

Securities Regulation Daily Wrap Up, ENFORCEMENT—S.D.N.Y.: No April Fools' gag: 'Turnaround Queen' says SEC's ALJ regime distressed, (Apr. 2, 2015)

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By Mark S. Nelson, J.D.

Self-described business “Turnaround Queen” Lynn Tilton has her eyes on a new target she says is just as distressed as the companies her investment firm has tried to rescue. Tilton, the object of an SEC enforcement action begun in late March, yesterday filed the latest in a string of law suits by persons charged or investigated by the SEC who dispute the constitutionality of the SEC's administrative apparatus. Two of the other cases against the SEC have ended, but Tilton's and three more are still alive (*Tilton v. SEC*, April 1, 2015).

Patented investment method. Tilton's suit against the SEC echoes the claims made by at least five other targets of agency investigations who have previously challenged the constitutionality of the SEC's administrative powers. Tilton claims the SEC's administrative law judges (ALJs) were not duly appointed by the Commission. She also claims the ALJs enjoy too many layers of good cause removal in violation of Article II of the U.S. Constitution and the Supreme Court's 2010 *Free Enterprise* opinion.

The SEC's administrative case alleges that Tilton and Patriarch Partners violated the Investment Advisers Act and its related rules. At the time the SEC announced the charges against her, Andrew J. Ceresney, Director of the SEC's Enforcement Division, said in a press release that the agency was focused on Tilton's alleged fiduciary duty lapses. “We allege that instead of informing their clients about the declining value of assets in the CLO funds, Tilton and her firms have consistently misled investors and collected almost \$200 million in fees and other payments to which they were not entitled,” said Ceresney.

According to Tilton's suit against the SEC, her company, Patriarch Partners, is one of the biggest women-owned firms in the U.S. Tilton founded the company in 2000 in order to rescue a variety of troubled companies, including mapmaker Rand McNally, the Jeanine Lobell-founded Stila Cosmetics, and MD Helicopters, a company that makes and distributes high-performance rotorcraft.

Tilton's online Patriarch Partners biography touts the business methods she uses to decide which companies she will try to save. Some of those methods are embodied in United States Patent No. 6,654,727 (the '727 patent), which was granted to her on November 25, 2003. The '727 patent, describes a method for securitizing investment portfolios that contain a minimum percentage of distressed business loans. The funds targeted by the SEC's enforcement action emphasize the use of collateralized loan obligations by some of Tilton's funds.

Scorecard. Besides Tilton's case, three more actual or presumed targets of SEC investigations have open Article II cases against the agency: *Duka v. SEC*; *Gray Financial Group, Inc. v. SEC* (first amended complaint filed on last day of March); and *Bebo v. SEC*. Most of these cases will raise subject matter jurisdiction and other standing issues.

Laurie Bebo's suit against the SEC faces an uncertain future after a federal judge in Milwaukee dismissed the case earlier this month, although Bebo has appealed that decision to the Seventh Circuit. Bebo's administrative hearing before ALJ Cameron Elliot is set for April 20 in Milwaukee.

In addition to the Article II claim, Bebo's case had challenged the constitutionality of a Dodd-Frank Act provision that gave the Commission the power to impose civil penalties in administrative proceedings. Judge Rudolph T. Randa noted that Bebo's suit was “compelling and meritorious,” but that the federal district court was the wrong place for her case because the SEC's administrative process would let her raise the Article II issue before the agency's ALJ (the Commission is already reviewing this issue in a different administrative case called *Timbervest*). The judge also said Bebo can raise her affirmative defense before the ALJ, and she can appeal an adverse final Commission order to a federal appeals court.

The remaining two cases are slated to end due the plaintiffs' opting to voluntarily dismiss their claims against the SEC. Those cases are: *Peixoto v. SEC* and *Stilwell v. SEC*.

Attorneys: Savid M. Zornow (Skadden, Arps, Slate, Meagher & Flom LLP) and Susan E. Brune (Brune & Richard LLP) for Lynn Tilton.

Companies: Patriarch Partners LLC; Patriarch partners VIII, LLC; Patriarch Partners XIV, LLC; Patriarch Partners XV, LLC

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