UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION, :	
Plaintiff, :	Civil Action No. 12 CIV 7728 (GBD)
-against- :	ECF CASE
YORKVILLE ADVISORS, LLC, MARK ANGELO and EDWARD SCHINIK, :	
Defendants. :	
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MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS YORKVILLE ADVISORS, LLC, MARK ANGELO, AND EDWARD SCHINIK'S MOTION TO DISMISS THE COMPLAINT

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TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

STATEMENT OF FACTS 3

A. Background 3

B. Yorkville's Investment Strategy Targets Undervalued Companies 3

C. Yorkville's Investors Were Well Informed Of Yorkville's Investment Strategies And The Associated Risks And Difficulty Valuing Portfolio Assets 4

D. Yorkville's Valuation Policy and Procedures Were Designed To Ensure Good Faith Valuations Of Level-3 Assets 7

ARGUMENT 8

I. THE SEC'S COMPLAINT IS UNTIMELY UNDER DODD-FRANK AND SHOULD BE DISMISSED 9

II. THE SEC FAILS TO ALLEGE FRAUD 10

A. The Complaint Fails To Allege That The Valuations Were Fraudulent 12

i. The SEC Fails To Allege That The Valuations Were False When Made 12

ii. The SEC Fails To Allege That The Supposed "Mis-Valuations" Were Material 14

1. Selecting 7 Out Of 116 Positions And Failing To Provide "Actual" Portfolio Value Are Insufficient To Plead Materiality 14

2. Any Mis-Valuation Was Immaterial In Light Of The "Total Mix" Of Information 16

iii. The SEC Fails To Allege That The Mis-Valuations Were Made With Scienter 17

1. The SEC's Allegations Do Not Demonstrate Motive Or Opportunity 18

2. The SEC Fails To Allege Recklessness 19

3. Alleging Overvaluation Of 7 Out Of 116 Positions Does Not Support An Inference Of Scienter 21

B. The SEC Fails To Allege The Remaining Representations Constitute Fraud 22

III. THE SEC'S AIDING AND ABETTING AND CONTROL PERSON ALLEGATIONS ALSO FAIL 24

CONCLUSION 25

TABLE OF AUTHORITIES

Page

CASES

Acito v. IMCERA Grp., Inc.,
47 F.3d 47 (2d Cir. 1995)....................11

Arnold v. KPMG LLP,
334 Fed. Appx. 349 (2d Cir. 2009)....................9

ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.,
493 F.3d 87 (2d Cir. 2007)....................3, 8, 10

Basic, Inc. v. Levinson,
485 U.S. 224 (1988)....................16

Bell Atl. Corp. v. Twombly,
550 U.S. 544 (2007)....................8

Bustamante v. Napolitano,
582 F.3d 403 (2d Cir. 2009)....................9

City of Monroe Emps. Ret. Sys. v. Hartford Fin. Servs. Grp., Inc.,
No. 10 Civ. 2835 (NRB), 2011 WL 4357368 (S.D.N.Y. Sept. 18, 2011)....................22

DiVittorio v. Equidyne Extractive Indus., Inc.,
822 F.2d 1242 (2d Cir. 1987)....................12

Edison Fund v. Cogent Inv. Strategies Fund, Ltd.,
551 F. Supp. 2d 210 (S.D.N.Y. 2008)....................18

Ernst & Ernst v. Hochfelder,
425 U.S. 185 (1976)....................17

Fait v. Regions Fin. Corp.,
655 F.3d 105 (2d Cir. 2011)....................12, 13

Glassman v. Computervision Corp.,
90 F.3d 617 (1st Cir. 1996)....................16

Greebel v. FTP Software, Inc.,
194 F.3d 185 (1st Cir. 1999)....................16

Halperin v. eBanker USA.com, Inc.,
295 F.3d 352 (2d Cir. 2002)....................16, 23

Hutchinson v. Deutsche Bank Sec. Inc.,
647 F.3d 479 (2d Cir. 2011)....................15

In re Alamosa Holdings, Inc. Sec. Litig.,
382 F. Supp. 2d 832 (N.D. Tex. 2005) 20

In re Allied Capital Corp. Sec. Litig.,
No. 02 Civ. 3812 (GEL), 2003 WL 1964184 (S.D.N.Y. Apr. 25, 2003) 15

In re Citigroup Inc. Sec. Litig.,
753 F. Supp. 2d 206 (SD.N.Y. 2010)....................15

In re Countrywide Fin. Corp. Sec. Litig.,
No. CV-07-05295-MRP, 2009 WL 943271 (C.D. Cal. Apr. 6, 2009) 9

In re Deutsche Bank AG Sec. Litig.,
No. 09 Civ. 1714 (DAB), 2012 WL 3297730 (S.D.N.Y. Aug. 10, 2012)....................13

In re Loral Space Commc'ns Ltd. Sec. Litig.,
No. 01 Civ. 4388 (JGK), 2004 WL 376442 (S.D.N.Y. Feb. 27, 2004)....................17, 18

In re NYSE Specialists Sec. Litig.,
503 F.3d 89 (2d Cir. 2007)....................8

In re REMEC Inc. Sec. Litig.,
702 F. Supp. 2d 1202 (S.D. Cal. 2010)....................20

In re UBS Sec. Litig.,
No. 07 Civ. 11225 (RJS), 2012 WL 4471265 (S.D.N.Y. Sept. 28, 2012)....................17

Int'l Fund Mgmt. v. Citigroup Inc.,
822 F. Supp. 2d 368 (S.D.N.Y. 2011)....................22

Jackson Nat'l Life Ins. Co. v. Merrill Lynch & Co.,
32 F.3d 697 (2d Cir. 1994)....................9

Kalnit v. Eichler,
264 F.3d 131 (2d Cir. 2001)....................10, 17, 18

Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,
501 U.S. 350 (1991)....................9

Lighthouse Fin. Grp. v. Royal Bank of Scotland Grp., PLC,
No. 11 Civ. 398 (GBD), 2012 WL 4616958 (S.D.N.Y. Sept. 28, 2012).................... passim

Meridian Horizon Fund, L.P. v. Tremont Grp. Holdings, Inc.,
No. 09 Civ. 3708, 2012 WL 6168151 (S.D.N.Y. Dec. 11, 2012)....................24

P. Stolz Family P'Ship L.P. v. Daum,
355 F.3d 92 (2d Cir. 2004)....................9

Roberts v. Corrothers,
812 F.2d 1173 (9th Cir. 1987)....................9

Rombach v. Chang,
355 F.3d 164 (2d Cir. 2004)....................8, 11

Sable v. Southmark/Envicon Capital Corp.,
819 F. Supp. 324 (S.D.N.Y. 1993)....................16

San Diego Cnty. Emps. Ret. Ass'n v. Maounis,
749 F. Supp. 2d 104 (S.D.N.Y. 2010)....................16, 17, 23

SEC v. DiBella,
587 F.3d 553 (2d Cir. 2009)....................24

SEC v. Lowy,
396 F. Supp. 2d 225 (E.D.N.Y. 2003)....................17

SEC v. Lucent Techs., Inc.,
610 F. Supp. 2d 342 (D.N.J. 2009)....................20

SEC v. Mannion,
789 F. Supp. 2d 1321 (N.D. Ga. 2011)....................11

SEC v. Merchant Capital, LLC,
483 F.3d 747 (11th Cir. 2007)....................16

SEC v. Monarch Funding Corp.,
192 F.3d 295 (2d Cir. 1999)....................10, 11

SEC v. Moran,
922 F. Supp. 867 (S.D.N.Y. 1996)....................11, 17

SEC v. Northshore Asset Mgmt.,
No. 05 Civ. 2192 (WHP), 2008 WL 1968299 (S.D.N.Y. May 5, 2008)....................19, 21

SEC v. Steadman,
967 F.2d 636 (D.C. Cir. 1992)....................11

STATUTES AND OTHER AUTHORITIES

15 U.S.C. § 77q(a)....................10, 11

15 U.S.C. § 78....................9, 10, 24

15 U.S.C. § 80b-6....................11

17 C.F.R. § 240.10b-5..10

17 C.F.R. § 275.206(4)-8 11

Fed. R. Civ. P. 9(b) 11

Fed. R. Civ. P. 12(b)(1)...9

Fed R. Civ. P. 12(b)(6)...3, 8

PRELIMINARY STATEMENT

Even before it began its three-year investigation of Yorkville Advisors, LLC ("Yorkville") for valuation fraud, the SEC prematurely determined that Yorkville had engaged in improper conduct and that it would bring this Complaint. This is evident from its press release announcing the Complaint where it bragged that its "Aberrational Performance" program, which uses "proprietary risk analytics to identify hedge funds with suspicious returns," "put Yorkville front and center on our radar screen."[1] Despite three years of a fruitless investigation and a complete lack of any compelling indicia of fraud, the SEC refuses to recognize that its algorithms were wrong and instead has filed a misleading pleading that obfuscates the truth and falls far short of stating a valid claim under the federal securities laws.

The Complaint is riddled with shortcomings born of an investigation designed to confirm preconceived conclusions rather than determine the truth. The SEC claims that Yorkville, its principal Mark Angelo, and its employee Edward Schinik (collectively, "Defendants") committed fraud in connection with the valuation of a very small portion of Yorkville's portfolio in 2008 and 2009. However, the SEC has engineered its claims by ignoring (and asking the Court to ignore) several inconvenient truths:

- the SEC carefully cherry-picked a mere 7 of Yorkville's 116 portfolio positions (the "7 Positions") that it claims were overvalued and makes no allegations about the entirety *or* the remainder of the portfolio;

- the 7 Positions, like almost all of Yorkville's 116 positions, were considered Level-3, hard-to-value assets and, therefore, as a matter of law, these valuations are not only subjective, but also occurred in 2008 and 2009, a period of extreme unprecedented market disruption;

- the 7 Positions, like the other 109 positions, were valued by Yorkville's valuation committee which included as one of its three members, a former SEC enforcement lawyer;

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[1] http://www.sec.gov/news/press/2012/2012-209.htm

- Angelo, the portfolio manager who stood to benefit the most from any purported overvaluation, was not involved in any way in the valuation of the 7 Positions (or the portfolio as a whole);

- Schinik, an employee of Yorkville, does not share in any Yorkville profits or otherwise benefit from an improper valuation of the portfolio;

- the valuations of the 7 Positions were specifically considered and evaluated by Yorkville's independent auditor, McGladrey LLP ("McGladrey"), in connection with its unqualified 2008 and 2009 audit opinions. The Complaint does not and cannot allege that McGladrey resigned, revoked the audit opinions, or required a restatement in the face of the alleged "fraud" at Yorkville. In fact—to the contrary—McGladrey's 2008 and 2009 audit opinions remain intact without any need for restatement; and

- the four other purported "misrepresentations," related to the age of the portfolio, available cash, collateral and the use of third-party valuation consultants, were not material and did not result in any alleged overvaluation of the 7 Positions or the portfolio as a whole.

The SEC's problems are compounded by the fact that the Complaint fails to acknowledge that Yorkville repeatedly informed investors, prospective investors and McGladrey that:

- Yorkville invested in distressed, financially unstable companies, that often face liquidity issues and whose value (by definition) is not readily apparent;

- valuations of these "Level-3" investments were "inherently uncertain" and speculative and may not be realized;

- writedowns were discretionary;

- each deal was privately negotiated and had unique characteristics and risks; and

- not every investment was secured and, in any case, the ability to collect on collateral was never certain.

Even if the Complaint could overcome all of these glaring pleading deficiencies, it must, nonetheless, be dismissed because the SEC's claims are untimely pursuant to the 180-day statute of repose under the Dodd-Frank Act. Indeed, the Complaint does not—and cannot—allege that it complied with the mandatory requirement that it file its enforcement action against Defendants within six (6) months of providing them with the Wells notices. The SEC's public position that the statute of repose is simply an "internal deadline" flies in the face of federal law.

For these reasons, as discussed below, Defendants respectfully request that the Complaint be dismissed with prejudice.

STATEMENT OF FACTS[2]

A. Background

Yorkville, which was founded in 2001 by Angelo, is a New Jersey-based investment manager of YA Global Investments, LP ("YA Global"). It provides specialty financing primarily to financially-distressed, micro-cap and small-cap publicly traded companies in a variety of sectors, including mining, oil & gas, healthcare, real estate, manufacturing & shipping and technology.[3] Angelo is a managing member of Yorkville and serves as Yorkville's president.[4] Schinik is a certified public accountant and joined Yorkville in 2005 as its chief financial officer and chief operating officer.[5]

B. Yorkville's Investment Strategy Targets Undervalued Companies

Yorkville utilizes a variety of structured products in making its investments, including convertible or straight debt instruments, convertible preferred securities, Standby Equity Distribution Agreements ("SEDAs"), common stock and cash or cash equivalents of U.S. and foreign issues.[6] Most of these companies have suffered, at various times, from some fundamental weakness—low or no liquidity, poor or fluctuating management, low stock price,

[2] In ruling on a 12(b)(6) motion, a court may consider the Complaint as well as "any written instrument attached to the complaint, statements or documents incorporated into the complaint by reference, legally required public disclosure documents filed with the SEC, and documents possessed by or known to the plaintiff and upon which it relied in bringing the suit." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 98 (2d Cir. 2007).
[3] A true and correct copy of the Complaint ("Compl.") is attached as Exhibit ("Ex.") A to the Declaration of Nicolas Morgan, dated December 17, 2012 ("Morgan Decl."), ¶¶ 1, 17; *see also* the true and correct copy of the Confidential Private Placement Memorandum of YA Global Investments (U.S.), LP (the "PPM"), p. 2, attached as Ex. B to the Morgan Decl. and referenced in Compl., ¶ 17.
[4] Compl., ¶ 11.
[5] Compl., ¶ 12.
[6] Compl., ¶ 18; PPM, p. 18.

defaults on debt, or going concern opinions—characteristics that make them unattractive to traditional lenders, such as banks.[7]

Yorkville, however, targets these companies because, through its private deals with them, Yorkville negotiates favorable repayment terms in the form of convertible debt instruments, which provide Yorkville with the best features of both equity and debt instruments.[8] These debentures contain both fixed and floating conversion features that allow Yorkville to convert profitably at a discount to the market even if the stock price dropped precipitously.[9]

In addition to the equity feature, Yorkville often negotiates a security interest in the companies in which it invests, including the 7 Positions. Depending on the terms of the deal, this interest could include the ability to foreclose on certain assets of the company or the ability to take the company over and privately run it, in the event that the company defaults on Yorkville's investment.[10]

C. Yorkville's Investors Were Well Informed Of Yorkville's Investment Strategies And The Associated Risks And Difficulty Valuing Portfolio Assets

Yorkville's investors and prospective investors were well informed about Yorkville's investment strategy. Specifically, Yorkville disclosed that its investment strategy was to focus on financially-impaired companies and to privately negotiate a deal with that company.[11] To that end, Yorkville was clear that investment in the Fund involved a "high degree of risk," and that the investment program was "speculative," which could result in an investor losing all of its investment in the Fund:[12]

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[7] PPM, p. 2; *see also* the true and correct copy of the Due Diligence Questionnaire (the "DDQ"), p. 13, attached as Ex. C to the Morgan Decl. and referenced in Compl., ¶ 34.
[8] PPM, pp. 18, 20; DDQ, p. 12.
[9] PPM, p. 20.
[10] DDQ, p. 12.
[11] PPM, p. 18; DDQ, p. 12.
[12] PPM, pp. 21, 33; DDQ p. 18.

> There can be no assurance that the fund will achieve its investment objective. An investor could lose its entire investment. [13]

Yorkville informed investors and prospective investors that each deal had distinct characteristics and often unforeseen risks, including that "[t]he convertible securities may or may not be secured and any security may or may not be adequate to ensure collection":[14]

> [d]ue to the directly negotiated nature of the Fund's principal investment strategies, there may also be unique risks associated with a particular transaction that are difficult to predict.[15]

In light of the distressed nature of Yorkville's target companies, Yorkville investors and prospective investors were repeatedly cautioned about the "potentially illiquid nature of investment in the Interests" and "the potential total loss of capital."[16] Yorkville investors knew that "[a] significant portion of the Fund may be invested in assets in illiquid investments and, therefore, will be subject to less frequent liquidity." [17]

Yorkville was also clear about the difficulty and "inherent uncertainty" involved in the valuation of its investments:[18]

> [V]alues [of convertible debt instruments, preferred stock, warrants and promissory notes] were estimated by the Investment Manager in the absence of readily ascertainable market values. Because of the inherent uncertainty of performing such valuations, the Investment Manager's estimated values of that securities may differ significantly from the values may be realized in the future.[19]

Yorkville's audited financial statements also described so-called Level-3 assets as having:

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[13] PPM, p. 19.
[14] PPM, pp. 18, 35.
[15] PPM, p. 36.
[16] PPM, p. 33.
[17] DDQ, p. 18.
[18] PPM, p. 19.
[19] PPM, p. 19.

> little, if any, market activity for the asset or liability. The inputs into the determination of fair value are based upon the best information in the circumstances and may require significant management judgment or estimation.[20]

These assets include equity and debt positions in private companies and private investments in public companies.[21] Yorkville explained in the notes to its financial statements that in determining "fair value," Yorkville's Valuation Committee made a "good faith" determination of "fair value" based on "[v]arious factors."[22] The financial statements further explicitly detailed that:

> [i]n determining fair value, [the Valuation Committee] … evaluate[d] whether an impairment of an investment ha[d] occurred as a result of a special adverse condition affecting the issuer of a convertible debt or promissory note obligation.[23]
>
> Yorkville's financial statements also disclosed the uncertainty of valuing these assets:
>
> the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments. . . . Because of the inherent uncertainty of valuation, the estimated values of these securities may differ significantly from the values that would have been used had a ready market for the securities existed and differences could be material.[24]

Investors were also cautioned that "if the judgments regarding appropriate valuations (which are based on many factors) are incorrect, the value of the Fund's net assets and accuracy of the Fund's reported performance could be adversely affected."[25] Yorkville reserved "the right to change the [valuation] policy at its discretion" and informed investors that it was not limited by valuation guidelines and criterion set forth in its investor materials.[26]

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[20] *See* the true and correct copy of excerpts of YA Global's Audited Financials for the year 2008 (the "Audited Financials"), p. 18, attached as Ex. D to the Morgan Decl. and referenced in Compl., ¶ 88.
[21] Audited Financials, p. 18.
[22] Audited Financials, p. 19.
[23] Audited Financials, p. 19.
[24] Audited Financials, p. 19.
[25] DDQ, p. 18.
[26] PPM, p. 29.

D. Yorkville's Valuation Policy and Procedures Were Designed To Ensure Good Faith Valuations Of Level-3 Assets

In addition to its thorough disclosures, Yorkville implemented various valuation controls in an effort to determine appropriate valuations for its Level-3 assets. Specifically, Yorkville maintained a three-member Valuation Committee that was responsible for implementing Yorkville's valuation policy and reaching good-faith valuations of the fund's hard-to-value assets.[27] The Committee was comprised of Schinik, Gerald Eicke, a principal at Yorkville, and David Fine, a former SEC-enforcement attorney. Prior to October 2008, Eric Hansen, another former SEC attorney, held Fine's role on the Committee. Notably, Angelo, the most significant member of Yorkville, was purposely excluded from the Committee and played no role in the Committee's determination of valuations. Instead the Committee was carefully constructed so that a majority of its members did not share in Yorkville's profits (only Eicke was a member of Yorkville). In addition, it had someone with auditing experience (Schinik), a former SEC enforcement lawyer (Hansen and Fine), and someone who was very familiar with Yorkville's deals (Eicke).[28] The Committee originally met periodically, ensuring that each position was reviewed every quarter.[29]

Prior to 2008, Yorkville used a "conservative valuation policy," in which convertibles were "kept at the lower of cost or market until gains were realized."[30] Upon the adoption of the accounting standard known as Financial Accounting Standards Board Statement of Financial Accounting Standards 157 – Fair Value Measurements ("FAS 157") in 2008, Yorkville assigned

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[27] *See* the true and correct copy of excerpts of Yorkville's Compliance Policies and Procedures Manual (the "Compliance Manual"), p. VI-4, attached as Ex. E to the Morgan Decl. and referenced in Compl., ¶ 29.
[28] DDQ, pp. 5-6.
[29] *See* the true and correct copy of Yorkville's pitch book, p. 7, attached as Ex. F to the Morgan Decl. and referenced in Compl., ¶ 34.
[30] DDQ, p. 13.

a "fair value" to convertibles.[31] "Fair value" is described as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."[32] During the period at issue, McGladrey audited Yorkville's financial statements and rendered an opinion in each year that the financial statements presented Yorkville's financial position fairly in conformity with generally accepted accounting principles.[33]

ARGUMENT

While the Court must accept as true all facts alleged in the Complaint and should draw "all reasonable inferences in the plaintiffs' favor" for purposes of this motion, it "need not accord 'legal conclusions, deductions or opinions couched as factual allegations a presumption of truthfulness.'"[34] Instead, "[t]o survive dismissal, the plaintiff must provide the grounds upon which [its] claim[s] rest[] through factual allegations sufficient 'to raise a right to relief above the speculative level.'"[35] The Supreme Court, the Second Circuit, and this Court have made plain that "labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do."[36] Specifically, as this Court stated, "[p]lausibility requires 'more than labels and conclusions.'"[37] Here, the SEC's allegations do not come close to meeting the required threshold, and, accordingly, the Complaint should be dismissed.

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[31] Audited Financials, p. 18.
[32] Audited Financials, p. 18.
[33] *Id.*, p. 1.
[34] *Rombach v. Chang*, 355 F.3d 164, 169 (2d Cir. 2004) (affirming dismissal of securities action); *In re NYSE Specialists Sec. Litig.*, 503 F.3d 89, 95 (2d Cir. 2007); Fed. R. Civ. P. 12(b)(6).
[35] *ATSI*, 493 F.3d at 98 (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007)).
[36] *Twombly*, 550 U.S. at 555 (affirming dismissal of securities fraud complaint where allegations were not plausible on their face); *see also ATSI*, 493 F.3d at 98 n.2 (applying *Twombly* standard and affirming dismissal).
[37] *Lighthouse Fin. Grp. v. Royal Bank of Scotland Grp., PLC*, No. 11 Civ. 398, 2012 WL 4616958, at *4 (S.D.N.Y. Sept. 28, 2012) (J. Daniels) (granting defendants' motion to dismiss).

I. THE SEC'S COMPLAINT IS UNTIMELY UNDER DODD-FRANK AND SHOULD BE DISMISSED

As a threshold matter, the SEC's claims are time-barred and must be dismissed with prejudice. The SEC has failed to meet its burden of alleging that its Complaint was brought within the 180-day statute of repose under the Dodd-Frank Act.[38] This provision of the Act requires the SEC to commence an enforcement action within 180 days of providing written Wells notification to the potential defendant of the Commission's investigation. Because the Complaint does not and cannot allege that it was filed within the 180-day repose period, it is time-barred under Dodd-Frank.[39]

Repose periods "serve as a cutoff," extinguishing a defendant's liability if a claim is not brought within the defined repose period.[40] The Second Circuit has described a "repose period" as an "absolute limitation" on a plaintiff's ability to bring a claim.[41] The purpose of a statute of repose is to "create certainty" for defendants as to potential litigation.[42] And, as this Court noted

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[38] 15 U.S.C. § 78d-5(a)(1) ("[n]ot later than 180 days after the date on which Commission staff provide a written Wells notification to any person, the Commission staff shall either file an action against such person or provide notice to the Director of the Division of Enforcement of its intent to not file an action"); *see also Bustamante v. Napolitano*, 582 F.3d 403, 409 (2d Cir. 2009) (holding that an agency's failure to meet a mandatory deadline specifying a consequence divests jurisdiction); Fed. R. Civ. P. 12(b)(1).

[39] Because the statute of repose is jurisdictional in nature, the court may consider Defendants' motion to dismiss under Federal Rule of Civil Procedure 12(b)(1), which permits consideration of facts external to the complaint. *Roberts v. Corrothers*, 812 F.2d 1173, 1177 (9th Cir. 1987) ("[T]he existence of disputed material facts will not preclude the trial court from evaluating for itself the merits of jurisdictional claims.").

[40] *See, e.g.*, *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 363 (1991); *Arnold v. KPMG LLP*, 334 Fed. Appx. 349, 363 (2d Cir. 2009) (affirming district court's holding that statute of repose barred plaintiff's Exchange Act claims); *P. Stolz Family P'Ship L.P. v. Daum*, 355 F.3d 92, 106 (2d Cir. 2004) (holding that plaintiffs' Exchange Act claim was barred by the statute of repose).

[41] *Jackson Nat'l Life Ins. Co. v. Merrill Lynch & Co.*, 32 F.3d 697, 704 (2d Cir. 1994) (repose period is "an absolute limitation which applies whether or not the investor could have discovered the violation").

[42] *In re Countrywide Fin. Corp. Sec. Litig.*, No. CV-07-05295-MRP, 2009 WL 943271, at *4 n.6 (C.D. Cal. Apr. 6, 2009) (holding that the statute of repose barred the action against defendant).

with regard to the related subject of statutes of limitation under the federal securities laws, it is plaintiff's burden to allege the timeliness of its claims.[43]

Accordingly, because the SEC does not allege that it has complied with the 180-day requirement, the Complaint should be dismissed as untimely.

II. THE SEC FAILS TO ALLEGE FRAUD

The SEC has attempted to state fraud-based causes of action under three different provisions of the federal securities laws: Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), Section 17(a) of the Securities Act of 1933 (the "Securities Act"), and Section 206 of the Investment Advisers Act of 1940 (the "Advisers Act") and various rules promulgated thereunder.

To state a claim under Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder, the SEC must adequately allege that a defendant "(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."[44]

Section 17(a) of the Securities Act largely parallels Section 10(b) of the Exchange Act. "Essentially the same elements" must be established in connection with the offer or sale of a security,[45] except that "no showing of scienter is required for the SEC to obtain an injunction under subsections (a)(2) or (a)(3)."[46] Thus, to state a claim under Section 17(a)(2) and (3), the

[43] *Lighthouse Fin. Grp.*, 2012 WL 4616958, at *12 ("The burden is on Plaintiffs to affirmatively plead compliance with the statute of limitations because it is a substantive element of the cause of action.").
[44] *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999) (holding that district court erred in granting summary judgment to the SEC on securities fraud claims); *see also ATSI*, 493 F.3d at 105 (affirming dismissal of complaint for failure to sufficiently plead securities fraud); *Kalnit v. Eichler*, 264 F.3d 131 (2d Cir. 2001) (affirming dismissal of case for securities fraud); 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.
[45] *Monarch*, 194 F.3d at 308.
[46] *Id.*; 15 U.S.C. § 77q(a)(2)-(3).

Commission must establish at least negligence with respect to a material misrepresentation or omission, and with regard to Section 17(a)(1) the SEC must allege scienter.[47]

Similarly, Section 206(1) of the Advisers Act prohibits "any investment adviser" from "employ[ing] any device, scheme, or artifice to defraud any client or prospective client,"[48] and Sections 206(2) and (4) and Rule 206(4)-8 thereunder, prohibit fraudulent and deceptive practices by investment advisers.[49] Scienter is a required element of proof for a violation under Section 206(1), and the SEC must establish at least negligence to prove violations of Sections 206(2) and 206(4).[50]

For all of the SEC's claims under the foregoing provisions, the SEC "must state with particularity the circumstances constituting fraud."[51] Specifically, Rule 9(b) requires that the Complaint "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent."[52] Rule 9(b) applies to each violation alleged in the Complaint.[53] Where multiple defendants are asked to respond to allegations of fraud, the complaint must inform each

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[47] *Monarch*, 194 F.3d at 308; 15 U.S.C. § 77q(a)(2)-(3).
[48] 15 U.S.C. § 80b-6(1). Significantly, to state a cause of action under Section 206(1), the SEC must allege fraud against one of the funds rather than fraud against the funds' investors. *SEC v. Mannion*, 789 F. Supp. 2d 1321, 1338, 1343 (N.D. Ga. 2011) (granting motion to dismiss to extent Commission's claims under sections 206(1) and (2) are premised on "fraud against the Fund's investors rather than against the Fund itself"). Because the SEC has failed to allege any fraud by Yorkville or Angelo against the funds, the claims under Section 206(1) fail as a matter of law.
[49] 15 U.S.C. § 80b-6(2)-(4); 17 C.F.R. § 275.206(4)-8.
[50] *See, e.g., SEC v. Steadman*, 967 F.2d 636, 641 n.3 and 643 n.5 (D.C. Cir. 1992) (holding that defendants did not act with requisite scienter to be liable for securities fraud); *SEC v. Moran*, 922 F. Supp. 867, 897 (S.D.N.Y. 1996) (granting motion to dismiss and holding that the SEC failed to plead facts to support its allegations of scienter against defendant).
[51] Fed. R. Civ. P. 9(b). Rule 9(b) applies to each violation alleged in the Complaint. *See*, *e.g.*, *Rombach*, 355 F.3d at 172.
[52] *Acito v. IMCERA Grp., Inc.*, 47 F.3d 47, 51 (2d Cir. 1995) (affirming dismissal with prejudice because plaintiffs failed to plead facts sufficient to state a claim for securities fraud).
[53] *See*, *e.g.*, *Rombach*, 355 F.3d at 172.

defendant of the nature of his alleged participation in the fraud.[54] As set forth below, the Complaint fails to meet these heightened requirements and must be dismissed.

A. The Complaint Fails To Allege That The Valuations Were Fraudulent

The gravamen of the SEC's complaint is that Defendants' failure to "mark down" 7 of Yorkville's 116 portfolio investments caused those investments to be held at values that did not reflect "fair value."[55] However, the SEC fails to plead that these isolated "mis-valuations" were either actionably false when made, material, or made with the requisite level of scienter.

i. The SEC Fails To Allege That The Valuations Were False When Made

Courts in this Circuit, including this Court, and others have consistently recognized that "valuing complex, illiquid instruments . . . is not a straightforward exercise."[56] As the Second Circuit explained in *Fait*, "management's determination of the 'fair value' of the assets . . . [is not a] matter[] of objective fact."[57] Recognizing that estimations of value are normally subjective opinions, to allege falsity in connection with a federal securities fraud claim in this context, a plaintiff must allege that the valuation was "objectively false *and disbelieved by the defendant at the time it was expressed*."[58]

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[54] *See DiVittorio v. Equidyne Extractive Indus., Inc.*, 822 F.2d 1242, 1247 (2d Cir. 1987) (complaint failed to allege specific defendants' connection to the fraud with sufficient particularity).

[55] Compl. ¶¶ 40-42. Not surprisingly, the SEC fails to allege the total number of positions in the portfolio. However, one of the documents referenced and relied upon by the SEC describes 116 portfolio positions, which Defendants adopt here merely for purposes of argument in the absence of an appropriate allegation by the SEC. A true and correct copy of the Collateral Data Report is attached as Ex. G to the Morgan Decl. and referenced in Compl. ¶¶ 55-58.

[56] *Lighthouse Fin. Grp.*, 2012 WL 4616958, at *11 (granting defendants' motion to dismiss).

[57] *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 at time made).

[58] *Lighthouse Fin. Grp.*, 2012 WL 4616958, at *11 (quoting *Fait*, 655 F.3d at 110) (emphasis added).

As a threshold matter, the SEC never alleges—as it must—that the valuations were "objectively false."[59] Instead, the SEC contends that the 7 Positions' "carrying values did not reflect 'fair value' and should have been marked down by Yorkville,"[60] and alleges cursorily that the purported "overvaluation" is "evidenced" by "Defendants' own supporting documentation or otherwise publicly available information."[61] However, the SEC fails to identify with any specificity what Yorkville documents demonstrate the true or false valuations, much less what information those documents contain.

Moreover, the SEC does not allege any contemporaneous witness statement, email or communication indicating that Defendants "disbelieved" the valuations. Rather, the SEC points to a number of market indications that, in the SEC's view (with the benefit of hindsight), should have caused Defendants to mark down the valuations sooner than they did.[62] But the SEC does not plead any facts to indicate that Defendants did not consider that information or willfully ignored it.

In addition to its failure to allege falsity of the valuations and defendants' own disbelief in such valuations, the SEC fails to allege that the valuations were objectively false *at the time they were made*.[63] Instead, the SEC alleges that Yorkville's auditor at year-end 2010, *i.e.*, well

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[59] *Fait*, 655 F.3d at 110; *In re Deutsche Bank AG Sec. Litig.*, No. 09 Civ. 1714 (DAB), 2012 WL 3297730 (S.D.N.Y. Aug. 10, 2012); *Lighthouse Fin. Grp.*, 2012 WL 4616958, at *11.
[60] Compl. ¶ 42.
[61] *Id.* at ¶ 43.
[62] *Id.* at ¶¶ 42(a) (projected sales price based on estimated earnings), 42(b) (estimated proceeds not properly discounted), 42(c) (settlement of bankruptcy claims should have resulted in write-downs and estimated value of future claims not properly assessed), 42(d) (portfolio company's management's estimate of asset value insufficient to support valuation), 42(e) (portfolio company's management's estimate of asset value insufficient to support valuation), 42(f) (damage to oil company well should have caused downward valuation adjustment), 42(g) (uncertainty of collecting on judgment should have caused write down).
[63] *Lighthouse Fin. Grp.*, 2012 WL 4616958, at *9 ("Business judgments that, with the benefit of hindsight, prove to be wrong do not necessarily equate to fraudulent conduct."); *In re Deutsche Bank AG Sec. Litig.*, 2012 WL 3297730, at *2 ("After *Fait*, Plaintiffs must allege that Defendants did not believe their valuation statements at the time they made them.").

after the time period of the purported mis-valuations, required Yorkville to make certain mark-downs.[64] Rather than supporting the SEC's fraud claim, the allegation that the auditor required mark-downs after the fact actually undermines the allegation of fraud. The SEC concedes that Yorkville's auditor was involved in reviewing the valuation of each of the investments in the portfolio.[65] However, the SEC does not and cannot allege that Yorkville's auditor ever rejected any of the valuations at issue, ever required a restatement of the financials, or ever required a mark-down until after the period at issue in this litigation. The SEC's hindsight estimations of the value of the 7 Positions does not sufficiently state a claim for fraud.

ii. The SEC Fails To Allege That The Supposed "Mis-Valuations" Were Material

Even if it could show that the valuations of the 7 Positions were false, the SEC must still allege that these purported "mis-valuations" were material to investors. It cannot do so here. The SEC has impermissibly focused on 7 out of 116 positions in the portfolio without providing any meaningful measure of what it contends was the "actual" value of the 7 Positions or the entire portfolio and without alleging that the portfolio was overvalued. The SEC has further ignored the "total mix" of information available to investors about the investments, which information renders immaterial any alleged mis-valuation of the cherry-picked positions.

1. Selecting 7 Out Of 116 Positions And Failing To Provide "Actual" Portfolio Value Are Insufficient To Plead Materiality

The SEC's pleading strategy appears to have been to identify 7 out of 116 positions in the Yorkville portfolio and then claim that those 7 Positions were overvalued by some amount. For obvious reasons, such an approach provides an insufficient basis to assess whether the purported mis-valuations were material.

[64] Compl., ¶ 43.
[65] *Id.* at ¶ 42(a) through 42(g).

Courts routinely dismiss securities fraud claims where, as here, a complaint alleges that defendants overvalued securities in portfolios without explaining how the stated values were excessive and by what amount.[66] Said differently, "[i]n order to plead fraud with particularity, plaintiffs must state by how much [Defendants] overvalued the investments, both to give defendants notice of the circumstances of the alleged fraud and to allow the Court to assess the magnitude and materiality of the fraud."[67] For the same reason, a complaint must allege how the supposedly "overvalued" positions are material to investors in light of the entire portfolio.[68]

Here, the SEC fails to identify the "accurate" valuations for the few positions it selected.[69] In some instances, *e.g.* Isonics, the SEC does not offer *any* indication of what the more appropriate valuation should be.[70] As for the remaining six assets, the SEC offers vague allegations of more appropriate writedowns, but the SEC does not claim that these assets were worthless, does not provide any specific "actual" value, and does not provide the basis as to why the SEC's proposed writedowns would be more appropriate.[71] Finally, the Complaint does *not* allege that Yorkville's portfolio as a whole was overvalued, and, because the 7 Positions constituted a very small percentage of Yorkville's total assets under management in 2008 and

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[66] *See, e.g., In re Allied Capital Corp.*, No. 02 Civ. 3812 (GEL), 2003 WL 1964184, at **4-5 (S.D.N.Y. Apr. 25, 2003) ("[P]laintiffs have not sufficiently pled that Allied's valuation policies resulted in its overvaluing some of its investments. The Complaint simply states plaintiffs' opinion that various valuations were inappropriate, and sometimes a brief reason for that opinion, but fails to allege what plaintiffs contend was the true valuation, or to plead specific facts indicating that Allied's values were incorrect, or how Allied's accounting policy caused any overstatement. . . . [P]laintiffs have not alleged the *extent* of any such overvaluation") (emphasis in original); *In re Citigroup Inc. Sec. Litig.*, 753 F. Supp. 2d 206, 243 (S.D.N.Y. 2010) ("[P]laintiffs do not allege adequate facts establishing the inadequacy of the writedowns. . . . The mere allegation that some other company reached a different valuation is too vague to support the inference that Citigroup's valuation was incorrect.").
[67] *In re Allied Capital Corp.*, 2003 WL 1964184, at *5.
[68] *See In re Citigroup*, 753 F. Supp. 2d at 242; *see also Hutchinson v. Deutsche Bank Sec. Inc.*, 647 F.3d 479 (2d Cir. 2011) (affirming dismissal of complaint on the grounds that impairment of certain assets was not material in relation to "entire investment portfolio").
[69] *In re Allied Capital Corp.*, 2003 WL 1964184, at *4.
[70] Compl., ¶ 42(d).
[71] *See id.* at 42(a) through 42(g).

2009, any purported "overvaluation" of that small fraction of the portfolio is immaterial as a matter of law.[72]

2. Any Mis-Valuation Was Immaterial In Light Of The "Total Mix" Of Information

Even if the Complaint somehow alleged material misrepresentations with respect to the valuations of the 7 Positions—which it does not—Yorkville readily recognized and warned investors about the inherent subjectivity involved in valuing the portfolio assets. As detailed above, Yorkville's documents were replete with such cautionary language. Accordingly, these documents contained sufficient cautionary language to put the valuations in context and negate any suggestion that the valuations were materially false.[73] A statement or omission "is material if there is 'a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'"[74] Under the related "bespeaks caution" doctrine, cautionary language of the sort present here renders certain types of alleged misrepresentations or omissions immaterial as a matter of law.[75] The Court must examine whether, as a whole, a reasonable investor would have been misled in light of the total mix of information available.[76]

[72] Compl., ¶¶ 42-43; *see Greebel v. FTP Software, Inc.*, 194 F.3d 185, 206 (1st Cir. 1999) (alleged overstatement of revenue by 4.2 percent was not material); *Glassman v. Computervision Corp.*, 90 F.3d 617, 633 (1st Cir. 1996) (3 to 9 percent misstatement of revenues was not material).
[73] *SEC v. Merchant Capital, LLC*, 483 F.3d 747, 767-68 (11th Cir. 2007) (finding projections immaterial under bespeaks caution doctrine).
[74] *See Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 357 (2d Cir. 2002) (affirming that documents did not contain material misrepresentations); *San Diego Cnty. Emps. Ret. Ass'n v. Maounis*, 749 F. Supp. 2d 104, 119-21 (S.D.N.Y. 2010) (granting motion to dismiss).
[75] *Halperin*, 295 F.3d at 357 ("Certain alleged misrepresentations in a stock offering are immaterial as a matter of law because it cannot be said that any reasonable investor could consider them important in light of adequate cautionary language set out in the same offering."); *Maounis*, 749 F. Supp. at 119-20 (courts must consider total circumstances in determining if alleged misrepresentations are material).
[76] *Basic, Inc. v. Levinson*, 485 U.S. 224, 234 (1988) (As the Supreme Court has held, the "role of the materiality requirement is not to attribute to investors a child-like simplicity."); *Sable v. Southmark/Envicon Capital Corp.*, 819 F. Supp. 324, 334 (S.D.N.Y. 1993) ("'corporations are not required to address their stockholders as if they were children in kindergarten.'").

Yorkville's documents, including its PPMs and DDQs, plainly state to investors that the fund invests in distressed, illiquid assets, and painstakingly detail the risks associated with investing in these assets. For example, the PPM contains 13 pages of risk factors, including specific warnings about "valuation." Page i of the PPM states that "[m]any companies in which the Fund invests are in trouble or uncertain financial condition." Pages ii and iii also identify the risks of investing including "lack of liquidity." In the face of such rich and thorough risk disclosure, the SEC's suggestion that a small fraction of the portfolio was mis-valued falls woefully short of properly alleging a material misrepresentation.[77] Therefore, the SEC's valuation based claims should be dismissed.

iii. <u>The SEC Fails To Allege That The Mis-Valuations Were Made With Scienter</u>

Scienter requires a "mental state embracing intent to deceive, manipulate, or defraud," "extreme recklessness," or "conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care."[78] With regard to its Exchange Act 10(b), Securities Act 17(a)(1), and Investment Advisers Action 206(1) claims, the SEC must plead particular facts to (1) show defendants have motive and opportunity to commit the fraud or (2) constitute strong circumstantial evidence of conscious misbehavior or recklessness.[79] "To survive a motion to dismiss, a plaintiff must plead 'an inference of scienter *at least as likely as* any plausible opposing inference.'"[80]

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[77] *See Maounis*, 749 F. Supp. 2d at 111-12 (dismissing federal securities fraud claim where "[t]he PPM devotes more than fifteen pages to 'RISK FACTORS' associated with investment in the Fund").
[78] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976); *see also SEC v. Moran*, 922 F. Supp. at 897 (holding that the SEC failed to set forth facts to support allegations that defendant acted with requisite intent or extreme recklessness); *Lighthouse Fin. Grp.*, 2012 WL 4616958, at *6 (plaintiffs did not adequately allege scienter).
[79] *Kalnit*, 264 F.3d at 138, 140-42; *In re Loral Space Commc'ns Ltd. Sec. Litig.*, No. 01 Civ. 4388 (JGK), 2004 WL 376442 (S.D.N.Y. Feb. 27, 2004).
[80] *In re UBS Sec. Litig*., No. 07 Civ. 11225 (RJS), 2012 WL 4471265, at *11 (S.D.N.Y. Sept. 28, 2012) (dismissing plaintiffs' complaint against defendants); *SEC v. Lowy*, 396 F. Supp. 2d 225, 242-44 (E.D.N.Y. 2003) (holding that the SEC failed to show defendant acted with scienter).

1. <u>The SEC's Allegations Do Not Demonstrate Motive Or Opportunity</u>

The SEC alleges that the motive and opportunity arise from Yorkville's fee structure, under which "Yorkville received a Management Fee of 2% of the net worth of each fund." "In addition, the Funds paid an incentive fee of 20% of their net income (including net unrealized gains), of which 70% was paid to Angelo."[81] According to the SEC, "Defendants employed a fraudulent scheme to increase Yorkville's net worth, and thus the fees it charged, by deliberately ignoring obvious decreases in the value to certain of its investments, failing to subject those investments to Yorkville's stated valuation policies, and causing those investments to be carried at inflated values."[82] In short, the SEC claims that Defendants mis-valued only 7 assets out of 116 so that Angelo would profit from the increased fees he would ostensibly receive as majority owner of Yorkville.

This theory of scienter has many fatal flaws. First, courts, including this Court, regularly reject this type of incentive-based compensation allegation as insufficient to satisfy scienter pleading requirements.[83] In *Edison Fund v. Cogent Inv. Strategies Fund, Ltd.*, the district court held:

> [t]he 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.[84]

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[81] Compl., ¶¶ 23 & 24.
[82] Compl., ¶ 25.
[83] *Lighthouse Fin. Grp.*, 2012 WL 4616958, at *6 ("allegations that Defendants' incentive-based compensation provided financial motive to delay taking impairment charges is not pleaded with sufficient particularity and does not give rise to a strong inference of scienter"); *Edison Fund v. Cogent Inv. Strategies Fund, Ltd.*, 551 F. Supp. 2d 210, 227 (S.D.N.Y. 2008) (plaintiffs' attempt to plead motive and opportunity lack sufficient factual support); *Kalnit*, 264 F.3d at 139-42 (general allegations about a desire to be compensated did not sufficiently allege scienter); *In re Loral Space*, 2004 WL 376442 (holding plaintiffs failed to plead facts sufficient to show a concrete motive and opportunity).
[84] 551 F. Supp. 2d at 227; *Kalnit*, 264 F.3d at 139-42; *In re Loral Space*, 2004 WL 376442.

Second, these allegations completely ignore Yorkville's established internal controls specifically designed to prevent any suggestion that incentive fees would impact valuations. Further, Schinik, a member of the Committee, is not alleged (and could not be alleged) to have an ownership interest in Yorkville, and thus he did not stand to profit from Yorkville's incentive-based compensation. The Complaint does not (and cannot) allege that Schinik's salary or bonus were in anyway tied to or dependent upon management fees earned by Yorkville or were tied to the Fund's performance.

As for Angelo, a majority owner of Yorkville, the Complaint does not (and cannot) allege that he was on the Valuation Committee,[85] or that Angelo influenced the valuation decisions or had anything whatsoever to do with valuation at Yorkville.

In any case, the Complaint does not allege that Schinik or Angelo were responsible for valuing the portfolio or the 7 Positions or for determining what write-downs, if any, were appropriate. The SEC has failed to set forth any facts to show that any of the Defendants had either the motive or the opportunity to commit fraud.

2. The SEC Fails To Allege Recklessness

Even if the SEC had alleged a compelling motive and opportunity, which it has not, the SEC fails to plead scienter by recklessness, which requires the Commission to allege "conduct which is highly unreasonable and which represents [an] extreme departure from standards of ordinary care."[86]

To the contrary, the SEC's allegations show that Yorkville's auditor, McGladrey, was actively engaged in Yorkville's valuation to ensure that Yorkville's financial statements were

[85] Compare Compl. ¶ 12 (alleging Schinik served on valuation committee) with Compl. ¶ 11 (not alleging Angelo had any role on valuation committee).

[86] *SEC v. Northshore Asset Mgmt.*, No. 05 Civ. 2192 (WHP), 2008 WL 1968299, at *7 (S.D.N.Y. May 5, 2008) (recklessness requires "[a]n egregious refusal to see the obvious, or to investigate the doubtful").

presented fairly in accordance with generally accepted accounting standards. Courts have recognized that defendant's outside auditors' approval significantly undermines a showing of scienter.[87] Specifically, in *SEC v. Lucent Technologies, Inc.*, the district court dismissed the SEC's enforcement action and held:

> [a]lthough the auditors' approval of the accounting at issue here does not establish as a matter of law that the accounting was proper, it does seriously undermine the suggestion that Carter knowingly aided and abetted a scheme to misstate Lucent's financials.[88]

Here, the Complaint contains no allegations that McGladrey revoked its 2008 or 2009 audits or resigned due to a purported fraud at Yorkville. In fact, the Complaint does not allege any facts to suggest that McGladrey ever rejected or doubted Yorkville's policies, methodologies or valuations or that McGladrey engaged in any wrongdoing. McGladrey concluded that the financial statements, rather than demonstrating an extreme departure from standards of ordinary care, were in fact presented fairly in accordance with generally accepted accounting principles.[89] The SEC does not allege that McGladrey ever changed or withdrew its audit opinion or required any restatement during the SEC's three-year investigation. McGladrey issued its audit opinion for 2009 almost a year after the SEC commenced its investigation into Yorkville's valuations. Such an unwavering and unchallenged conclusion by Yorkville's auditor eviscerates any lingering suggestion that Defendants acted with fraudulent intent.

But there is more. The Complaint alleges that the "mis-valued" assets were valued at face value, which apparently is supposed to insinuate some further suggestion of fraud or

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[87] *In re REMEC Inc. Sec. Litig.*, 702 F. Supp. 2d 1202, 1251 (S.D. Cal. 2010) (dismissing claims against company and CFO in light of auditor's approval); *SEC v. Lucent Techs., Inc.*, 610 F. Supp. 2d 342, 367 (D.N.J. 2009) (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).

[88] *SEC v. Lucent Techs.*, 610 F. Supp. 2d at 367.

[89] Audited Financials, p. 1.

impropriety.[90] But this allegation is wholly consistent with Yorkville's represented valuation methodology prior to July 2008, which considered the face value or "cost" of the debenture—the only actual trading value input available—as a starting point for valuation and an approximation of fair value in the aggregate.[91] After July 2008, Yorkville changed its methodology based on the fair value of certain of its convertibles.[92] Before and after the July 2008 change, the goal was to approximate fair value in the aggregate, and the "lower of cost or impaired" would be a relevant starting point for such an inquiry. Thus, the fact that Yorkville continued to carry some of its positions at "face value" or cost, would not have been any sort of red flag, would not necessarily have been an erroneous "fair value," and does not give rise to an inference of scienter. For this reason alone, the SEC has not and cannot allege that the valuation of only these 7 Positions in a manner consistent with Yorkville's standard valuation strategy applied to the entire portfolio represents an "extreme departure from standards of ordinary care."[93] Moreover, because these valuations do not represent a deviation 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."[94]

3. Alleging Overvaluation Of 7 Out Of 116 Positions Does Not Support An Inference Of Scienter

Finally, the SEC does not allege that Yorkville overvalued its entire portfolio (or a majority of its portfolio, half of its portfolio, or even a substantial portion of its portfolio). Instead, the SEC alleges that Yorkville "overvalued" a mere 7 out of its 116 positions—a subset

[90] Compl., ¶ 42.
[91] 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").
[92] Compl., ¶ 35.
[93] *SEC v. Northshore Asset Mgmt.*, 2008 WL 1968299, at *7.
[94] *Id.*

too small to support an inference of scienter.[95] For at least all of the reasons stated above, the Complaint fails to plead facts to establish that Defendants possessed the requisite scienter.

B. The SEC Fails To Allege The Remaining Representations Constitute Fraud

Perhaps recognizing that its valuation-based allegations fail to state a cause of action for fraud, the SEC identifies a handful of purportedly "related" representations as "false and misleading." Tellingly, however, the SEC fails to allege that any of these other purported representations—regarding the use of third-party valuation expert, Pluris, the age of the portfolio, the amount of cash, and collateral—were material to investors.

To be sure, the SEC identifies several representations that it alleges are false and misleading:

- statements concerning collateral securing investments "were false and misleading;"[96]
- statements concerning role of the valuation committee were "false;"[97]
- statements about the amount of cash in the portfolio were "false;"[98]
- statements about the age of the portfolio investments were "false;" and[99]
- statements about the role of third-party valuation agent Pluris were "false."[100]

At no point in the Complaint, however, does the SEC allege that any of these purportedly false statements were material to investors, to McGladrey, or to anyone else.

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[95] *See Int'l Fund Mgmt. 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).
[96] Compl., ¶ 46, 50, 52, 54 & 55.
[97] Compl., ¶ 60.
[98] Compl., ¶ 67.
[99] Compl., ¶ 72.
[100] Compl., ¶¶ 76, 81, 86 & 91.

The SEC's failure to allege that any of these ancillary representations were material is undeniably fatal and makes perfect sense in light of its emphasis on the valuation issues and the "total mix" of information available to investors, prospective investors and McGladrey. [101] Specifically:

- Yorkville explicitly reserved "the right to change the [valuation] policy at its discretion" and informed investors that it was not limited by valuation guidelines and criterion set forth in its investor materials.[102]
- Yorkville investors were well aware of the characteristics of the convertibles in Yorkville's portfolio and the "inherent uncertainty" in valuing them.[103]
- Yorkville investors were also well informed about particular "Risk Factors," such as the age of the portfolio, cash and collateral, with respect to these convertibles.
- Yorkville repeatedly informed investors that the amount of time it would take to exit out of an investment varied from deal to deal and depended on a number of factors, any one of which could lengthen that timeframe.[104]
- Yorkville also informed its investors that exiting out of an investment and adhering to the goal of a 12 to 18 month "investment horizon" was left to Yorkville's discretion.[105]
- Yorkville disclosed to investors that most of its available cash was invested.[106]
- Yorkville's disclosures repeatedly warned about the uncertainty of collecting on collateral.[107]

The only instance in which the SEC even attempts to allege that these supposed misstatements were "material" to investors is with respect to the age of the portfolio. The SEC alleges that the age of the portfolio investments was important to investors only "because as investments of this kind age, the likelihood diminishes that the Funds would receive a positive

[101] *See Halperin*, 295 F.3d at 357 (A statement or omission "is material if there is 'a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'"); *Maounis*, 749 F.Supp.2d at 119-20 (same).
[102] PPM, p. 29, *supra* p. 6.
[103] PPM, p. 19.
[104] PPM, p. 20.
[105] PPM, p. 20.
[106] PPM, p. 35.
[107] PPM, p. 19.

return on their investment."[108] But this allegation reverts to the issue at the heart of the SEC's case—valuation, and how the age of those investments might affect the investments' value. Because the SEC does not set forth facts to support its valuation claims, its allegations regarding this purported misstatement also fail as a matter of law.

The SEC has attempted to dress up a valuation case with a hodge-podge of purportedly false statements to a small handful of individuals, all of which relate in one way or another to the real issue in this case: valuation. Because these other representations are ancillary and are contradicted or supplemented by more fulsome disclosures in the "total mix" of information available to investors, the SEC has not alleged, and cannot reasonably allege, that any of these representations were material to investors.

III. THE SEC'S AIDING AND ABETTING AND CONTROL PERSON ALLEGATIONS ALSO FAIL

The Complaint also alleges that Angelo and Schinik aided and abetted Yorkville's alleged violations of Section 10(b), Rule 10b-5 and the Advisers Act. Liability for aiding and abetting violations of the federal securities laws requires, among other things, a primary violation.[109] Similarly, as this Court held, "[t]o plead a claim under [Section 20(a) of the Exchange Act], a plaintiff must adequately plead an underlying violation."[110]

Here, because the SEC fails to make out an underlying violation of the Securities Act, Exchange Act, or Advisers Act, the aiding and abetting and control person claims must fail.[111]

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[108] Compl., ¶ 69.
[109] *SEC v. DiBella*, 587 F.3d 553, 566 (2d Cir. 2009); see also 15 U.S.C. § 78t(e).
[110] *Lighthouse Fin. Grp.*, 2012 WL 4616958, at *12.
[111] Further, as discussed above, the SEC has utterly failed to allege that Angelo had any role or influence over the valuation committee, the valuation process, or any specific or general decisions to write-down or not to write-down the value of any asset. In the absence of such allegations, the suggestion that Angelo is a "control person" for purposes of the SEC's claims must fail. *See Meridian Horizon Fund, L.P. v. Tremont Grp. Holdings, Inc.*, No. 09 Civ. 3708, 2012 WL 6168151 (S.D.N.Y. Dec. 11, 2012) (dismissing

CONCLUSION

For the foregoing reasons, Defendants respectfully request that the Court dismiss the Complaint. Because the SEC has had the benefit of years of pre-litigation investigation, the current allegations are presumably not going to improve with the benefit of an amended complaint. Accordingly, the dismissal should be without leave to amend.

Dated: Los Angeles, California
December 17, 2012

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control person claim against defendant and holding that plaintiff failed to plead culpable participation, a necessary element of section 20(a)).