment years after the valuation dates, in place of Defendants' subjective business judgment backed by contemporaneous audited fair value opinions derived in good faith by Yorkville Advisors LLC's ("Yorkville" or "YA") Valuation Committee and its third-party valuation consultants (Valuation Research Corporation ("VRC")), and reviewed and re-reviewed by the fifth largest auditing firm in the U.S. led by a highly experienced auditing team (McGladrey & Pullen LLP ("McGladrey")). Notwithstanding these inconvenient facts, the SEC pronounces this fraud. But the evidence tells a different story.

The SEC claims that the Defendants fraudulently derived values for 15 out of the Fund's approximately 265 hard-to-value portfolio positions; it makes no objection to the fair values that YA derived for the other 250 positions in the portfolio (though it somehow alleges that the entire portfolio is overvalued). But the record is devoid of any evidence to suggest a fraudulent valuation scheme, much less evidence of the sophisticated scheme that would be necessary to carry out fraudulent valuations in the amount of hundreds of millions of dollars. There is no evidence of conspiracy. There is no evidence of manipulation or cover-up. There is no evidence of anything other than a good faith process conducted by a Valuation Committee and its independent consultant, VRC, to derive valuation opinions that are appropriately subjective in nature. McGladrey's national risk department re-reviewed the 2008 and 2009 audits during the course of the SEC's investigation and determined that there was no evidence of fraud. Those audits remain intact, without restatement, to this day. The SEC cannot ask the Court to ignore this undisputed fact.

That the record does not contain evidence supporting the SEC's valuation claims is not surprising – Defendants know that they did not violate the law. What is surprising is that the SEC spent little effort in discovery on two issues that were of interest to the Court during oral argument at the motion to dismiss stage: the deficiency of the SEC's valuation fraud claims, and the SEC's unfounded allegations that Defendants had withheld from McGladrey alternate "valuations" derived by Pluris Valuation Advisors, LLC ("Pluris"). Instead of trying to prove its valuation fraud claim, the SEC retained an "expert" and asked him *not* to derive fair value opinions for the 15 allegedly mis-valued positions. This enforcement action cannot advance without *any* evidence to contradict the contemporaneous fair value opinions derived by YA or VRC, and reviewed and re-reviewed by its auditor, McGladrey. And if this purported "expert" testimony is excluded as it should be under *Daubert*, the SEC has no evidence that YA's valuations were wrong, much less the byproduct of a fraud scheme.

With respect to the SEC's claims concerning Pluris, at oral argument on Defendants' motion to dismiss, the SEC argued that YA concealed from McGladrey "valuation" reports prepared by Pluris, an independent consultant. The SEC led the Court to believe that Pluris had fair valued the Fund's convertible debenture portfolio "millions of dollars less" than the fair value placed by YA's Valuation Committee. But Pluris and McGladrey confirmed during discovery what they had already told the SEC before it initiated this action: that Pluris did not fair value the convertible debentures, did not provide any completed valuation reports, and never intended the draft reports it did prepare to be relied upon by McGladrey in auditing the Fund's financial statements. During the course of the SEC's pre-complaint investigation, McGladrey reviewed the Pluris materials and confirmed that they were not relevant and had no impact on McGladrey's audit of the Fund, and so there was no need to restate its prior audits. Thus, the SEC's sole basis for claiming objective falsity of YA's valuation opinions remains entirely discredited.

As for the SEC's fraudulent misrepresentation claims, in this protracted investigation and enforcement action, there is no evidence to suggest that Defendants ever made a knowingly false statement to an investor or potential investor or that they intended to deceive any investors or otherwise acted with scienter or even negligence. Tellingly, the U.S. investors who purportedly made the statements identified in the Complaint never contacted the SEC to complain about Angelo, Schinik, or anyone at YA, but instead were cold-called by the SEC during its investigation. The SEC did not seek to depose any of the foreign investors and prospective investors that were supposedly defrauded by the Defendants with false misrepresentations. The few investors who testified under subpoena by Defendants did not support the SEC's misrepresentation claims.

After eight years of investigation and discovery, the record mandates grant of summary judgment for Defendants.

## STATEMENT OF FACTS[1]

YA is an investment manager of YA Global, which provides specialty financing through a variety of unique structured products primarily in the form of lower-quality debt securities to financially-distressed, micro-cap, and small-cap publicly traded companies as well as private companies in a variety of sectors. Angelo is YA's President, Managing Member, and at all relevant times he was the Fund's portfolio manager. Schinik serves as YA's Chief Financial

[1] A complete summary of the relevant facts is contained in the accompanying Local Civil Rule 56.1 Statement of Undisputed Material Facts In Support of Defendants' Motion For Summary Judgment ("Def. 56.1 Statement").

Officer and Chief Operating Officer and is the Chair of YA's Valuation Committee. (Def. 56.1 Statement, ¶¶ 15, 17, 19.)

The Fund's investors and prospective investors were informed that YA's investment strategy was to focus on and negotiate deals with financially challenged companies, and they received thorough disclosures of the risks associated with that strategy. (*Id.* ¶¶ 45, 46, 263.) In addition, YA maintained robust, multi-level internal and external controls, which include: (1) using a Valuation Committee that did not include the portfolio manager (Angelo) to review and value the portfolio; (2) employing a Compliance Officer, even though one was not required; (3) engaging a well-respected independent auditing firm (McGladrey); (4) retaining outside valuation experts to assist in valuing certain parts of the Fund's portfolio; (5) sending monthly "one pagers" and quarterly letters to investors describing, among other things, the Fund's cash position; (6) providing investors with access to a "data room" containing additional information about YA and its investments; and (7) maintaining a Board of Directors, including a former SEC Commissioner. (*Id.* ¶¶ 47, 48, 55, 58, 59, 120, 138, 144, 173, 174.)

McGladrey conducted an annual review of the Fund's portfolio and the debt positions. It also reviewed the collateral underlying the investments and information that was publicly available about the portfolio companies. To assist with its audit, McGladrey was given full access to YA employees, including the bankers on various deals, the accounting group, and third parties, including Pluris, VRC, and the portfolio companies. McGladrey was also provided with necessary documents, including valuation memoranda that YA analysts or bankers had prepared on various deals. After months of review each year, McGladrey issued audits for the Fund for the years 2008 and 2009, both of which remain intact. (*Id.* ¶¶ 173, 176-181, 197.)

In August 2009, the SEC commenced an investigation concerning YA's valuation methodologies and application of those methodologies to its valuation of the Fund's assets. The SEC took sworn testimony from YA (including Angelo and Schinik), McGladrey, VRC, Pluris, and others during its investigation. As a result of the SEC investigation, McGladrey conducted extensive "supplemental procedures" to investigate the SEC's claims that YA had engaged in a "fraudulent scheme" to mis-value the portfolio and withhold information necessary for McGladrey to properly audit the Fund. McGladrey also re-reviewed its 2008 and 2009 audits. Following those extensive reviews, McGladrey determined not to issue a qualified or adverse opinion regarding the Fund's audits. The fact that McGladrey did not issue an adverse opinion means that it did not find evidence of a fraudulent scheme to materially inflate values of assets to improperly generate unearned fees. (*Id.* ¶¶ 198-221.)

The SEC's pre-Complaint investigation and discovery in this litigation all confirm that Angelo had no involvement whatsoever with valuation decisions at YA. It also confirms that Schinik, although the chair of the three-person Valuation Committee, could not, and did not, control, manipulate, or unduly influence the Valuation Committee process or its valuation opinions. And there is no record evidence of any YA employees discussing or contemplating a scheme to inflate values of Fund assets, delay write-downs, or consider fees or compensation in connection with forming their valuation opinions. (*Id.* ¶¶ 72-73, 77-78.)

Separate from the valuation claims, the SEC has alleged a handful of misrepresentations to individual investors, scattered about 2008 and 2009. The few investors deposed in this litigation – after Defendants, not the SEC, subpoenaed them – either deny or do not recall receiving the alleged misrepresentations, did not view them as misleading, or do not consider them material. There is no record evidence of any YA employees discussing or contemplating a plan or purpose to mislead investors. (*Id.* ¶¶ 240-48, 250, 254-55, 274, 301, 307, 312.)

The SEC filed its Complaint on October 17, 2012, asserting eight claims for relief for alleged violations of:

(a) Section 17(a) of the Securities Act (against all Defendants);

(b) Section 10(b) of the Exchange Act and Rule 10b-5 (all Defendants);

(c) control person liability under Section 20(a) of the Exchange Act (Angelo);

(d) Sections 206(1) and 206(2) of the Advisers Act (YA and Angelo);

(e) Section 206(4) and Rule 206(4)-8 of the Advisers Act (YA and Angelo);

(f) aiding and abetting liability under Section 10(b) of the Exchange Act and Rule 10b-5 (Angelo and Schinik);

(g) aiding and abetting liability under Sections 206(1) and 206(2) of the Advisers Act (Angelo and Schinik); and

(h) aiding and abetting liability under Section 206(4) and Rule 206(4)-8 of the Advisers Act (Angelo and Schinik).

## ARGUMENT

### I. APPLICABLE LEGAL STANDARDS

On a motion for summary judgment, "the burden is upon the moving party to demonstrate that no genuine issue respecting any material fact exists." *Gallo v. Prudential Residential Servs.*, *LP*, 22 F.3d 1219, 1223 (2d Cir. 1994). "When the burden of proof at trial would fall on the nonmoving party, it ordinarily is sufficient for the movant to point to a lack of evidence . . . on an essential element of the nonmovant's claim." *Cordiano v. Metacon Gun Club, Inc.*, 575 F.3d 199, 204 (2d Cir. 2009). "Where the moving party demonstrates 'the absence of a genuine issue of material fact,' the opposing party must come forward with specific evidence demonstrating the existence of a genuine dispute of material fact." *Brown v. Eli Lilly & Co.*, 654 F.3d 347, 358 (2d Cir. 2011) (internal citation omitted). "More specifically, it 'must do more than simply show that there is some metaphysical doubt as to the material facts' and 'may not rely on conclusory allegations or unsubstantiated speculation.'" *Id.* (internal citation omitted).

**A. Section 10(b) of the Exchange Act and Rule 10b-5**

To establish a violation of Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder, the SEC must prove that Defendants "(1) made a material misrepresentation or a material omission as to which he had a duty to speak, or used a fraudulent device; (2) with scienter; (3) in connection with the purchase or sale of securities." *SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 285 (2d Cir. 2013) (quoting *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999)), *cert. denied*, 134 S. Ct. 2896 (2014). "A failure of proof on any one of these . . . essential elements of plaintiffs' claims 'necessarily renders all other facts immaterial' and requires summary judgment in favor of defendants." *In re N. Telecom Ltd. Sec. Litig.*, 116 F. Supp. 2d 446, 455 (S.D.N.Y. 2000) (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986)).

To establish scheme liability under Rule 10b-5(a) or (c), the Commission must prove that each Defendant performed "an inherently deceptive act that is distinct from an alleged misstatement." *SEC v. Wey*, No. 15-cv-7116 (PKC), 2017 WL 1157140, *14 (S.D.N.Y. Mar. 27, 2017) (quoting *SEC v. Kelly*, 817 F. Supp. 2d 340, 344 (S.D.N.Y. 2011)); *see also Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005) ("[W]here the sole basis for such claims is alleged misrepresentations or omissions, plaintiffs have not made out a market manipulation claim under Rule 10b–5(a) and (c)."); *WPP Lux. Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011) (scheme liability possible only "when the scheme also encompasses conduct beyond those misrepresentations or omissions."). "Defendants must have participated in an illegitimate, sham or inherently deceptive transaction where their conduct or role had the purpose and effect of creating a false appearance." *Wey*, 2017 WL 1157140, *14 (quoting *SEC v. CKB168 Holdings, Ltd.*, 210 F. Supp. 3d 421, 445 (E.D.N.Y. 2016)).

**B. Section 17(a) of the Securities Act**

Section 17(a) largely parallels Section 10(b) of the Exchange Act, with the SEC required to establish "essentially the same elements . . . in connection with the offer or sale of a security." *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1567 (2d Cir. 1996). But "no showing of scienter is required for the SEC to obtain an injunction under subsections (a)(2) or (a)(3)" of Section 17(a). *Monarch*, 192 F.3d at 308; *see also SEC v. Ginder*, 752 F.3d 569, 574 (2d Cir. 2014) (explaining that "[s]cienter is not required to prove a defendant violated [Section 17(a)(2) or (a)(3)]" and that "[a] showing of negligence is sufficient.").

**C. Section 206 of the Advisers Act**

Section 206(1) of the Investment Advisers Act of 1940 (the "Advisers Act") prohibits investment advisers from "employ[ing] any device, scheme, or artifice to defraud any client or prospective client;" and section 206(2) prohibits investment advisers from "engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." 15 U.S.C. § 80b-6(1) & (2). Sections 206(1) and 206(2) have been interpreted as substantively indistinguishable from Section 17(a) of the Securities Act, except that Section 206(1) requires proof of fraudulent intent, while Section 206(2) simply requires proof of negligence by the primary wrongdoer. *See SEC v. Moran*, 922 F. Supp. 867, 896-97 (S.D.N.Y. 1996); *SEC v. PIMCO Advisors Fund Mgmt. LLC*, 341 F. Supp. 2d 454, 470 (S.D.N.Y. 2004).

Section 206(4) prohibits investment advisers from engaging in fraudulent, deceptive, or manipulative practices in interstate commerce. Rule 206(4)-8 thereunder prohibits investment advisers from making false statements of material fact to any investor or prospective investor in a pooled investment vehicle, or failing to state material facts necessary to make statements made to such investors not misleading. *See* 15 U.S.C. § 80b-6(4); C.F.R. § 275.206(4)-8. Thus, section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder are substantially the same as Sections 206(1) and 206(2), except that they apply to investment advisers of "pooled investments." *SEC v. Hansen*, No. 13-CV-1403 (VSB), 2017 WL 1298022, at *6 (S.D.N.Y. Mar. 31, 2017) (citing *SEC v. Rabinovich & Assocs., LP*, No. 07 Civ. 10547 (GEL), 2008 WL 4937360, at *4 (S.D.N.Y. Nov. 18, 2008)).

**D. Aiding and Abetting**

Liability for aiding and abetting under Section 10(b) requires a "showing that the defendant joined the specific venture and shared in it, and that his efforts contributed to its success, or in other words, . . . that the defendant consciously assisted the commission of the specific [violation] in some active way." *SEC v. DiBella*, 587 F.3d 553, 566 (2d Cir. 2009); *see also* 15 U.S.C. § 78(e). *Accord SEC v. Stanard*, No. 06 Civ. 7736 (GEL), 2009 WL 1960234, at *31 (S.D.N.Y. Jan. 27, 2009) ("Courts have been clear in requiring a showing of 'actual knowledge of the violation by the aider and abettor'"). Thus, the SEC must prove "(1) a primary violation of [Section 10(b)], (2) actual knowledge of the violation by the aider and abettor, and (3) that the aider and abettor substantially assisted the primary violation." *SEC v. Espuelas*, 579 F. Supp. 2d 461, 471 (S.D.N.Y. 2008). Proving substantial assistance requires showing "that the aider and abettor's conduct was a substantial causal factor in the perpetuation of the underlying violation." *Id.*

At least one Circuit has held that pre Dodd-Frank, the SEC was required to prove that an accessory had "knowledge of wrongdoing" – *i.e.*, a "general awareness . . . that his role was part of an overall activity that was improper." *SEC v. Washington Inv. Network*, 475 F.3d 392, 406 (D.C. Cir. 2007). Some courts, however, have taken the view that if the alleged aider and abettor owed a fiduciary duty to the defrauded party, then recklessness is enough. *See, e.g.*, *SEC v.*

*Landberg*, 836 F. Supp. 2d 148, 155 (S.D.N.Y. 2011). Recklessness is not merely heightened negligence; it represents an "extreme departure from the standards of ordinary care." *Stanard*, 2009 WL 196023 at *28; *see also Decker v. Massey-Ferguson, Ltd.,* 681 F.2d 111, 121 (2d Cir. 1982) (for recklessness to satisfy the scienter requirement, "[i]t must … approximate an actual intent to aid in the fraud").

## II. DEFENDANTS ARE ENTITLED TO SUMMARY JUDGMENT ON THE VALUATION CLAIMS

The core of the SEC's claim is that "Defendants engaged in a fraudulent scheme pursuant to which they reported false and inflated values" for certain securities instead of writing them down so that they could "increase the Funds' assets under management," "allowing Defendants to claim entitlement to greater fees than allowable." Compl., ¶ 1. But this case has none of the hallmarks of deception that would have been necessary to carry off a scheme to defraud investors to the tune of hundreds of millions of dollars of fraudulent NAV – which would have required defrauding one of the largest auditing firms in the country as well as a large independent third-party valuation consultant.

As the SEC's own enforcement staff recently noted, enforcement actions in federal courts concerning hard-to-value securities "generally involve scenarios where the investment adviser's conduct is more akin to furthering a fraudulent enterprise," that the SEC "faces high hurdles in" such cases, and that the SEC's "actions tend to focus on fairly egregious conduct."[2]

The SEC's recent valuation fraud prosecutions bear this out. For example, in *SEC v. Lee*, the SEC alleged that the defendant overvalued his book of hard-to-value assets "by fabricating bid/offer quotes" and feeding them to a third-party brokerage, which would unwittingly re-

[2] Salvatore Massa, *Outside a Black Box: Court and Regulatory Review of Investment Valuations of Hard-to-Value Securities*, 8 Wm. & Mary Bus. L. Rev. 1, p. 51 (2016) (law review article by an SEC attorney in the Division of Enforcement, Asset Management Unit).

submit them to employees at the defendant's employer who were responsible for verifying the defendant's trading position. 720 F. Supp. 2d 305, 318 (S.D.N.Y. 2010) (Daniels, J.). The defendant's "tactics became more elaborate" over time, including emailing from his home computer detailed grids of fabricated bids and offers to the third-party brokerage. *Id.* In *SEC v. Balboa*, a portfolio manager was shown to have inflated his hedge fund's assets by instructing co-conspirators to provide inflated values for warrants to an independent valuation agent to give the false appearance that the independent agent was providing the values to the fund.[3] In *SEC v. Lauer*, the SEC alleged that defendant orchestrated a manipulation of stock prices to inflate the value of private funds he managed, including purchasing large amounts of stock of shell companies with no operations, which drove the market price of the shares upward. No. 03-80612, 2008 WL 4372896, at *12-13 (S.D. Fla. Sept. 24, 2008). And in *Rockies Fund, Inc. v. SEC*, the court upheld an SEC administrative ruling against a defendant fund that "used an ad hoc process that mainly consisted of rubber-stamping [a director's] recommendations" to value restricted stock. 428 F.3d 1088, 1096 (D.C. Cir. 2005).

This case looks nothing like the others. There is no record evidence of falsified numbers, fake appraisals, plotting by co-conspirators to manipulate valuations, or anyone at YA improperly directing or influencing valuation decisions. There is no evidence that Schinik, Angelo, or anyone else instructed YA employees to deceive or hide material information from investors, auditors, or third-party valuation consultants. There is no evidence of *anyone* conspiring to delay or avoid write-downs or otherwise engage in any activity designed to fraudulently inflate Net Asset Value ("NAV"). Indeed, there is no evidence that the Valuation

[3] *See* Nate Raymond, Ex-Millennium Global Manager Gets Four Years In Prison Over Fraud, REUTERS, June 23, 2014, http://www.reuters.com/article/us-usa-crime-balboa-idUSKBN0EY2C520140623 (last visited on July 28, 2017); SEC Litigation Release No. 22176, *SEC Charges Hedge Fund Manager and Broker With Multi-Million Dollar Overvaluation Scheme* (Dec. 2, 2011), https://www.sec.gov/litigation/litreleases/2011/lr22176.htm (last visited on July 28, 2017).

Committee even considered impact on NAV when it made valuation decisions on any particular security. The record also is devoid of evidence to suggest anyone manipulated valuations to achieve higher fees for YA, to avoid redemptions, or for any other purpose. (*See* Def. 56.1 Statement ¶¶ 65-67, 73, 78, 114-19, 218.) Without admissible evidence of objective falsity, much less a scheme to falsify valuations, this case must be dismissed.

### A. YA Made No Material Misstatements In Reaching Fair Values Of The 15 Positions In Its Portfolio

Courts in this Circuit, including this Court, and others have consistently recognized that "valuing complex, illiquid instruments . . . is not a straightforward exercise." *Lighthouse Fin. Grp. v. Royal Bank of Scotland Grp., PLC*, 902 F. Supp. 2d 329, 345 (S.D.N.Y. 2012) (granting defendants' motion to dismiss) (Daniels, J.). There "is no one authoritative method of determining fair value, since valuing securities for which no current market exists involves the exercise of judgment, and is inherently imprecise." *In re Allied Capital Corp. Sec. Litig.*, No. 02 Civ. 3812 (GEL), 2003 WL 1964184, *1 (S.D.N.Y. Apr. 25, 2003).

As the Second Circuit has explained, "management's determination of the 'fair value' of the assets . . . [is not a] matter[] of objective fact" but rather subjective opinion. *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 110 (2d Cir. 2011) (affirming dismissal of complaint because plaintiffs insufficiently alleged that purported misstatements were false and that defendants believed them to be false when made). Accordingly, "liability for making a false statement of opinion may lie if either 'the speaker did not hold the belief she professed' or 'the supporting fact she supplied were untrue.'" *Tongue v. Sanofi*, 816 F.3d 199, 210 (2d Cir. 2016) (quoting *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318, 1327 (2015)); *see also Fait*, 655 F.3d at 110; *City of Omaha v. CBS Corp.*, 679 F.3d 64, 67-68 (2d Cir. 2012) (applying *Fait*'s reasoning to Section 10(b) claims); *Pirnik v. Fiat Chrysler Autos., N.V.*, No. 15-CV-7199

(JMF), 2016 WL 5818590, at *8 (S.D.N.Y. Oct. 5, 2016) (applying *Omnicare* and *Fait*, and holding that statements regarding reserves for product warranties and recalls are opinion). Liability may also lie if "the speaker omits information whose omission makes the statement misleading to a reasonable investor." *Tongue*, 816 F.3d at 210 (citing *Omnicare*, 135 S. Ct. at 1332). As this Court has specifically held, it does not suffice to allege "that Defendants should have known that their valuations were inaccurate." *Lighthouse Fin. Grp.*, 902 F. Supp. 2d at 345. Here, there is no record evidence to demonstrate falsity of any of YA's valuations.

#### 1. Valuations of the 15 Positions Were Not Objectively False or Subjectively Disbelieved and Did Not Omit Material Information

The Supreme Court and Second Circuit have "emphasized that meeting the standard" for proving valuation fraud "is no small task." *Tongue*, 816 F.3d at 210 (citing *Omnicare*, 135 S. Ct. at 1332). Reasonable investors "understand that opinions sometimes rest on a weighing of competing facts," and "a reasonable investor does not expect that *every* fact known to an issuer supports its opinion statement." *Id.* A statement of opinion "is not necessarily misleading when an issuer knows, but fails to disclose, some fact cutting the other way." *Id.* And an investor considers each statement "in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information." *Id.* (citing *Omnicare*, 135 S. Ct. at 1330).

As noted above at pp. 10-11, there is no record evidence of falsified numbers, an alternate set of books, plotting by co-conspirators to manipulate valuations, or anyone at YA (much less Schinik or Angelo) improperly directing or influencing valuation decisions. Instead, the record includes ample evidence demonstrating YA's good faith efforts to value its hard-to-value, Level III assets fairly. This is evidenced most directly by: (a) YA's use of independent third-party valuation consultants; (b) YA's robust valuation policies and procedures; and (c) the Fund's auditors performing detailed reviews of YA's valuation processes and signing off on the Fund's financials at the time of audit and again during a re-review during the course of the SEC's investigation.

(a) Independent Third-Party Valuation Consultants. In 2009, YA hired VRC, a large independent multi-national valuation consultant recommended by its auditor, to derive fair value opinions for certain portfolio positions, primarily private assets, that the Valuation Committee believed should be valued externally (the "VRC Valued Positions"). (Def. 56.1 Statement, ¶¶ 144-46.) Ultimately the Valuation Committee selected 12 portfolio positions for VRC to independently value in 2009. (*Id.* ¶ 147.) Five of those are among the 15 Positions at issue in this case. (*Id.* ¶ 148.)

The Valuation Committee tasked one of its experienced analysts, James Carr, with making sure that VRC received all information that it needed to provide fair value opinions. (*Id.* ¶¶ 149-50.) Carr had full authority to provide VRC with any information or documents relevant to VRC's valuation process, without need to seek advance approval from anyone at YA. Neither Angelo nor Schinik (nor anyone at YA) restricted or discouraged Carr or anyone else at YA from sending information or documents to VRC. Angelo, in fact, had no role in determining what body of information or documents were provided to VRC. (*Id.* ¶¶ 151-55.)

With YA's encouragement, VRC also sought and used information directly from sources other than YA, including the portfolio companies themselves and publicly available sources. (*Id.* ¶¶ 156-57.) In short, the VRC engagement was a robust valuation process. (*Id.* ¶¶ 159-61.) By December 2009, VRC was valuing approximately 65 percent of the Fund's portfolio in terms of dollar value of assets under management. (*Id.* ¶ 164.)

VRC produced valuation reports, which included VRC's discounted cash flow ("DCF") models, weighted average cost of capital ("WACC") calculations, competitor information, and various other analyses. (*Id.* ¶ 159.) VRC would provide a range of high, medium, and low fair value opinions for each VRC Valued Position – each of them representing fair value. (*Id.* ¶ 161.) Yet, the Valuation Committee took a conservative approach, adopting VRC's middle or low valuations. It did not use the high ones. (*Id.* ¶¶ 162-63.)

Certainly, for the 5 of the 15 Positions that YA valued based on VRC's valuation opinions, it would be inappropriate to find the valuation to be objectively false. *See SEC v. Lucent Techs., Inc.*, 610 F. Supp. 2d 342, 367 (D.N.J. 2009) (finding that most persuasive evidence in favor of granting summary judgment is that company's management, its outside auditor, and outside counsel approved of accounting decision); *In re REMEC Inc. Sec. Litig.*, 702 F. Supp. 2d 1202, 1251 (S.D. Cal. 2010) (summary judgment dismissal appropriate where defendant relied on staff accountants and outside auditors to prepare accurate financial reports). The mere fact that the SEC disagrees with YA's and the third-party valuation consultants' fair value determinations is insufficient to demonstrate falsity. *See In re Citigroup Inc. Sec. Litig.*, 753 F. Supp. 2d 206, 243 (S.D.N.Y. 2010) ("The mere allegation that some other company reached a different valuation is too vague to support the inference that Citigroup's valuation was incorrect.").

(b) <u>YA's Valuation Policies and Procedures</u>. YA employed robust valuation policies and procedures that complied with applicable accounting standards. (Def. 56.1 Statement ¶¶ 107-13.) YA's Valuation Committee included former SEC enforcement lawyers who have testified that they used fair and reasonable best efforts to come up with appropriate valuations. (*Id.* ¶¶ 57, 74.) The Committee met regularly and kept meeting minutes, gathered relevant information, derived fair valuations based on subjective opinions, and wrote down the value of its assets as appropriate during the relevant time period. (*Id.* ¶¶ 61-71, 74-76.) There is no evidence that YA delayed or avoided write-downs for any improper purpose. (*Id.* ¶ 78.)

The Fund's auditors agreed. McGladrey audited YA's valuation procedures and practices, expressed no concerns, and signed off on the 2008 and 2009 financials. (*Id.* ¶¶ 173-97.) In 2011, when YA hired a new auditing firm, Rothstein & Kass ("R&K"), to conduct its 2010 audit, McGladrey told the R&K audit partner "that there were no matters of [YA] management integrity." (*Id.* ¶ 220.) R&K, as part of its audit for 2010, reviewed McGladrey's 2009 work papers and determined that McGladrey "had performed proper procedures in accordance with GAAS" for the 2009 audit. (*Id.* ¶¶ 224-26.) Thus, even while under the cloud of the SEC's investigation, independent auditors reviewing YA's valuation policies and procedures found no cause for concern.

(c) <u>Auditor Review, Sign-off on Financials, and Rejection of SEC's Fraud Claim</u>. McGladrey was actively engaged to ensure that the Fund's 2008 and 2009 financial statements were presented fairly in accordance with generally accepted accounting standards ("US GAAS"). (*Id.* ¶¶ 173, 175.) As part of its audit procedures, McGladrey reviewed the collateral underlying the Hard-to-Value Assets, reviewed the Fund's portfolio companies' SEC filings, had direct access to the portfolio companies, and had full access to YA's analysts, bankers, and accounting personnel. (*Id.* ¶¶ 176-81.) It reviewed YA's entity level controls and concluded that none of the collected information indicated a potential risk of material misstatement of the financial statements. McGladrey gave special attention to the subject of valuation in its audit opinion of the Fund. (*Id.* ¶¶ 182-84.) It had full access to YA's third-party valuation consultants, Pluris and VRC; reviewed YA's valuation memoranda and documents relating to collateral; and tested the valuation opinions reached by the Valuation Committee. The audits spanned months.[4] (*Id.* ¶¶ 185-89.)

After the SEC began investigating YA and raised valuation concerns, McGladrey took extra steps to review the Fund's financials and YA's valuation procedures and practices, focusing on issues that the SEC raised as key to Defendants' supposed "fraudulent scheme." McGladrey's supplemental procedures, conducted from August 2009 through April 2012, included analysis of the collateral supporting YA's valuations and of YA's use of Pluris. (*Id.* ¶¶ 198-207.) McGladrey also had its national risk department (as opposed to the audit partner who ran the Fund's audits) conduct a re-review of the 2008 and 2009 audits. (*Id.* ¶¶ 208-09.)

McGladrey concluded that the Collateral Data Reports did not affect McGladrey's Audit Reports. (*Id.* ¶ 206.) McGladrey also concluded that YA's engagement of Pluris to determine fair values for the Fund's convertible debenture portfolio "was essentially a work in progress and did not affect the previously issued audit opinions." (*Id.* ¶ 207.) McGladrey never changed or withdrew its audit opinions or required any restatement. McGladrey also did not issue an adverse opinion stating that the Fund's financial statements did not present fairly, in all material respects, the Fund's financial position. (*Id.* ¶¶ 193-96, 211-18.)

McGladrey's independent determination to stand by the Fund's financial statements is determinative. "Had McGladrey found a 'fraudulent scheme,' [by YA] as asserted by the SEC in its Complaint in this matter, that would have materially 'inflated values' of assets to improperly generate 'more than $10 million in unearned fees,' the auditor would have had an obligation to

[4] McGladrey's testimony highlights that the audits were rigorous and were taken seriously. According to the Fund's audit partner at McGladrey, Jeffrey Yager, "Yorkville's audits were extremely complex and difficult" (Def. 56.1 Statement ¶ 221) and "[t]here was a significant amount of time that was spent on these audits in reviewing the documentation and all the audit information, books and records that were provided to us and going back and forth and questioning them, challenging them on a lot of different things." (*Id.* ¶ 189.) Moreover, "well over 95 percent of the investments [were] level three investments ranging – and these are distressed companies, probably the most difficult to value where it involves subjectivity, judgment and then the auditor having to make a determination as to whether those judgments are reasonable or not. It takes quite a bit of judgment." (*Id.* ¶ 192.)

issue an adverse opinion that the Fund's financial statements did not present fairly, in all material respects, the Fund's financial position." (Ex. 11,[5] Lundelius Report, ¶ 38; Def. 56.1 Statement ¶¶ 193-96.) By not issuing an adverse opinion, McGladrey affirmatively concluded that it had not found evidence of a fraudulent scheme. (*Id.*)

The SEC's allegations of objective falsity remain unsupported. Specifically, the SEC alleged that YA withheld certain information about Pluris from McGladrey, claiming falsely that "Pluris consistently calculated valuations at an amount less than Yorkville's own valuations," that "[e]ach of Pluris's 2008 reports showed total convertible valuations that were millions of dollars less than the total face value of the convertibles (and thus lower than the value that Yorkville calculated," that "Angelo was involved in the decision to terminate Pluris's convertible valuation engagement," and that "[i]f Angelo had provided Auditor with Pluris's actual valuation reports, the reports would not have supported the alleged 'reasonableness' of the Funds' fair value." Compl., ¶¶ 91-93. The Court wound up relying on those allegations to allow the SEC's otherwise deficiently plead Complaint to survive Defendants' motion to dismiss. *See* MTD Decision at p. 8. But the SEC knew when it filed its Complaint that these allegations were false. McGladrey, Pluris, and YA's employees all had testified under oath *before the SEC filed the Complaint* that:

- Pluris had never completed any valuations of the Fund's convertible portfolio and had never issued a final valuation report. (Def. 56.1 Statement ¶¶ 126-29, 285-87.) At best, Pluris had attempted to apply a pooled modeling approach that it used to value warrants to the Fund's convertible debenture portfolio – something Pluris categorized as an "attempt" or an "analysis" and specifically *not* a "full valuation analysis security by security" that would derive fair value. (*Id.* ¶ 125.)

- Pluris internally determined that even its attempt to apply the pool modeling approach to the Fund's convertible debenture portfolio *did not provide a fair value estimate*, because the pooled model approach was unable to capture all of the information

[5] Citations in this Memorandum of Law and in the accompanying Rule 56.1 Statement to "Ex. __" are references to Exhibits attached to the Declaration of Caryn G. Schechtman, filed July 28, 2017 in support of the instant motion.

necessary to even estimate the fair value of the Fund's convertible debenture portfolio. Pluris principal Espen Robak repeatedly testified to this. (*Id.* ¶¶ 126-29.)

- Pluris also advised the SEC that while its pooled modeling approach was tested for reliability as to its application to warrants, it was never tested – and could not be tested – for reliability as applied to a convertible debenture portfolio. (*Id.* ¶ 127.)

- YA believed at all times that Pluris had *not* provided it with valuations that reflected fair value. (*Id.* ¶ 130.)

- Angelo was not involved in any decision to terminate Pluris's convertible debenture valuation engagement, and the SEC had no basis for making this false allegation. (*Id.* ¶ 133.)

- McGladrey had conducted supplemental procedures during the course of the SEC investigation and testified under oath – before the SEC filed its Complaint – that it had concluded that the information provided by Pluris concerning YA's convertible debenture portfolio was not reliable or relevant and "was essentially a work in progress and did not affect the previously issued audit opinions." (*Id.* ¶¶ 207, 287.)

Knowing all of this, the SEC further perpetuated a fraud on the Court by allowing the Court at the motion to dismiss to operate under the misimpression that "[YA] went to Pluris, and asked Pluris to do a valuation of the funds, or the relevant entities. They did a low valuation. [YA] wanted a high valuation. So [YA] went to the auditors and gave them a different number that you pulled out of the air, simply because it sounds good. And there is no basis on which you came up with that number." (*Id.*, Ex. 129, MTD Transcript, 20:18-21:1.) To counter the Court's very specific questioning about the Pluris allegations, the SEC stated at oral argument that McGladrey did not restate its year-end 2009 audit after receiving all of the relevant information about Pluris during the course of the investigation because "many of the positions had already been marked down by other auditors," and "the need to do a restatement, for example, of the earlier years, was not necessary because they had already written down the values of those." (*Id.* at 36:16-21.) This was false, and the SEC knew that during the oral argument.

In truth, when McGladrey issued its report in April 2011 concerning YA's use of Pluris, the last-completed audit was for year-end 2009, which McGladrey signed off on in August 2010

(Ex. 54, Subsequent Event Memo; Ex. 13, 2009 Audited Financials). The year-end 2010 audit was not completed until October 2011 (by R&K). (Def. 56.1 Statement ¶ 225.) Thus, the SEC fabricated a rationale for why McGladrey concluded no restatement of the 2009 audit was warranted to conceal the real reason, which McGladrey had already confirmed to the SEC under oath: that Pluris's work was "not reliable or relevant" or material to the audit. (*Id.* ¶ 287.)

In addition to the fabricated Pluris allegations, the SEC also has tried to demonstrate falsity by claiming Angelo and Schinik knew the valuations were incorrect. But those allegations are unsupported or, in most cases, directly contradicted. Angelo was not on the Valuation Committee, did not influence valuation decisions, and was not involved in the valuation process at YA. (*Id.* ¶¶ 72-73.) As for Schinik, the Valuation Committee – not Schinik – set the valuations for the portfolio. There is no evidence to suggest that Schinik manipulated the Valuation Committee process or that he could influence valuation decisions more than any other member of the Committee. To the contrary, all committee members participated in the Committee's valuation decisions. (*Id.* ¶¶ 74-78.) In fact, of the three members of the Valuation Committee, Schinik had the least input at Valuation Committee meetings about the performance of any of the portfolio companies in the Fund. (*Id.* ¶¶ 99-104.)

In short, after years of investigation and litigation, the SEC can present no evidence of any false or fraudulent valuation. All the SEC can offer is its hindsight opinion on YA's valuation of 15 out of 265 highly subjective Level III securities (five of which were fair valued with assistance of VRC). This is insufficient as a matter of law to prove valuation fraud.

**2. The SEC Cannot Demonstrate Falsity Because it Cannot Quantify the Alleged Mis-Valuations**

To this day, neither the SEC nor its "expert" can identify the "correct" fair values for the 15 Positions, much less all of the approximately 265 positions in the Fund. As explained in

Defendants' Motion to Exclude Testimony of the SEC's Proposed Expert, filed on July 28, 2017 ("Def. Daubert Br."), the SEC's expert concedes that he did not do an independent valuation of any of the 15 Positions. (*See, e.g.*, Def. Daubert Br. at 8 (citing Berenblut Dep. Day 1, 118:5-6) ("I did not perform a separate valuation of the [15 Positions]").) And for the reasons set forth in the Daubert motion, this Court should exclude the SEC expert's testimony, especially any testimony in which he purports to opine that the Fund's valuations were overstated by a particular amount.

The SEC's failure to conduct a valuation of the 15 Positions precludes it from being able to quantify the alleged overvaluations. This failure to demonstrate the extent of the alleged overvaluation is fatal.[6] *See In re Allied Capital Corp.*, 2003 WL 1964184 at *4-5 (dismissing action where complaint "fails to allege what plaintiffs contend was the true valuation" and where "plaintiffs have not alleged the *extent* of any such overvaluation"); *Caiafa v. Sea Containers Ltd.*, 525 F. Supp. 2d 398, 411 (S.D.N.Y. 2007) (allegations that fail "to specify the amount by which the containers were overvalued, and at what times," are insufficient); *Schick v. Ernst & Young*, 141 F.R.D. 23, 27 (S.D.N.Y. 1992) (securities fraud complaint held "insufficient because it fails to allege the amount of the purported overstatement").

The decision in *SEC v. Mannion*, No. 1:10-cv-3374, 2013 WL 1291621, at *14 (N.D. Ga. Mar. 25, 2013), is instructive. In that case, the record showed that certain hedge fund assets were overvalued, but "[t]he record does not show the amount by which the convertible debentures and bridge loans were overvalued in any NAV." *Id.* at *12. The court granted summary judgment to

[6] SEC enforcement staff recently acknowledged this, noting that "one strand of cases treating valuation as entirely subjective and immune to most claims of fraud relates to situations where applicable accounting guidance provides wide latitude to the party valuing the security. . . . [I]n these situations, courts have ruled that it is *not enough for plaintiffs to show a variance in their approach to how a security should be valued--the plaintiff must also show the dollar impact of the variance*." Massa, *Outside a Black Box: Court and Regulatory Review of Investment Valuations of Hard-to-Value Securities*, pp. 43-44 (emphasis added).

the defendants "[a]bsent evidence of the extent of these overvaluations," holding that "[a] trier of fact cannot conclude that the overvaluations . . . based on the convertible debentures and bridge loans were material, and Defendants are entitled to summary judgment on the Commission's overvaluation claims based on these assets." *Id.* This case merits the same result. The SEC expert, assuming *arguendo* he was qualified, should be barred from offering any testimony about the fact or amount of any alleged overvaluation. The SEC's overvaluation claims must therefore fail as a matter of law.

**B. The SEC's Claim Fails Because There Was No Scienter**

To establish liability under Section 10(b) and Rule 10b-5, as well as Advisers Act Section 206(1), the SEC must "prove that the defendant acted with scienter, 'a mental state embracing intent to deceive, manipulate, or defraud.'" *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007) (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193-94 & n. 12 (1976)). At the summary judgment stage, the SEC "must produce evidence '(1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness.'" *Shenk v. Karmazin*, 868 F. Supp. 2d 299, 305 (S.D.N.Y. 2012) (quoting *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007)).

Defendants' motion must be granted because the SEC fails to "produce[] evidence from which a reasonable jury could infer that the defendant acted with the requisite scienter." *Shenk*, 868 F. Supp. 2d at 307; *see also Steed Fin. LDC v. Nomura Sec. Int'l, Inc.*, 148 F. App'x 66, 69 (2d Cir. 2005) (affirming summary judgment because plaintiff failed to provide sufficient evidence that would enable a jury to find the requisite scienter) (summary order); *Freedman v. Value Health, Inc.*, 135 F. Supp. 2d 317, 341-42 (D. Conn. 2001), *aff'd by*, 34 F. App'x 408 (2d Cir. 2002) (granting summary judgment on section 10(b) and rule 10b-5 claims where plaintiff failed to provide sufficient proof of scienter). This Court recognized from the start that the SEC's scienter allegations are scant, writing in its decision on Defendants' motion to dismiss that the Complaint "fails to allege that Yorkville's misrepresentations concerning collateral and the overvaluation of seven of their investments[7] were material and made with scienter or negligence." (MTD Decision at p. 8.) Nevertheless, the SEC pleaded for a chance to take discovery despite the Court's reservations. (Ex. 129, MTD Transcript, 68:15-69:12.) Four years of discovery have further gutted the SEC's ability to prove scienter. There is no email, document, or piece of testimony that suggests that YA, Schinik, or Angelo acted with intent to derive false or unfair valuations. There is no evidence that suggests that Angelo derived valuations at all.[8]

#### 1. Defendants Had Neither Motive Nor Opportunity to Commit Fraud

Motive requires showing "concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures." *Kalnit v. Eichler*, 264 F.3d 131, 139 (2d Cir. 2001) (internal quotations omitted); *SEC v. Treadway*, 430 F. Supp. 2d 293, 331 (S.D.N.Y. 2006) ("This potential gain must be a 'concrete and personal benefit to the individual defendants resulting from the fraud' beyond desire for the corporation to appear profitable or desire to keep stock prices high to increase officer compensation.") (citing *Kalnit*, 264 F.3d at 139); *see also Chill v. Gen. Elec.*, 101 F.3d 263, 268 (2d Cir. 1996) ("The motive to maintain the appearance of corporate profitability, or of the success of an investment, will naturally involve benefit to a corporation, but does not 'entail concrete benefits.'"). The "motive" showing is generally met when corporate insiders allegedly make a misrepresentation in order to sell their own shares at a

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[7] At the time of the Court's decision, the SEC had attempted to allege fraud only as to the 7 Positions.

[8] As noted above, scienter is not required to establish a violation of Section 206(2). A finding of willful negligence suffices. Nevertheless, Defendants' conduct as evidenced by the record also is insufficient to sustain any finding that Defendants acted negligently. As a result, summary judgment should also be granted to Defendants on Section 206(2).

profit. *Novak v. Kasaks*, 216 F.3d 300, 308 (2d Cir. 2000). Opportunity entails "the means and likely prospect of achieving concrete benefits by the means alleged." *Id.* at 307.

The SEC alleges motive based on YA's fee structure, under which "Yorkville received a Management Fee of 2% of the net worth of each fund," and under which "the Funds paid an incentive fee of 20% of their net income (including net unrealized gains), of which 70% was paid to Angelo." Compl., ¶¶ 23 & 24. The SEC argues that "Defendants employed a fraudulent scheme to increase Yorkville's net worth, and thus the fees it charged . . . ." Compl., ¶ 25. The SEC's theory, based on generalized incentives, is inadequate to prove scienter.

**a. Insufficient Evidence of Motive and Opportunity by Angelo**

The SEC's motive allegations focus exclusively on Angelo's compensation incentives. The SEC claims that Defendants mis-valued 7-to-15 assets out of approximately 265 so that Angelo would profit from the increased fees he would ostensibly receive as majority owner of YA. But this theory of scienter is fatally flawed. The "desire to earn management fees is a motive generally possessed by hedge fund managers, and as such, does not suffice to allege a 'concrete and personal benefit' resulting from fraud. To accept a generalized allegation of motive based on a desire to continue to obtain management fees would read the scienter requirement out of the statute." *Edison Fund v. Cogent Inv. Strategies Fund, Ltd.*, 551 F. Supp. 2d 210, 227 (S.D.N.Y. 2008) (internal citation omitted); *Kalnit*, 264 F.3d at 139-42 (general allegations about a desire to be compensated did not sufficiently allege scienter); *In re Loral Space & Commc'ns Ltd. Sec. Litig.*, No. 01 Civ. 4388 (JGK), 2004 WL 376442, at *6 (S.D.N.Y. Feb. 27, 2004) ("Motives generally possessed by most corporate directors and officers do not suffice."); *In re Refco Inc. Sec. Litig.*, 503 F. Supp. 2d 611, 645 (S.D.N.Y. 2007) ("the mere desire to increase officer compensation or stock prices does not give rise to a 'strong inference' of fraudulent intent because such desires are omnipresent"). This Court has taken a similar view, holding in *Lighthouse* there was no strong inference of scienter based on allegations that incentive-based compensation provides financial motive to delay taking impairment charges. *Lighthouse Fin. Grp.*, 902 F. Supp. 2d at 340. Beyond generalized financial incentives, the SEC can present no evidence to support fraudulent motive by Angelo.

As for opportunity, the SEC cites Angelo's status as a majority owner of YA, but that too is insufficient. Courts are clear that a defendant's executive position alone does not establish scienter. *See Police & Fire Ret. Sys. of Detroit v. SafeNet, Inc.*, 645 F. Supp. 2d 210, 234-35 (S.D.N.Y. 2009) (scienter cannot be inferred "solely from the fact that, due to the defendants' board membership or executive managerial position, they had access to the company's internal documentation as well as any adverse information," and/or "based only on allegations related to the [board] Committee's title and job responsibilities"). Based on little more than the fact of Angelo's position, the SEC then offers scattered allegations that Angelo *knew* about valuation misconduct. For example, the SEC has claimed that Angelo knew that information provided to McGladrey regarding valuation was false, but those allegations were and remain unsupported. Every witness, and every document, evidences that Angelo was not involved in YA's valuation process. (Def. 56.1 Statement ¶¶ 72-73.) There is no evidence to the contrary. He attended no Valuation Committee meetings, was not consulted and did not opine on valuation determinations, did not change or influence valuation decisions (and had no authority to do so), had no role in deciding what information was provided to McGladrey, did not participate in discussions with McGladrey concerning valuation decisions, and he was not involved in valuation decisions by YA's third-party valuation consultants. Angelo also did not set limits or quotas on write-downs, and he did not instruct anyone at YA to withhold information from the Valuation Committee, auditors, or third-party valuation consultants or become aware at any time (including to date) that anyone at YA withheld material information from the Valuation Committee, auditors, or third-party valuation consultants. (*Id.* ¶¶ 72-73, 133, 153-54.)

**b. Insufficient Evidence of Motive and Opportunity by Schinik**

The SEC has not alleged (in the Complaint or in opposing Defendants' motion to dismiss) that Schinik had motive or opportunity to commit fraud, aside from noting his membership on the Valuation Committee (while ignoring the other members). As with Angelo, job title or position alone is not enough to prove scienter. *See SafeNet*, 645 F. Supp. 2d at 234-35.

Schinik never had an ownership interest in YA, did not stand to profit from YA's incentive-based fees, and neither his salary nor his bonus (nor those of the other Valuation Committee members) were based on the amount of management fees or incentive fees earned by YA. His compensation was not tied to the Fund's performance. (Def. 56.1 Statement ¶¶ 21-23, 60.) Moreover, the Valuation Committee – not Schinik – set the valuations for the portfolio. (*Id.* ¶¶ 61-71, 74-119.) And committee member David Fine – not Schinik – knew much more about the investments and advised the Valuation Committee on them for consideration in deriving valuations. (*Id.* ¶¶ 99-102.) There is no evidence to suggest that Schinik manipulated the Valuation Committee process or that he could (or did) influence valuation decisions more than any other member of the Committee. (*Id.* ¶¶ 77-78.) To the contrary, the evidence shows that the Valuation Committee members all provided information for the committee to consider and had input into the Committee's valuation opinions. (*Id.* ¶¶ 61-71, 74-119.) The SEC is unable to demonstrate motive and opportunity as to Schinik.

### 2. The SEC Fails to Present Sufficient Evidence of Conscious Misbehavior or Recklessness

Conscious misbehavior or recklessness is demonstrated by conduct that is "highly unreasonable" and "represents an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *Kalnit*, 264 F.3d at 142 (quoting *Honeyman v. Hoyt* (*In re Carter-Wallace Sec. Litig.*), 220 F.3d 36, 39 (2d Cir. 2000) (internal quotations omitted)); *see also Treadway*, 430 F. Supp. 2d at 331. An "egregious refusal to see the obvious, or to investigate the doubtful" can also establish recklessness. *Novak*, 216 F.3d at 308; *Chill*, 101 F.3d at 269. To survive summary judgment, the SEC must provide: (1) admissible evidence that Defendants were aware of facts or had access to information contradicting their public statements and thus that they knew or should have known they were misrepresenting material facts related to YA; or (2) facts demonstrating that Defendants failed to review or check information that they had a duty to monitor, or ignored obvious signs of fraud. *See Novak*, 216 F.3d at 308. In such situations, however, the conduct must still rise to the level of "highly unreasonable or extreme misconduct, rather than simply to mere deviations from standards of ordinary care." *In re Livent, Inc. Noteholders Sec. Litig.*, 151 F. Supp. 2d 371, 422 (S.D.N.Y. 2001) (citing *Novak*, 216 F.3d at 309). It is insufficient to allege that Defendants "ought to have known." *Hart v. Internet Wire, Inc.*, 145 F. Supp. 2d 360, 368 (S.D.N.Y. 2001) (internal quotations omitted).

This case has no signs of egregious misconduct or scheme activity, like manipulation of stock prices or information to inflate the value of individual positions,[9] ignoring quoted market

[9] *See, e.g.*, *Lauer*, 2008 WL 4372896 at *12-13 (alleging that defendant orchestrated a manipulation of stock prices to inflate the value of privates funds he managed, including purchasing large amounts of stock of shell companies with no operations, which drove the price of the shares upward).

prices for securities that have an active market,[10] or soliciting sham quotes from brokers to justify inflated valuations.[11] And there is no evidence showing YA or any individuals scheming to mis-value positions, ignoring or concealing red flags about the portfolio, or conspiring or instructing anyone to hide information. Instead, the evidence shows that:

- YA's Valuation Committee met regularly and kept minutes of their meetings; gathered relevant information; considered the portfolio in good faith, deriving fair valuations based on its subjective opinions; and wrote down the value of its assets as appropriate during the relevant period (Def. 56.1 Statement ¶¶ 61-71, 74-76);

- the Valuation Committee operated at all times independent of and without any direction from or review or control by Angelo (*id.* ¶¶ 73, 153-54);

- by design, the Valuation Committee included individuals with significant compliance and securities law or regulatory experience, including YA's Chief Compliance Officer, two former SEC enforcement lawyers, and a former director in the equity compliance department at UBS (*id.* ¶¶ 55-58);

- no one person controlled the Valuation Committee's decisions or otherwise set the valuations of YA's portfolio (*id.* ¶¶ 74-76);

- YA hired third-party valuation consultants to help value portions of the portfolio that it believed it could not value internally (*id.* ¶¶ 120-64);

- YA empowered and encouraged the third-party valuation consultants to obtain information directly from the portfolio companies and other sources, in addition to information that YA provided (*id.* ¶¶ 154-57);

- the Valuation Committee corrected its third-party valuation consultant, Pluris, when it thought it was valuing YA's warrant portfolio too high (*id.* ¶ 121);

- YA avoided taking the "high range" of valuation numbers provided by its third-party valuation consultant, VRC, and opted for the more conservative "middle range" or low valuation numbers despite the fact that VRC considered the "high range" within the range of fair value (*id.* ¶¶ 161-62); and

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[10] *See, e.g.*, SEC Litigation Release No. 18432, *SEC Charges Former Hedge Fund Manager Edward Strafaci for Fraudulent Valuation* (Oct. 29, 2003), https://www.sec.gov/litigation/litreleases/lr18432.htm, and complaint, https://www.sec.gov/litigation/complaints/comp18432.htm (announcing charges relating to the Lipper convertible hedge funds) (last visited on July 28, 2017).

[11] *See, e.g.*, SEC Press Release No. 2016-119, *Hedge Fund Managers and Former Government Official Charged in $32 Million Insider Trading Scheme* (June 15, 2016), https://www.sec.gov/news/pressrelease/2016-119.html (announcing charges relating to Visium Asset Management LP) (last visited on July 28, 2017).

- YA's valuation policies complied with applicable accounting standards (*id.* ¶¶ 107-13).

Moreover, McGladrey engaged in an extensive detailed audit process, gave special attention to valuation issues in its audit opinion (*id.* ¶¶ 182-84), and signed off on the financials for 2008 and 2009 (*id.* ¶¶ 173, 175). McGladrey then had its risk management team specifically review financials and prior audits in light of the SEC's allegations, and it determined that its previously issued opinions did not need to be changed, withdrawn, or restated. Nor did it issue an adverse opinion. (*Id.* ¶¶ 198-207.)

The facts concerning McGladrey's extensive review and sign-off, alone, demonstrate that YA's valuation activities did not involve an extreme departure from standards of ordinary care. Courts have recognized that an outside auditor's approval significantly undermines a showing of scienter. *See In re REMEC*, 702 F. Supp. 2d at 1251 (dismissing claims against company and CFO in light of auditor's approval); *Lucent*, 610 F. Supp. 2d at 367 (dismissing civil enforcement action); *In re Alamosa Holdings, Inc. Sec. Litig.*, 382 F. Supp. 2d 832, 854 (N.D. Tex. 2005) (dismissing action where Complaint did not allege facts to contradict the approval of the financial statements by outside auditor). It strains reason that with such a lucid process – much of it taking place during the SEC's investigation – any highly unreasonable or extreme misconduct would go undetected and persist as the SEC alleges.

The Complaint alleges that some of the "mis-valued" 15 Positions were valued at face value, which apparently is supposed to insinuate some further suggestion of fraud or impropriety. Compl., ¶ 42. But this allegation is wholly consistent with YA's represented valuation methodology before July 2008, which considered the face value or "cost" of the convertible debenture – the only actual trading value input available – as a ceiling for valuation. Compl., ¶ 34 ("From the time of its inception until July 2008, Yorkville based the value of the Funds' convertibles . . . at 'the lower of cost or impaired' [which] . . . approximated fair value in the aggregate . . . ."). YA told its investors that the convertible debenture portfolio was consistently valued at the lower of cost or impaired – meaning that YA recognized unrealized losses but not unrealized gains based upon the immediate ability to convert and trade the debenture in the market. (Def. 56.1 Statement ¶¶ 80-81, 277 n.6, 280.) After July 2008, at its auditor's request, YA changed its methodology to allow for valuations above face value. (*Id.* ¶ 82.) Thus, the fact that YA continued to carry some of the Fund's positions at "face value" or cost would not have been a red flag to YA or its auditor, would not have been an indication of an erroneous "fair value," and does not give rise to an inference of scienter.[12] To the contrary, it was a conservative approach to valuing convertible debentures that YA believed it would be able to monetize. Using this conservative valuation approach for the 15 Positions, in a manner consistent with YA's standard valuation strategy recognized by its auditor and applied to the entire portfolio, in no way represents an "extreme departure from standards of ordinary care." *SEC v. McNulty*, 137 F.3d 732, 741 (2d Cir. 1998). Moreover, because these valuations do not deviate from the Valuation Committee's application of its valuation policy, it cannot constitute "[a]n egregious refusal to see the obvious, or to investigate the doubtful." *Id.*

In light of the overwhelming evidence of the Defendants' good faith efforts to value the 15 Positions fairly, and the SEC's failure to identify sufficient contrary evidence, there remains no material issue of fact as to Defendants' lack of fraudulent intent. Moreover, it bears noting that the SEC's claim of "overvaluation" still is based, at most, on 15 out of 265 positions. (Def. 56.1 Statement ¶¶ 12, 14, 24.) The fact that the SEC's suit rests largely on a small subset of

[12] Before the SEC filed its Complaint, McGladrey confirmed under oath that carrying positions at cost was not a red flag, and it specifically rejected the SEC's insinuation that YA "just automatically reverted to cost" in violation of Statement of Financial Accounting Standards 157 ("SFAS 157"). McGladrey noted that YA went through its valuation procedure, and cost could be deemed to be fair value. (Ex. 47, Yager Jan. 2011 Tr., 144:7-25.)

positions further undercuts any inference that Defendants acted with intent to falsely inflate valuations and defraud investors. *See Int'l Fund Mgmt., S.A. v. Citigroup Inc.*, 822 F. Supp. 2d 368, 385 (S.D.N.Y. 2011) (ability to allege scienter as to fraction of portfolio assets insufficient to allege scienter as to overvaluation of all portfolio assets); *City of Monroe Emps. Ret. Sys. v. Hartford Fin. Servs. Grp., Inc.*, No. 10 Civ. 2835 (NRB), 2011 WL 4357368, at *17-18 (S.D.N.Y. Sept. 18, 2011) (allegation that defendants overvalued certain assets and therefore must have overvalued other assets was insufficient to establish scienter).

**a. No Conscious Misbehavior or Recklessness by Angelo**

The SEC complains that "Defendants engaged in a fraudulent scheme pursuant to which they reported false and inflated values" for certain securities instead of writing them down so that they could "increase the Funds' assets under management," "allowing Defendants to claim entitlement to greater fees than allowable." Compl., ¶ 1. Angelo could not possibly have been a part of a scheme to report false and inflated values for the 15 Positions, however, because there is no evidence in the record to suggest that he was ever involved whatsoever in their valuation.

The naked assertion in the Complaint that Angelo "knew that many of the Funds' largest positions could not support their face values because Yorkville employees apprised him of the positions' poor performance," and that Angelo "accepted and utilized" the valuations set by the Valuation Committee is therefore unsupportable. Compl., ¶ 41. Without evidence of the fundamental issue of Angelo's conscious disregard, knowledge of, or participation in some fraudulent scheme with Valuation Committee members to delay or avoid mark downs or derive false valuations for the purpose of inflating fees, the SEC cannot sufficiently support a claim that Angelo's acceptance and use of the valuations set by the Valuation Committee violates any federal securities law. Indeed, the record evidence is to the contrary. The Valuation Committee members each independently testified that they believed that they engaged in a good faith process designed to derive fair valuations and that they did not falsely value any of the Fund's positions. (Def. 56.1 Statement ¶¶ 74-76, 93.) And McGladrey issued clean audits for each year in question, determining that they should remain intact even after conducting a re-review during the course of the SEC's investigation. (*Id.* ¶¶ 173-222.) Angelo's acceptance and use of valuations set by the Valuation Committee – which he had no authority to override or reject – and verified by McGladrey is no evidence of fraud.

Similarly, the Valuation Committee members all consistently testified that they regularly obtained information for use in valuation decisions directly from the same employees that the SEC vaguely claims were apprising Angelo of the "positions' poor performance" (Compl., ¶ 41). (*See* Def. 56.1 Statement ¶¶ 94, 97, 100, 103.) But there is no record evidence that Angelo instructed employees to hide negative information about portfolio positions from Valuation Committee members, or that he knew of or consciously disregarded anyone hiding negative information from the Valuation Committee. Again, to the contrary, the evidence shows that the Valuation Committee regularly reviewed and considered negative information about portfolio positions, received directly from the employees tasked with day-to-day management of the portfolio positions. (*Id.* ¶ 97.) And the Valuation Committee would write down portfolio positions as a result of this information. (*Id.* ¶¶ 105-06.) The SEC's effort to implicate Angelo in a supposed fraudulent valuation scheme remains unsupported.

#### b. No Conscious Misbehavior or Recklessness by Schinik

The SEC likewise is unable to present admissible evidence demonstrating recklessness by Schinik. As detailed above, Schinik was a member of the Valuation Committee but did not control, manipulate, or contravene it. (*Id.* ¶¶ 74-78) In fact, his role with the committee was rather ancillary compared to the uncharged members of the Valuation Committee. David Fine (a former SEC enforcement attorney), not Schinik, was much more aware of the portfolio investments given his roles on the Investment Committee and as an in-house lawyer for YA. Fine was responsible for understanding the business terms of YA's investments in portfolio companies and preparing legal documents that reflected those terms. It was Fine's practice to share with the other members of the Valuation Committee relevant information that he learned at Investment Committee meetings, so they could consider the information in connection with the valuation process. (*Id.* ¶¶ 99-102.) Gerald Eicke, who supervised YA's bankers, also had detailed information about the portfolio positions which he presented to the Valuation Committee. (*Id.* ¶ 103.) Unlike Fine and Eicke, Schinik was not able to provide "specific information on the status of companies" at Valuation Committee meetings, but he was able to provide current information on payment history and conversion history. (*Id.* ¶ 104.)

Likewise, there is no evidence of Schinik (or anyone) recklessly misrepresenting valuation-related issues to investors or McGladrey, or of Schinik asking others to do so. (*Id.* ¶¶ 78, 221.) And the transparency of the valuation process within the company and with third parties made it virtually impossible for Schinik to engage in any conscious misbehavior or recklessness.

Any quibbles the SEC has raised concerning valuation methods, or Pluris's role, are readily undercut by McGladrey's independent determinations to sign off on the 2008 and 2009 financials, and to stand by those opinions even after the re-review that the SEC prompted during its investigation.

### 3. There is Insufficient Evidence to Impute Scienter to the Company

Summary judgment must also be granted as to the Company because a corporate defendant's scienter is "necessarily derived from its employees," and there is no genuine dispute as to any material fact suggesting that Angelo or Schinik acted with scienter. *In re REMEC*, 702 F. Supp. 2d at 1259 (quoting *In re Marsh & McLennan Cos. Sec. Litig.*, 501 F. Supp. 2d 452, 481 (S.D.N.Y. 2006)); *In re Monster Worldwide, Inc. Sec. Litig.*, 549 F. Supp. 2d 578, 583 (S.D.N.Y. 2008) (accord). In *In re REMEC*, the court granted a corporate defendant's motion for summary judgment on a claim under Section 10(b) and Rule 10b-5, because there were "no extraordinary circumstances to justify holding [the company] liable when the executives [had] been granted summary judgment on scienter." 702 F. Supp. 2d at 1259. The court noted that "[i]n most cases, when there is no evidence that an individual acted with intent to commit securities fraud, the corporate entity is not liable." *Id.* (citing *Teachers Ret. Bd. v. Fluor Corp.*, 654 F.2d 843, 853 (2d Cir. 1981) (granting summary judgment to corporation where the record contained no evidence that any officer acted with scienter). So, too, here.

## III. DEFENDANTS ARE ENTITLED TO SUMMARY JUDGMENT ON THE MISREPRESENTATION CLAIMS.

The SEC's Complaint offers an incoherent and illogical scattering of misrepresentations with no discernible target of investors or prospective investors. But the handful of investors and prospective investors cited by the SEC (out of hundreds) either deny or don't recall receiving the alleged misrepresentations, do not view them as misleading, or do not consider them material. There is likewise no evidence of a plan or purpose to mislead investors. Thus, the prevailing evidence is that the alleged representations were not made at all, not false when made, or not made in the offer or sale or in connection with the purchase or sale of a domestic security, and there is no evidence of scienter. Moreover, the alleged statements also are not material in light of contemporaneous, accurate written disclosures that YA provided to investors.

The SEC's half-hearted efforts in discovery are naturally of no help to its claim. For example, despite the fact that it was investigating oral statements allegedly made in 2008 and 2009, and the fact that none of these investors or prospective investors affirmatively contacted the SEC to complain about YA but instead were cold-called by the Staff, the SEC chose not to take investigative testimony to verify any of these supposed fraudulent statements from a single investor or prospective investor during its three-year investigation. Then, the SEC chose not to confirm the accuracy of any of the alleged oral statements with their sources before filing the Complaint. (Ex. 102, Bramwell Dep., 86:3-87:9; Ex. 99, Gill Dep., 120:18-121:13; Ex. 101, Slodowitz Dep., 95:20-97:8; Ex. 115, Sanders Dep. 143:8-18.) And then the SEC chose not to subpoena a single investor referenced in the Complaint for testimony during discovery.[13] Simply put, the SEC's reward for its dilatory efforts can only be summary judgment dismissal of its misrepresentation claims.

### A. YA Made No Material Misrepresentations Concerning Collateral

The SEC claims that Defendants made five scattered misrepresentations about collateral underlying YA's investments in Debt Securities to investors and/or prospective investors – three oral statements by Angelo (Compl., ¶¶ 48, 49, 51) and two in YA's written materials (Compl., ¶¶ 55, 56, 59). No genuine issue of material fact remains as to these claims because: (1) there is insufficient evidence that the statements were made or that they were false when made; (2) there is insufficient evidence of scienter; and (3) the statements were not material.

#### 1. There Is Insufficient Evidence That Angelo Made the Oral Statements or That They Were False When Made

The SEC claims that Angelo made three disparate false statements concerning collateral: (1) in April 2008, a supposed oral statement that the loan-to-value ratio for the Fund's investments was 33 percent (to Michael Gill of Austin Capital); (2) in December 2008, supposed oral statements that the portfolio was "widely over-collateralized" (to Daniel Coesmans of MN

[13] The SEC advised YA's counsel in June 2015 that it intended to depose 19 investors but then subpoenaed none of them. Defendants subpoenaed those investors referenced in the Complaint who were U.S. residents (including one of those listed on the SEC's June 2015 list). Ex. 130, email dated June 4, 2015. The SEC did not cross-subpoena them but did attend and ask questions. The SEC did not seek deposition testimony from any of the foreign investors or prospective investors referenced in the Complaint, including Ashton Funds, Eden Rock, MN Services, and 49 Degrees North.

Services), that the Funds had "lots of collateral behind each note" and "that if a Portfolio Company couldn't pay off a note, then the Funds would get 100% of the money back because they had secured collateral" (to Mitchell Slodowitz on behalf of JMC), and "the value of the Portfolio Companies' assets, and the Fund's collateral in their assets, all supported the value of the Funds' portfolio (to Scott Bramwell of Cornerstone Wealth Management); and (3) in April 2009, a supposed oral representation that the convertible investments were "well covered" and "in good shape" (to Coesmans).[14] (*See* Compl., ¶¶ 48-51; Ex. 131, email dated November 14, 2012.) The SEC cannot carry its burden of establishing a triable issue of fact on these allegations.

As for the supposed statement in April 2008, there is insufficient evidence that Angelo ever said it. Michael Gill of Austin Capital has no recollection of Angelo discussing collateral, much less loan-to-value ratios with him, and there is no documentary evidence to support that Angelo made any alleged statement to Gill that the loan-to-value ratio for the Fund's investments was 33 percent in April 2008. (*See* Def. 56.1 Statement ¶¶ 240-42; Ex. 100, Gill Dep. Ex. 6 at p.

[14] The SEC also alleges that YA's director of investor relations told a prospective foreign investor in Fund II – *not* YA Global – that 95 percent of Fund II's convertibles have first liens on Portfolio Company assets worth 200 percent of the loan's value. Fund II is not at issue in this case. In any event, there is no record evidence that this statement was made or that it was false when made with respect to Fund II.

59 (notes of April 2008 meeting containing no mention of collateral, or loan-to-value ratio)).[15] Moreover, the SEC cannot present sufficient evidence that this statement would have been false when made, even if Angelo had made this statement at an April 2008 meeting, which he did not.

The evidence on the supposed December 2008 and April 2009 statements is similarly lacking. There is no record evidence that Angelo told Coesmans of MN Services that the portfolio as a whole was "widely over collateralized" in December 2008 or that the convertible debenture as a whole was "well covered" and "in good shape" in April 2009. (Def. 56.1 Statement ¶ 243.) And Slodowitz (of JMC) specifically testified that he has no recollection of Angelo telling him that there was "lots of collateral behind each note" or "that if a Portfolio Company couldn't pay off a note, then the Funds would get 100% of the money back because they had secured collateral." (*Id.* ¶ 244.) According to Slodowitz, no one at YA ever made him any guarantees on return. (*Id.* ¶ 245 ("I don't remember having someone say 'guarantee a return.'").)[16]

Lastly, contrary to the allegations in the Complaint, Bramwell does not recall even discussing collateral with Angelo in December 2008. (*Id.* ¶ 246.) At best, Bramwell testified

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[15] At most, Gill's notes contain hand-written notations from a July 2008 meeting that was attended by Angelo and others, that say "Collateral" "over collateralized 3-5x" "often turns out to be 1:1" "they look at market cap first." (Ex. 100, Gill Dep. Ex. 6 at pp. 180-81.) The SEC chose not to take testimony from Gill during the investigation. When he was deposed in 2015, Gill had no recollection of the discussion that these notes supposedly reflect and readily acknowledged that these notes were not "verbatim" and that he may have omitted words when taking notes. (Def. 56.1 Statement ¶ 242.) Angelo, on the other hand, specifically recalls telling investors that *at the time of investment*, YA had historically sought to obtain collateral to secure its convertible debentures and that collateral included stock pledges, which is consistent with YA's Due Diligence Questionnaires and the PPM. (*Id.* ¶ 242 n.3.) Likewise, Anderson, YA's former head of the Investor Relations Department, recalls Angelo discussing collateral with investors in terms of a "general target that Yorkville would look for" and that he "would include stock pledges as part of the collateral" in those investor discussions. (*Id.*) Further, Angelo specifically recalls telling investors that when assessing whether to do an investment, YA often looked to market capitalization of the company first and would regularly choose deals that had better equity exit potential over a deal that might have stronger hard collateral assets. (*Id.*) Gill's notes also reflect that Angelo told him that one of the ways that the Fund could lose money on an investment is if they are wrong on their estimate of collateral value. (*Id.*)

[16] Moreover, any alleged misrepresentations to Slodowitz (oral or written) in December 2008 or thereafter cannot serve as a basis for a Section 17, Section 10 or Section 20 claim (Claims 1, 2, 3, 6 or 7) since Slodowitz was a representative for JMC, which last invested in the Fund in 2006.

that it was "kind of [his] understanding" that the value of the Portfolio Companies' assets, and the Funds' collateral in their assets, all "supported the value of the Funds' portfolio." (*Id.* ¶ 247.) He admitted that this "understanding" would have come from conversations with Angelo *after* the NAV of the Fund had declined. (*Id.* ¶ 248.) Thus, Bramwell himself forecloses the possibility that Angelo made the alleged statements in December 2008. Bramwell further testified that Angelo never offered him any guarantees and did not tell him that the entire portfolio was secured by first liens, and he also testified that he viewed the YA investment as "high risk." (*Id.* ¶ 250.)

Even if there was sufficient evidence that Angelo uttered the words that the SEC wants to put in his mouth (which there is not), the alleged statement was not false when made as it is undisputed that the value of the Fund's portfolio was supported by, among other things, collateral including stock pledges, oil and gas assets, real property, and intellectual property. (*See, e.g.*, *id.* ¶ 249.)

### 2. There Is Insufficient Evidence That the Written Statements Were False When Made

The Complaint cites two supposedly fraudulent misrepresentations by YA concerning collateral: (1) a written statement in August 2009 contained in a Collateral Data Report ("CDR") that went to approximately four of YA's approximately 200 investors, supposedly stating that the portfolio was "collectively over-collateralized by $232 million" (Compl., ¶¶ 55, 56); and (2) a written statement in a YA Due Diligence Questionnaire beginning in February 2009 that "the Valuation Committee meets each month to re-evaluate the asset value of the underlying collateral of each of the Fund's positions" (Compl., ¶ 59). Neither allegation can survive summary judgment.

As for the SEC's claim that the CDR distributed in August 2009 "stated that the investments listed in the report were collectively over-collateralized by $232 million" (Compl., ¶ 56), the document does not say this at all, nor is this a reasonable inference (*see* Def. 56.1 Statement ¶¶ 253-55). The CDR is simply a spreadsheet that presents information about collateral for individual portfolio positions and shows clearly that 68 of the 116 listed positions were under-collateralized. (*Id.*) In order to conclude that the CDR even suggests (because it clearly does not state) that the portfolio was collectively over-collateralized by $232 million, the reader would have to draw the unsupported and unheard of conclusion that the collateral for any individual position in the portfolio cross-collateralized every other position in the portfolio.

Mitchell Slodowitz – the only CDR recipient that the SEC examined – agreed, stating that he "wouldn't expect the collateral from one investment to be used for collateral for another investment. The investments stand by themselves. Companies stand by themselves." (Ex. 101, Slodowitz Dep., 80:5-9.) This interpretation of the CDR by Slodowitz, at his deposition, when presented with the CDR, is the only logical one.[17] And there is no evidence that anyone at YA, much less Angelo, ever told any investor or prospective investor that the collateral for any individual position (cross-collateralized or otherwise) secured the other positions, and there is no allegation to the contrary. Further, Slodowitz does not recall Angelo or anyone at YA ever telling him to interpret the CDR as meaning that it was collectively over-collateralized. (Def. 56.1 Statement ¶ 255.)

Contemporaneous communications to investors further undermine the SEC's unfounded interpretation of the CDR. In a May 8, 2009, letter, YA told investors that YA was "concerned

[17] The SEC's implausible interpretation of the CDR, on the other hand, taken to its logical conclusion, would lead to an absurd result. Under the SEC's analysis, the same spreadsheet, this time referencing investments in U.S., Greek, and German treasury notes, would mean that if Greece defaulted on its bonds, the investor could turn to the United States to cover its Greek bond losses – a truly outlandish conclusion. In reality, the SEC misread the CDR or did not understand it and then filed its Complaint based upon that misinterpretation.

about the legacy names in our portfolio, *our collateral value* and possible future impairments." (*Id.* ¶ 251.) Again, on July 31, 2009, YA wrote to its investors that the Valuation Committee "has continued to impair positions" and noted that the Fund has experienced "credit losses." (*Id.* ¶ 252.)

The SEC likewise cannot prove fraud based on its claim that YA misrepresented that "the Valuation Committee meets each month to re-evaluate the asset value of the underlying collateral of each of the Fund's positions," and that "[b]oth Angelo and Schinik reviewed Yorkville's DDQs before Yorkville distributed them to investors and prospective investors, and they knew that this statement was false." Compl., ¶¶ 59-60. There is insufficient evidence that these statements were false when made or that they were material. The statement in the DDQ does not state that the Valuation Committee "valued" the asset value of the underlying collateral for each of the Fund's positions but instead that it "re-evaluated" it. Compl., ¶ 59. David Fine testified that while the Valuation Committee did not review the asset value of the underlying collateral for every portfolio position every month, it did engage in a review of the asset value of the underlying collateral for every position on a monthly basis, to the extent that it believed that it was necessary to properly value the position. (Def. 56.1 Statement ¶¶ 64-65.) There is insufficient evidence to suggest that it did not.

Moreover, even if the statement was false, there is insufficient evidence that Angelo knew it was false or that he "had no basis to believe that the representation made in the DDQs was accurate." Compl., ¶¶ 60, 61. To the contrary, the overwhelming evidence shows that Angelo was not involved in the valuation process and never attended Valuation Committee meetings. The evidence also shows that the Investor Relations Department was responsible for drafting the DDQs, and Angelo would have asked the IRD to confirm that it had consulted with and received approval on the content of DDQs and quarterly letters from the relevant departments that had provided the substantive information. (Def. 56.1 Statement ¶¶ 264-65.)

### 3. There Is Insufficient Evidence of Scienter

As the Court noted in its Order on Defendants' Motion to Dismiss, the SEC failed to allege that the misrepresentations concerning collateral were made with scienter or negligence. MTD Order, p. 8. There is no record evidence, direct or otherwise, that anyone at YA, including Angelo, intentionally or recklessly (or even negligently) deceived any investor or prospective investor about the collateral securing the Fund's investments. To the contrary, the record reflects that YA told its investors that it primarily targeted investments in microcap and small-cap publicly traded companies and that information about the majority of YA's investments was publicly available. (Def. 56.1 Statement ¶¶ 15, 49-50.) YA told investors that, *at the time of investment*, YA sought to "protect the Fund's downside through the financing structure employed, by obtaining a first position lien on the assets of a company, *and by securing a stock pledge equal to 3x to 5x the value of the investment*." (Ex. 23, 2008 DDQ, p. 13 (emphasis added); Def. 56.1 Statement ¶ 242 n.3.) YA separately informed investors that it considered stock pledges as part of the overall collateral for its investments. (Def. 56.1 Statement ¶ 45(f) (stating that security on YA's convertible debentures "may consist of interests in the issuer's assets and/or pledges of securities by the issuers and/or its principals."). The record also shows that YA advised investors that many of YA's portfolio companies "are troubled or are experiencing uncertain financial condition" (Ex. 23, 2008 DDQ, p. 12) and that the Fund could lose money if YA was "wrong on collateral value" (Ex. 100, Gill Dep. Ex. 6, p. 181). YA further made it clear to its investors that its convertible debentures may be unsecured or secured and that any collateral obtained may not be adequate to ensure full return on the investment. (Def. 56.1 Statement ¶ 45(e).) YA also told its investors that it did not calculate a "loan-to-value" collateral analysis on its portfolio. (Ex. 132, email dated February 8, 2008 at M&P 054884-5.)

The Complaint cites a February 2008 email attaching an incomplete chart of collateral numbers that was sent from James Carr to Sarahjon Kerins-Reilly (an IRD employee). The SEC presents this as evidence that Angelo knew the overall collateralization of the Fund in April 2008. Compl., ¶ 48. But it is clear from the face of the email that the attached chart is an incomplete work-in-progress that does not reflect the collateralization of the Fund. (Def. 56.1 Statement ¶ 261.) And, contrary to the allegation in the Complaint that Kerins-Reilly discussed the email with Angelo, there is no evidence in the record that Angelo ever received the email or was part of any discussions about it. (*Id.* ¶ 262.)

Instead, the record shows that in 2009, a single investor requested that YA provide its best estimate of what it would get if it had to liquidate the Fund's investments by quickly selling the collateral that secured all of the individual portfolio assets in the event of a complete economic melt-down. (*Id.* ¶ 256.) YA prepared that information to the best of its ability (in the CDR), explained its subjectivity to the investor, and provided it to only three other investors. (*Id.* ¶ 257.) While the SEC may disagree with the CDR and how it was prepared, there is no record evidence that YA employee James Carr prepared it in bad faith, that Schinik or Angelo believed that the subjective collateral valuations were false, that they attempted to manipulate or misrepresent it, or that it was anything but YA's best estimate in response to an investor's request.

### 4. The Alleged Statements Were Not Material

The touchstone on materiality is "whether defendants' representations or omissions, considered together and in context, would affect the total mix of information and thereby mislead a reasonable investor." *Rombach v. Chang*, 355 F.3d 164, 173 (2d Cir. 2004) (holding that "isolated statements" are insufficient to demonstrate materiality in light of accurate information provided to investors). Cherry-picking disparate statements containing "inaccurately summarized" information and ignoring that the company's written materials contain accurate information is no way to prove fraud. *DeMaria v. Andersen*, 318 F.3d 170, 181 (2d Cir. 2003) (affirming dismissal where "erroneous information would not have misled the average investor in light of the accurate information contained in the prospectus"); *see also Stadnick v. Vivint Solar, Inc.*, 861 F.3d 31, 38 (2d Cir. 2017) (applying *DeMaria* to affirm dismissal based on lack of materiality, and deeming plaintiff's materiality argument "too myopic, both temporally and with regard to the number of relevant metrics"). Moreover, a "very basic, very sensible principle of the law of fraud" is that written representations prevail over ones. *Carr v. CIGNA Sec., Inc.*, 95 F.3d 544, 547 (7th Cir. 1996).

Here, not a single investor has testified that the supposed misstatements concerning collateral were material to or even in connection with their investment decisions. And plain reason dictates that one CDR or the frequency of Valuation Committee meetings cannot sustain a fraud claim. Moreover, the record shows that investors received detailed, written disclosures from YA concerning the risks associated with collateral. (*See* Def. 56.1 Statement ¶ 45(e) (Hard-to-Value Assets "may be unsecured or secured" and any security obtained "may or may not be adequate to ensure its full collection"); *id.* ¶¶ 251-52.) There is no triable issue of fact concerning the supposed collateral-related misrepresentations.

**B. YA Made No Material Misrepresentations Concerning Age of the Portfolio**

The SEC alleges that "Yorkville, Angelo, and others made false statements to investors and prospective investors who specifically asked about the age of the investments in the Funds' portfolio." Compl., ¶ 69. There is insufficient evidence to show that these statements were false when made, material, or made with scienter.

Specifically, the SEC claims that on July 22, 2008, Angelo represented to Gill of Austin Capital that 75 percent of the Fund's portfolio was less than 18 months old and 90 percent of the portfolio was less than two years old. Compl., ¶ 70. Gill testified that he has no recollection of Angelo making this statement, but that if he had asked Angelo for information about the portfolio, he would have "hoped" that Angelo would have provided information that had been collected "within the past two months." (Def. 56.1 Statement ¶ 301.) Indeed, on May 27, 2008, YA's accounting department circulated age of portfolio data as part of a set of "key stats" to YA management showing that 74 percent of the portfolio was less than 18 months old, and 84 percent of the portfolio was less than 2 years old. (*Id.* ¶ 302.) Even if Angelo summarized this data a few weeks later for Gill, the SEC can cite no record evidence that Angelo had any reason to question the data or that he acted intentionally, recklessly, or negligently in relaying it to him.[18]

The SEC also alleges that YA's head of Investor Relations told prospective investor Gregor Etzweiler of 47 Degrees that 75 percent of the Fund's investments were less than 18 months old, and that 100 percent of the Fund's investments were less than two years old. Compl., ¶ 71. But there is no record evidence whatsoever about this misrepresentation. The SEC has failed even to identify when or where the alleged misrepresentation took place. Further, 47 Degrees was never an investor in any YA-managed fund; it was only a prospective investor in Fund II, which is not the fund at issue in this litigation. (Def. 56.1 Statement ¶ 304.)

[18] In support of its allegation that 44 percent of the portfolio was over 2 years old, the SEC relies on an unfinalized draft age of portfolio analysis prepared on June 20, 2008 by a YA employee who was not in the accounting department. But there is no evidence to suggest that this analysis was correct, that anyone at YA used this analysis, or that it was provided to Angelo or anyone in management. (Def. 56.1 Statement ¶ 303.) This contrasts starkly with the May 27, 2008, age of portfolio analysis, which was circulated by the accounting department as "key stats" to two members of YA's management and the Head of Investor Relations. (*Id.* ¶ 302.)

### C. YA Made No Material Misrepresentations Concerning Liquidity

The SEC alleges that in December 2008, Angelo told multiple investors that the Fund had between approximately $75 million and $100 million in cash. Compl., ¶¶ 64, 65. These allegations cannot survive summary judgment because there is insufficient evidence that the alleged statements were made, material, made in an offer or sale or in connection with a purchase or sale, or made with scienter.

Specifically, the SEC alleges that on December 2, 2008, Angelo told Michael Gill of Austin Capital that "the fund has about $100 million in cash." Compl., ¶ 64. The SEC further alleges that on December 3, 2008, Angelo told another investor, Michael Stavely at Eden Rock, that YA maintained a cash position of approximately 8 percent of its assets under management (totaling approximately $75 million). Compl., ¶ 65.

There is no record evidence at all sufficient to show the alleged misrepresentation to Stavely. Accordingly, it cannot serve as the basis for any claim against any Defendant.

As for Gill, he has no recollection of Angelo speaking to him about YA's cash position in December 2008 or at any time. (Def. 56.1 Statement ¶ 307.) Gill testified that his handwritten notes, which actually reference 10 percent cash and not a dollar amount of $100 million, (Ex. 100, Gill Dep. Ex. 6, p. 300), may indicate merely that he was told that YA was "typically targeting around 10 percent cash" (Ex. 99, Gill Dep., 147:20-148:9). Indeed, Angelo recalls telling investors that YA generally targeted cash and cash equivalents in the 5-to-10 percent range. (Def. 56.1 Statement ¶ 310.)

Putting aside the fact that there is insufficient evidence that the alleged statement was made, it would be immaterial anyway considering that Gill received written communications in the form of one-pagers from YA correctly identifying the Fund's cash (and cash equivalents) position both 14 days before the December 2, 2008, conversation, and again one day after that conversation. (*Id.* ¶ 313.)[19] It is axiomatic that Defendants' statements must be "considered together and in context" to determine whether they "would affect the total mix of information and thereby mislead a reasonable investor." *Rombach*, 355 F.3d at 173. Where statements may conflict or be inconsistent, no fraud claim lies where "erroneous information would not have misled the average investor in light of the accurate information" that defendant also provided, and where "inaccurately summarized" information "was actually cured by the accurate disclosure" elsewhere in the defendant's written disclosures. *DeMaria*, 318 F.3d at 181. Moreover, as a matter of law, written representations prevail over oral representations. *See Carr*, 95 F.3d at 547. There is no basis to conclude that Gill was misled.

In addition, Gill expressly testified that YA's cash position was not important to him. (Def. 56.1 Statement ¶ 312.) Indeed, there is no evidence that Gill or anyone else at Austin Capital became concerned after seeing the cash positions listed in the written communications in light of the statement the SEC has falsely attributed to Angelo. Thus, the only record evidence reveals that the supposed representation was not material, even if it was made.

Moreover, there is also no evidence to suggest that Angelo would have been acting with scienter even if he did provide an inaccurate cash number or percentage. The court "must assess 'whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.'" *Glaser v. The9, Ltd.*, 772 F. Supp. 2d 573, 586 (S.D.N.Y. 2011) (citation omitted). Angelo knew that the Fund disclosed its cash position to investors in writing twice every month, and whatever information he provided to investors orally could be checked against those communications. (Def. 56.1

[19] In fact, the one-pager containing the cash position sent one day after Angelo's alleged discussion with Gill showed a cash position of only 3 percent. This number was erroneously *low* because YA inadvertently forgot to include its ETFs (Exchange Traded Funds), which it considered cash equivalents, which accounted for another approximately $60 million. (*See* Def. 56.1 Statement ¶ 311.)

Statement ¶ 314.) He did not review the Fund's monthly asset reconciliation statements on a daily basis (*id.* ¶ 315), and there is no evidence to suggest that Angelo was involved in calculating – or manipulating – those numbers or that he saw them before talking to Gill. The balance of the evidence weighs heavily against finding scienter.[20]

The SEC also claims that YA's Fourth Quarter 2008 letter issued on January 23, 2009, which stated that the Fund had approximately $69 million in cash as of December 31, 2008, was false because the SEC believes that the Fund had cash and cash equivalents of only $10 million as of year-end 2008. Compl., ¶¶ 66 and 67. But the record clearly shows that as of year-end 2008, YA had $70.3 million in cash and cash equivalents. (Def. 56.1 Statement ¶ 311.) Consistent with YA's practice for calculating cash holdings since its inception, this figure included approximately $60 million of Exchange Traded Funds ("ETFs") that YA could sell out of in less than 24 hours if necessary. YA's consistent approach undercuts the SEC's fraud claim. *See Glaser*, 772 F. Supp. 2d at 589 ("consistency between defendants' corporate activities and public statements will cut against the inference of scienter"). The SEC can cite no evidence that this calculation method was inappropriate, that there was any misstatement, or that YA, Angelo, or anyone else acted with scienter.

### D. YA's Statements To Investors About Pluris's Role Were Not Made With Scienter and Were Not Material

The SEC cries fraud based on certain less-formal, one-off communications to individual investors by personnel in YA's Investor Relations Department ("IRD"), in which they imprecisely described Pluris's role with respect to the valuation of YA's convertible debentures.

[20] The SEC also alleges that Angelo told Gill on December 2, 2008, that Yorkville was continuing to receive "follow-on" investments that it actually had not received. Compl., ¶ 64. Putting aside that YA was continuing to receive follow-on investments including as late as December 2, 2008, and that Gill has no recollection of this discussion, Gill makes clear that this information was immaterial. (Def. 56.1 Statement ¶ 306.)

These allegations fail to amount to fraud for the same reasons as the liquidity allegations addressed in the immediately preceding section (*see* § III.C *supra*).

*First*, as a matter of law, YA's written representations prevail over these one-off oral representations. *See Carr*, 95 F.3d at 547. The record shows that YA's formal communications to investors concerning Pluris's role were accurate. For example, in the 2008 and 2009 DDQs, YA correctly stated that "[c]onvertible securities are privately traded and do not have an independent pricing source," and that "convertibles are kept at lower of cost or market until gains are realized," while also precisely stating in contrast that YA "has contracted with [Pluris] *to provide an independent valuation of the Warrants* held by the Fund." (Def. 56.1 Statement ¶ 266 (emphasis added).) The DDQ that was used between January and March 2009 also correctly added that YA "has engaged [Pluris] to assist in valuing the Fund's convertible debentures and convertible preferred stock on a monthly basis." (*Id.* ¶ 267.)

*Second*, the SEC cannot prove that the alleged one-off misstatements were material to any investor who heard them. The SEC claims that YA committed fraud in a March 9, 2009, Questionnaire that it sent to Reggie Sanders at Kodak Retirement Income Plan, one of YA's biggest investors, because it stated "[i]n the summer of 2008, Yorkville engaged a third party, Pluris Valuations, to independently price our loan book." (Def. 56.1 Statement ¶ 269.)[21] At that time, Pluris was assisting YA in the valuation of the convertible debenture portfolio by providing illiquidity discounts that the Valuation Committee used to test YA's model for discounts on the optionality component. The same Questionnaire also correctly stated "our Valuation Committee decided to make aggressive impairments in November and December of 2008." (*Id.* ¶ 270.) Sanders had also received a copy of YA's DDQ on February 20, 2009, less than 20 days prior,

[21] Neither Schinik nor Angelo were included on that communication, and there is no evidence in the record that they received that specific communication or were otherwise made aware of it. (Def. 56.1 Statement ¶¶ 271-72.)

which stated that "[c]onvertible securities are privately traded and do not have an independent pricing source." (*Id.* ¶ 268.) Sanders did not testify that this information was material, and he firmly declined to say that the statement in the Questionnaire concerning Pluris which the SEC says constitutes fraud was "misleading." (*Id.* ¶ 274.)

*Finally*, there is no evidence that Angelo or Schinik were aware of any of the imprecise communications. (*Id.* ¶ 271.)[22] Angelo was not included on the communications, and to the extent Schinik was copied, he consistently and repeatedly provided accurate information to investors and potential investors concerning Pluris's role and corrected any errors. (*Id.* ¶ 277.)[23] The total mix of information available to investors rendered any inconsistencies immaterial, and there is no evidence of any defendant acting with scienter. *See Rombach*, 355 F.3d at 173.

### E. YA Made No Material Misrepresentations Concerning Its Valuation Policies

In addition to its general complaint that YA did not fairly value the Fund's assets in compliance with GAAP, the SEC alleges three additional misrepresentations with respect to YA's valuation policies. These alleged misrepresentations were either not made, not false when made, or not material, and there are no indicia of scienter. The Fund's auditor, which paid extra attention to YA's valuation policies and procedures, raised no concerns of improper valuations by YA.

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[22] The SEC alleges one instance of Schinik allegedly verbally providing false information about Pluris in October 2009 to a prospective investor in Fund II – not YA Global (Compl., ¶ 85). And the SEC alleges that Angelo made an oral misrepresentation to Daniel Coesmans of MN Services about Pluris's role on April 14, 2009, and on January 6, 2010 (Compl., ¶ 84). There is no record evidence to support any of these allegations. (*See* Def. 56.1 Statement ¶¶ 275-76.)

[23] For example, in August 2008, Kerins-Reilly sent a draft investor communication to Schinik for his comments. In that letter, Kerins-Reilly incorrectly described Pluris as having been "recently acquired" "to independently value our convertibles as well." (Def. 56.1 Statement ¶ 277 n.6.) Schinik corrected the draft to say: "Previously we kept our convertible debentures and convertible preferred securities valued at the lower of cost or impaired until we exited the positions. Due to the impact of FAS 157, these securities will now be marked to fair value based on a number of factors including but not limited to the underlying price of the equity, the conversion discount and the trading volume of the equity. We have engaged Pluris Valuation Advisors to assist us in the valuation process." (*Id.*) Again in August 2009, Schinik provided Kerins-Reilly with an accurate description of Pluris's role so that she could include it in a written response to Kodak's consultants. (*Id.*)

(1) Use of financial models. The SEC claims that Angelo and Schinik misrepresented to McGladrey that YA used financial models to determine that cost approximated fair value. Compl., ¶¶ 36 and 38. Specifically, Angelo and Schinik signed management representation letters to YA's auditor that stated "[i]n some cases, the General Partner employed financial models to determine a 'best estimate' valuation or determine that cost approximates fair value for the particular security" (*see* Def. 56.1 Statement ¶ 292), yet they supposedly "knew" that this was false (Compl., ¶¶ 36 and 38).

The SEC's claim, however, lacks evidentiary support and logic. *First*, YA's Valuation Policy does not say that YA is required to use financial models; in fact, it says *nothing* about financial models. (Def. 56.1 Statement ¶¶ 290-91.) *Second*, YA *did* use financial models (prepared both internally and by third parties) in 2008 and 2009 in connection with valuing the Fund's convertible debentures. (*Id.* ¶¶ 293-95.) *Third*, in connection with the 2008 audit, YA explained to its auditor how it was using these financial models. (*Id.* ¶ 294.) *Fourth*, the record is clear that YA's auditor was intimately familiar with YA's valuation processes (*id.* ¶¶ 182-84), and the SEC did not even bother to ask Angelo, Schinik, or any McGladrey witness a single question about this alleged fraudulent sentence in the management letters. Further, in 2008 and 2009, YA used financial models in connection with analyzing projected cash flows for portfolio companies, and in 2009, YA adopted valuations prepared by VRC which used financial models. (*Id.* ¶¶ 294-95.)

Specific to Angelo, there is no record evidence that Angelo "knew" that YA did not use financial models to determine that cost approximated fair value. To the contrary, Angelo testified that while he was not involved in the valuation process, his understanding was that models were used in connection with the valuation of the optionality of the equity component of the convertible debentures – an understanding that is completely consistent with YA's actual use of financial models. (*Id.* ¶ 296.) Further, there is no evidence in the record that Schinik "knew" that YA did not use financial models. He, like all members of the Valuation Committee, correctly understood that YA used financial models to value the equity component of the convertible debentures that YA was marking above face value. (*Id.* ¶ 297.)

(2) <u>Valuation procedures.</u> The SEC identifies some inconsistencies in communications regarding how often YA's Valuation Committee met, and what portion of the portfolio was reviewed at each meeting, and pronounces this fraud despite the complete absence of evidence of scienter. Compl., ¶¶ 33 and 39. The facts are clear: YA's Valuation Committee met on a monthly basis with only occasional exception. (Def. 56.1 Statement ¶ 63.) Although it originally reviewed every position at every meeting, it later adopted a policy of reviewing at least one-third of the portfolio at every meeting as well as any other portfolio position that the Valuation Committee believed required more frequent review or a closer watch for possible impairment. (*Id.* ¶¶ 64-65.)[24] This process complied with GAAS. (*Id.* ¶¶ 107-09.)[25]

The SEC also alleges that the Valuation Committee did not retain all documents that the Compliance Manual required it to retain, and that this somehow constitutes fraud. Compl., ¶¶ 32, 39. Yet, this requires a tortured reading of the Compliance Manual (*see* Def. 56.1 Statement ¶ 70), and there is no record evidence that YA told its investors that the Valuation Committee

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[24] For example, according to Valuation Committee meeting minutes and YA's accounting records, Levitz, which is one of the 15 Positions, received at least monthly evaluations by the Valuation Committee in mid-2009. In early 2008, Levitz was written down 15 percent, and the Committee noted that they were "still trying to determine the likely outcome due to bankruptcy." On May 31, 2009, Levitz was written down an additional 5 percent, with the Committee noting that Levitz was "currently in legal negotiations and an outcome has not yet been determined." (Def. 56.1 Statement ¶¶ 114-19.) The minutes for June 30, 2009 were not available but Levitz was written down again. Then, on July 31, 2009, Levitz was written down again – an additional 5 percent. (*Id.*) Similarly, for example, in 2008, the Valuation Committee impaired its convertible debenture in a company called Deepfield at the September 2008 meeting by 20 percent and then again at the October 2008 meeting by another 35 percent. (*Id.*)

[25] Under GAAS, YA was allowed to rely on its reviews performed in a previous month in order to issue GAAS-compliant financial statements for a following month. (Def. 56.1 Statement ¶ 111.)

kept more detailed documentation of the valuation decisions that it made each month in the ordinary course of its meetings. Moreover, YA's documentation of its valuation decisions complied with GAAS. (*Id.* 107, 193-95.) And, once again, there is no evidence of scienter.

(3) Valuation methods. The SEC alleges that YA and Schinik did not comply with YA's Compliance Manual and therefore committed fraud because the Valuation Committee did not use certain methods in connection with valuation of convertible debentures, namely: independent pricing, periodic reviews and testing, or exception reporting. Compl., ¶ 37. But the Compliance Manual does not require YA to use any of those methods in connection with valuation of *any* of its convertible debentures, much less all of them. (Def. 56.1 Statement ¶ 298.) Nevertheless, the record shows that YA *did* use independent pricing, periodic reviews, testing, and exception reporting in connection with its valuation of convertible debentures and other securities. (*Id.* ¶ 299.)[26]

**F. Alleged Misrepresentations Made After January 2009 Cannot Serve As A Basis For A Section 17, Section 10, or Section 20 Claim**

As a matter of law, only misrepresentations made in an offer or sale, or in connection with a purchase or sale of, a security can serve as the basis for a claim under Section 17, Section 10, or Section 20. *See, e.g., SEC v. Mannion*, 789 F. Supp. 2d 1321, 1332 (N.D. Ga. 2011) (holding that dissemination of alleged misrepresentations in NAV statements to existing fund investors "did not occur in connection with the purchase or sale of any security" for purposes of 10(b) and 10b-5 claim); *Schwartz v. Duckett*, No. 88 CIV. 5395 (MBM), 1989 WL 16054, at *2 (S.D.N.Y. Feb. 21, 1989), *vacated in part* (May 26, 1989) ("because [defendant's] omission

[26] In addition, VRC provided independent pricing on a significant percentage of the portfolio in 2009, and Pluris provided independent pricing for the warrants in 2008 and 2009 as well as provided models to be used in the pricing of the convertible debentures in 2008 and 2009. (Def. 56.1 Statement ¶ 300.)

occurred months after the initial and revised offering of [the securities], it is also not actionable under § 17(a)").

Here, YA closed the Fund in February 2009 to investments, and the last investment in the Fund was made on December 1, 2008. (Def. 56.1 Statement ¶¶ 51-52.)[27] Any alleged oral or written misrepresentations made from at least February 2009 cannot have been made in an offer or sale, or in connection with a purchase of, a security. Accordingly, any such statements cannot serve as the basis for claims under Section 17, Section 10, or Section 20 (Claims 1, 2, 3, 6 and 7).

### G. Alleged Misrepresentations Made To Foreign Investors Cannot Serve As A Basis For A Section 17, Section 10, or Section 20 Claim

Under the standard set by the Supreme Court in *Morrison v. Nat'l Austl. Bank Ltd.*, any alleged misrepresentations that predate Dodd-Frank are actionable under Section 10 and Section 17 only if they were made in the offer or sale or in connection with the purchase or sale of a security in a *domestic* transaction, not a foreign one. 130 S. Ct. 2869, 2884 (2010) (the focus of the Exchange Act "is not upon the place where the deception originated, but upon purchases and sales of securities in the United States"); *SEC v. Goldman Sachs & Co.*, 790 F. Supp. 2d 147, 164 (S.D.N.Y. 2011) (applying *Morrison* to claims under Section 17(a) of the Securities Act). In this Circuit, a transaction is "domestic" when title passes or irrevocable liability is incurred in the United States. *See Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 62 (2d Cir. 2012).

Here, YA's foreign investors – including the ones referenced in the Complaint (MN Services and Eden Rock) – invested in YA's offshore feeder fund. As a result, those transactions are not "domestic" and, under *Morrison*, cannot serve as the basis for claims under Section 17,

[27] The Private Offering Memorandum dated November 2008 was the last one issued by YA. The Private Offering Memorandum is the only document that can constitute an "offer" of securities by YA under Section 17. (Def. 56.1 Statement ¶¶ 53-54.)

Section 10, or Section 20. Accordingly, Claims 1, 2, 3, 6 or 7 in the Complaint must be dismissed to the extent that they relate to non-domestic transactions.

## IV. ANGELO AND SCHINIK ARE ENTITLED TO SUMMARY JUDGMENT ON THE AIDING AND ABETTING CLAIM

The SEC has asserted claims for aiding and abetting liability against Angelo and Schinik for violations of Exchange Act Section 10(b) and Rule 10b-5 thereunder (Sixth Claim for Relief), and Advisers Act Sections 206 (Seventh and Eighth Claims for Relief).

As discussed above, there is no primary violation under the Exchange Act, so the aiding and abetting claim cannot survive as a matter of law. In the event of a primary violation, Angelo and Schinik cannot be liable for aiding and abetting the alleged Section 10(b) and Rule 10b-5 violations unless the SEC can establish: (1) each had actual knowledge of the primary violation and of his role in furtherance of the violation; and (2) each substantially assisted the primary violation. *SEC v. Cedric Kushner Promotions, Inc.*, 417 F. Supp. 2d 326, 334-36 (S.D.N.Y. 2006) (granting summary judgment for defendant holding that defendant did not aid and abet securities fraud); *see also DiBella,* 587 F.3d at 566; *Stanard,* 2009 WL 1960234 at *31 ("Courts have been clear in requiring a showing of actual knowledge of the violation by the aider and abettor").

There is insufficient evidence that Angelo or Schinik knew of any primary violation or their roles in furthering the alleged violation. There is no record evidence of a scheme to defraud investors, fabricate numbers, or conceal material information. The SEC can cite no evidence of Defendants conferring or conspiring to mislead investors concerning valuation issues or other matters.

For the same reasons, Angelo and Schinik cannot be found liable for aiding and abetting violations under Advisers Act Section 206. Neither Angelo nor Schinik had "knowledge of wrongdoing" – *i.e.*, a "general awareness . . . that his role was part of an overall activity that was improper." *Washington Inv.*, 475 F.3d at 406. Nor can the SEC prove recklessness representing an "extreme departure from the standards of ordinary care." *Stanard*, 2009 WL 196023 at *28; *see also Decker*, 681 F.2d at 121 (for recklessness to satisfy the scienter requirement, "[i]t must … approximate an actual intent to aid in the fraud"). The SEC's aiding and abetting claims lack evidentiary support and must be dismissed.

## V. ANGELO IS ENTITLED TO SUMMARY JUDGMENT ON THE CONTROL PERSON CLAIM

The SEC's failure to present triable issues of fact on the Exchange Act claims necessitates the dismissal of the SEC's Section 20(a) claim against Angelo as well. *See In re Centerline Holding Co. Sec. Litig.*, 380 F. App'x 91, 94 (2d Cir. 2010) (upholding dismissal of Section 20(a) claim due to plaintiffs' failure to adequately plead scienter with respect to the alleged primary violators).

Even in the event that any primary violation survives this motion, the Section 20(a) claim requires dismissal where, as here, the SEC is unable to present sufficient evidence to create a material issue of fact as to: (1) control by the alleged control person; and (2) the control person being in "in some meaningful sense a culpable participant" in the primary violation. *ATSI Commc'ns*, 493 F.3d at 108. The defendant "must not only have actual control over the primary violator, but have control over the transaction [or statement] in question." *H&H Acquisition Corp. v. Fin. Intranet Holdings*, 669 F. Supp. 2d 351, 361 (S.D.N.Y. 2009); *In re Sanofi-Aventis Sec. Litig.*, 774 F. Supp. 2d 549, 572 (S.D.N.Y. 2011). The defendant "must actually possess [this control] in fact, rather than in theory." *H&H*, 669 F. Supp. 2d at 361. In addition, Section 20(a)'s "culpable participation" element is equivalent to Section 10(b)'s scienter element, requiring the SEC to demonstrate "some level of culpable participation at least approximating recklessness in the section 10(b) context." *Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Tr. Fund v. Arbitron, Inc.*, 741 F. Supp. 2d 474, 492 (S.D.N.Y. 2010).

As summarized above, Angelo had no involvement in valuation, and so he cannot be a control person for purposes of the valuation claims. As for the misrepresentation claims, there is no primary violation considering that the statements were not made at all, or by Angelo, or at Angelo's behest. And the absence of scienter renders the SEC unable to demonstrate culpable participation by Angelo.

## CONCLUSION

For the foregoing reasons, Defendants respectfully request that the Court grant summary judgment dismissal of the SEC's claims against YA, Angelo, and Schinik, and grant such other relief as the Court deems just and proper.

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