U.S. SECURITIES AND EXCHANGE COMMISSION

Matter of

UNITED DEVELOPMENT FUNDING III, L.P., UNITED DEVELOPMENT FUNDING IV, *and* UNITED DEVELOPMENT FUNDING INCOME FUND V,

Respondents.

A.P. No. 3-18832

RESPONDENTS' REPLY MEMORANDUM IN FURTHER SUPPORT OF THEIR MOTION FOR SUMMARY DISPOSITION AND IN OPPOSITION TO THE DIVISION'S MOTION

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Respondents submit this reply memorandum in further support of their motion for summary disposition and in opposition to the Division's motion for summary disposition. The 2/26/2019 Order Setting Briefing Schedule directed both parties to file motions for summary disposition under Rule 250(b), along with briefs, affidavits and other supporting materials. The order specified that it was then "unclear" whether there would be an "evidentiary hearing before a trier of fact."

In support of their motion, Respondents have submitted and rely on the 3/28/2019 declaration of their president and CEO Hollis Greenlaw, who is a percipient witness with personal knowledge of the relevant facts and who is thus competent to testify as a witness in this matter. Respondents have, as directed, also submitted and rely on the 93 exhibits that are identified and incorporated in the Greenlaw declaration and that are relevant and necessary for fair consideration of this matter. Respondents have also submitted a 3/28/2019 brief supporting their motion, and a 4/29/2019 brief opposing the Division's motion.

The Division has identified a number of issues that it disputes, and that it says cannot be determined on a motion for summary disposition. While disputing relevance, the Division has thus demonstrated why there are fact issues requiring denial of its own summary disposition motion. The Division has also submitted two declarations by its counsel, obviously not a witness competent to testify on personal knowledge, on 3/27 and 4/26/2019 and a total of 33 exhibits in support of its arguments. The Division has also submitted a 3/27/2019 brief supporting its motion, and a 4/29/2019 brief opposing Respondents' motion ("Div. Opp.").

The Division's position is essentially that missing several periodic reports should result in deregistration in virtually any situation. This contradicts the Commission precedent requiring

that each §12(j) case be resolved based on a careful consideration and weighing of the particular evidence presented in the record against certain articulated factors. This factor-based analysis reflects what the Commission does in other types of administrative adjudication, for example cease-and-desist proceedings. *Matter of KPMG Peat Marwick LLP*, 2001 WL 47245 at *98-99 and n.115 (Jan. 19, 2001), *aff'd*, 289 F.3d 109, 120 (D.C. Cir. 2002), citing and relying on the D.C. Circuit's decision in *SEC v. Steadman*, 967 F.2d 636, 647-648 (D.C. Cir. 1992).

The factors the Commission uses to decide §12(j) cases include: "**[i]** the seriousness of the issuer's violations, **[ii]** the isolated or recurrent nature of the violations, **[iii]** the degree of culpability involved, **[iv]** the extent of the issuer's efforts to remedy its past violations and ensure future compliance, and **[v]** the credibility of its assurances, if any, against further violations." *Matter of Advanced Life Sciences Holdings, Inc.*, 2017 WL 3214455 at *3 (2017), quoting *Matter of Gateway International Holdings, Inc.*, 2006 WL 1506286 at *4 (2006).

As discussed below and in our earlier briefs, Respondents have made a substantial evidentiary submission (including 93 exhibits and the declaration of a witness with personal knowledge) as to each of these Commission factors. In contrast, the Division's briefs note each factor but then offer no evidentiary support for why it should prevail on each factor. The Division simply argues in conclusory fashion that missed filings are always serious, missed filings are always recurrent, missed filings always make a respondent culpable, missed filings show they have not yet been remedied, and missed filings render a respondent not credible.

With its substantial evidentiary submission, Respondents' motion has complied with the Rule 250 standard, but the Division's motion has not. "In assessing the summary disposition record, the facts, as well as the reasonable inferences that may be drawn from them, must be viewed in the light most favorable to the non-moving party." *Matter of Jaycee James*, 2010 WL 3246170 at *3 (ALJ April 2, 2010). "The evidence of the non-movant is to be believed, and all justifiable inferences are to be drawn in his favor. ... Neither do we suggest that the trial courts should act other than with caution in granting summary judgment or that the trial court may not deny summary judgment in a case in which there is reason to believe that the better course would be to proceed to a full trial." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986) (rejecting "trial on affidavits"). *See also Royal Crown Day Care LLC v. Dept. of Health and Mental Hygiene*, 746 F.3d 538, 544 (2d Cir. 2014) ("On a motion for summary judgment, a fact is material if it 'might affect the outcome of the suit under the governing law,'" quoting *Anderson*, 477 U.S. at 248).

Respondents renew their procedural objection (discussed in our 4/29/2012 opposition brief, pp. 2-3) to the failure to assign an administrative law judge or other hearing officer to consider both sides' summary judgment motions in the first instance. As previously stated, the Commissioners' many demands make it impossible for them to actually do the work contemplated by Rule 250 of personally reviewing the lengthy and detailed submissions in this matter. The Commissioners sit as a *de novo* review panel (as federal appeals courts review certain matters *de novo*), but only after an ALJ has already invested the time and effort to hear

counsel, personally review the submissions and exhibits and prepare an initial decision. The modern Commission is simply not equipped to sit as a court of first instance, even for a summary disposition where there is a substantive record. There is no way that the four sitting Commissioners can each abandon their other pressing obligations to spend days reading this record in order to make the determinations that Rule 250 and due process require. The inevitable result would be that the Commissioners would just skim the submissions, or more likely that they would be forced to rely on one or more faceless staff lawyers – the real judges, who would remain anonymous – for how they should decide the matter. This is fundamentally not fair, and does not comport with due process. And the fact that this case has no judge assigned while other cases do have an actively engaged judge additionally creates an equal protection problem.

(1) The "Seriousness of Violations" Factor

Respondents provided detailed documentary evidence among their 93 exhibits and in the Greenlaw declaration to demonstrate that the lapse in periodic reporting here resulted from events never before seen in a §12(j) proceeding. The facts presented here show a multi-year well-financed and sophisticated market manipulation by Kyle Bass and his Hayman entities (collectively "Hayman") that took hundreds of millions of dollars in market capitalization away from Respondents' unsuspecting investors in order to allow the Hayman manipulators to reap $48 million in illegal fraud proceeds. Respondents' earlier briefs reviewed and summarized this record evidence.

Respondents further presented detailed documentary evidence showing how the Hayman manipulators' program included targeted communications and other efforts to drive away a series of auditors Respondents were trying to engage or actually did engage. Respondents obviously could not file periodic reports without auditors to review quarterly reporting and audit annual reporting. Respondents also provided evidence showing that the inability to proceed with audit work continued until final resolution of the Staff's non-fraud allegations by no-admission settlement on 7/31/2018, whereupon this §12(j) proceeding quickly followed on 9/24/2018.

In response, the Division has provided no contrary evidence. Its counsel's two declarations do not address this point, nor do its 33 exhibits. All the Division can muster is a conclusory statement in its brief advising the Commission that "The Division disputes Respondents' claim that Hayman's actions 'unquestionably prevented Respondents from obtaining the audited financial statements and reviews they needed for periodic reporting.'" (Div. Opp. p. 5) What evidence does the Division rely on to try to show that Hayman's actions did not prevent audited financial statements and reviews? The Division does not come forward with evidence to attempt to rebut the substantial and detailed documentary evidence that Respondents have already placed into the record.

(2) The "Isolated or Recurrent" Factor

As demonstrated in Respondents' 93-exhibit evidentiary presentation and declaration, this matter reflects a persistent but singular effort by the Hayman manipulators to line their pockets through fraud at the expense of Respondents' investors. Respondents kept trying to engage auditors and pay their fees in full to get current in their periodic reporting. But after Hayman accused Respondents' auditors Whitley Penn of lying to investors, engaging new auditors was a challenge. After speaking with a number of substantial audit firms, Respondents succeeded in lining up Grant Thornton, which formed an audit team and prepared to take over the engagement. Until Hayman's activities drove them off, while contemporaneous documentary evidence in the record shows Hayman's Bass gloating that Respondents were still left without auditors.

After further efforts, Respondents succeeded in engaging EisnerAmper, which a week later received a package of Hayman's materials attacking Respondents. Followed by Hayman's documented social media campaign professionally targeted at DFW-area auditors to drive them away from Respondents. Then, as previously explained, EisnerAmper advised that it needed to see that the final judgment entered on the Staff's settlement would be on a non-scienter no-admission basis, and not on the basis of Hayman's scienter-based Ponzi allegations that had formed the core of Hayman's manipulation campaign.

In response, the Division has provided no contrary evidence. Again, its counsel's declarations are not evidence and do not address this point. The Division does not provide evidence countering the singular nature of Hayman's unitary attack or Respondents' singular and constant efforts to retain and keep auditors for their periodic reporting – the opposite of a "recurrent" deviation from duty.

(3) The "Degree of Culpability" Factor

Respondents' substantive evidence in the record shows that Hayman blasted away about $500M in market cap and caused Respondents' stock drop – from $17.60 to under $2 – through a targeted and professionally-run campaign that victimized Respondents and their shareholders. The campaign persisted over an extended period until Hayman could walk off with $48M in illegal profits. All the while, Respondents kept trying to engage auditors to get current in their reporting. On this evidentiary record, the "culpability" along with the $48M fraud profits were with Hayman, not with Respondents.

As with the other factors, the Division concludes that the missing filings themselves are all the Division must show to prove culpability. The Division concludes that Respondents are culpable because they "knew of their reporting obligations yet each failed to file numerous periodic reports." In the Division's view, simple non-filing for any reason "establishes a high degree of culpability that is more than sufficient to support summary disposition in the Division's favor." (Div. Opp. p. 10) If non-filing standing alone were sufficient, then each of

the "factors" would become meaningless, and we would then be left with no standards for issuing §12(j) orders – the opposite of the careful factor-based analysis that the *KPMG* case noted above imposed in the context of cease-and-desist orders.

As argued in Respondents' earlier briefing, the unique facts and circumstances here distinguish this case from *Matter of Eagletech Communications, Inc.*, 2006 WL 1835958 (2006), which may be the only other §12(j) Commission opinion involving short selling. In *Eagletech*, the issuer was subjected simply to "naked" short selling and argued that the Commission's adoption of Regulation SHO with a "grandfathering" clause resulted in a Constitutional "taking" without due process. However Eagletech actually stopped its periodic reporting while "experiencing extreme financial difficulties at the time," and admitted at the hearing that it lacked resources to get current in its reporting. *Id.* at *1-2. Here as discussed in detail below, UDF was subjected to a sophisticated, long-term and illegal short-and-distort attack designed to crater its stock price and drive off the series of audit firms UDF kept trying to engage and pay in full to do its audit work.

The same is true for initial decisions in §12(j) proceedings. The ALJ opinion in *Matter of China MediaExpress Holdings, Inc.*, 2012 WL 2884859 at *4 (ALJ July 16, 2012), like *Eagletech* involved simple short selling in the context of Deloitte resigning when it "concluded that the company was not proceeding in good faith," that the board did "not have a proper basis for concluding" its financials were "free from material misstatement," and that investors should no longer rely on the issuer's audited financials. Again, this is nothing like our case.

(4) The "Efforts to Remedy" Factor

Respondents' evidentiary submission shows Respondents' efforts to become current in reporting, including engagement of Riveron Consulting to reconstruct loan files that had been seized in the televised FBI raid provoked by Hayman. EisnerAmper required these loan files as part of the preparation to conduct its audit. EisnerAmper's audit work is presently in progress, and all participants are committed to getting it done promptly.

In opposition, the Division offers no evidence. It simply states, without proof, that "The Division disputes that Respondents are working to promptly file a comprehensive report on From 10-K." (Div. Opp. p. 5) After mistakenly characterizing Corp Fin's Financial Reporting Manual, the Division finds fault only with Respondents' reasonable decision to include 2017 and 2018 quarterly information, but not to also include 2016 quarterly information in view of its age and doubtful usefulness. (Div. Opp. pp. 4-5) The Division fails to note that Respondents recently advised through counsel that they would be willing to provide 2016 quarterly information as well, if asked to do so. Yet based on this, the Division opines that Respondents "are proposing, then, to file a report that contains far less than what Corp Fin discusses as 'comprehensive.'" (Div. Opp. p.5) Well beyond "disputed," this contention is just wrong.

(5) The "Credibility of Assurances" Factor

Respondents' evidence in the record shows its efforts to engage auditors and get current. This was an effort that, under intense fire from the Hayman manipulators, took Respondents from Whitley Penn to Grant Thornton to EisnerAmper. Then to engaging Riveron as consultants to reconstruct loan folders across their portfolio. Then to working with the Staff to finalize a non-scienter no-admission settlement that would allow EisnerAmper to proceed. The record evidence shows Respondents making extraordinary efforts, and it is difficult to imagine any entity trying harder. When Respondents give assurances, they mean it.

Again, the Division comes forward with no record evidence to rebut this proof. Just the conclusion that non-filings warrant a finding of no credibility. Again effectively rendering the factor meaningless by summarily concluding it cannot be satisfied.

Conclusion

Respondents' summary disposition motion should be granted, based on their substantive evidentiary submissions on each of the Commission's five *Gateway International* factors. This proceeding should be dismissed, and Respondents should be given an opportunity to complete their in-progress audit work by EisnerAmper and to file their comprehensive Form 10-K through the end of 2018 and subsequent Forms 10-Q for 2019. The Division's motion should be denied. Alternatively, this matter should be referred for an evidentiary hearing before a trier of fact.

Dated: May 13, 2019

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Certificate of Compliance

The undersigned certifies that this brief contains 2681 words, based on the word-count function of the Microsoft Word software used to prepare the brief.

/s/ William E. Donnelly

Certificate of Service and Filing

Pursuant to Rule 150(c)(2), I certify that on May 13, 2019, I caused the foregoing to be sent: **(1)** By **courier service (original and 3 copies)** directed to the Office of the Secretary, Securities and Exchange Commission, 100 F Street NE, Washington DC 20549-1090, with an electronic courtesy copy by **email** to apfilings@sec.gov. **(2)** By **email and express delivery service** directed to Keefe M. Bernstein and David Whipple, Fort Worth Regional Office, Securities and Exchange Commission, 801 Cherry Street, Suite 1900, Fort Worth, TX 76102, and BernsteinK@sec.gov and WhippleDa@sec.gov.

/s/ William E. Donnelly