JOHN W. HUBER, United States Attorney (#7226)
JOHN K. MANGUM, Assistant United States Attorney (#2072)
111 South Main Street, Ste. 1800
Salt Lake City, Utah 84111
Telephone: (801) 524-5682
Email: john.mangum@usdoj.gov

ERIN HEALY GALLAGHER, *pro hac vice*
DC Bar No. 985670, erin.healygallagher@usdoj.gov
ERIN R. HINES, *pro hac vice*
FL Bar No. 44175, erin.r.hines@usdoj.gov
CHRISTOPHER R. MORAN, *pro hac vice*
NY Bar No. 5033832, christopher.r.moran@usdoj.gov
Trial Attorneys, Tax Division
U.S. Department of Justice
P.O. Box 7238
Ben Franklin Station
Washington, D.C. 20044
Telephone: (202) 353-2452

IN THE UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF UTAH, CENTRAL DIVISION

UNITED STATES OF AMERICA, Plaintiff, vs. RAPOWER-3, LLC, INTERNATIONAL AUTOMATED SYSTEMS, INC., LTB1, LLC, R. GREGORY SHEPARD, NELDON JOHNSON, and ROGER FREEBORN, Defendants.	Civil No. 2:15-cv-00828 DN **UNITED STATES' BRIEF IN OPPOSITION TO DEFENDANTS' MOTION TO STRIKE** Judge David Nuffer Magistrate Judge Evelyn J. Furse

Based on a tortured reading of this Court's order denying their motion to bifurcate discovery and trial on the issue of the viability of their purported solar energy technology,[1] Defendants Neldon Johnson, RaPower-3, LLC, International Automated Systems, Inc., and LTB1, LLC, ("Defendants") now move to strike certain paragraphs of the complaint and prayer for relief against them[2]. But the United States' allegations that Defendants' technology is *not* viable are material and pertinent to the issues to be tried in this case, and are neither redundant nor scandalous.[3] Defendants' arguments in their untimely motion do not, and cannot, meet their heavy burden of showing that the allegations should be stricken. Defendants' motion to strike should be denied.

I. Statement of facts and issues to be decided.

A. Summary of the claims and defenses in this case.

The United States filed its complaint in this case on November 23, 2015 seeking to enjoin Defendants pursuant to 26 U.S.C. §§ 7402 and 7408 from (among other things[4]) organizing, promoting, and selling the "solar energy scheme" that they have been promoting since or before 2010.[5] As described in the complaint, the solar energy scheme purportedly offers a "disruptive and revolutionary" approach to capturing and using solar energy. The technology underlying the

[1] ECF Doc. 158.

[2] ECF Doc. 173.

[3] *See* Fed. R. Civ. P. 12(f).

[4] The United States does not claim to set forth, in this brief, *all* of the reasons that Defendants should be enjoined.

[5] ECF Docs. 2 and 35 ¶ 1(a).

solar energy scheme, purportedly invented by Neldon Johnson, uses "solar thermal lenses" on International Automated Systems, Inc.'s (IAS) "solar towers."

Defendants make money by selling the "lenses" to customers. As of 2012, they claimed to have "a thousand [customers] from all corners of the United States."[6] The United States alleges that so many customers are willing to buy the lenses because Defendants assure them that, in return, they will receive tax benefits far greater than the customers' cash outlay to join the scheme. The underpinnings of Defendants' solar energy scheme are their assertions that: 1) customers who buy lenses are in a "trade or business" or have bought the lenses for the purpose of making a profit; 2) customers may deduct such "business" expenses, consisting mostly of depreciation on the lenses, from their "ordinary income" like wages from their full-time jobs; and 3) customers may claim a solar energy credit to further reduce their tax liability. As of March 2015, Shepard told the IRS that "RaPower[-]3 should expand its member base by thousands of [customers]," all of whom would be "claiming tax benefits."[7]

But Defendants know, or have reason to know, that their statements (both about their technology and the tax benefits they promote) are false or fraudulent. Defendants also falsely inflate the value of the lenses they sell over the correct value of such lenses to increase the tax benefits they promote to their customers. This inflates the unwarranted deductions, credits, and corresponding harm to the United States Treasury. Defendants' financing structure allows their customers pay approximately 90 percent of the "down payment" for each lens only *after* the customer has received the "tax refunds/savings" from buying in to Defendants' solar energy

[6] Pl. Ex. 504 at Bates numbered page Gregg_P&R-002666.

[7] Pl. Ex. 10 at 6.

scheme.[8] Thus, the money lost to the Treasury from these unwarranted deductions and credits goes directly into Defendants' own pockets.

Defendants deny the United States' allegations. They contend that their solar energy scheme is not abusive; that the statements they have made in promoting the scheme are "grounded in fact and law" and that they were "provided tax advice from legal professionals regarding associated tax credits and deductions."[9]

In light of the allegations and defenses, the parties agreed that discovery would be needed on statements made by Defendants regarding the so-called technology, about any related federal tax deductions, credits or benefits they promote, and about Defendants' state of mind as they made such statements.[10]

B. This Court denied Defendants' motion to bifurcate trial on the issue of "the nature and viability of Defendants' purported solar energy technology."

More than six months after the start of discovery and approximately ten months after this case was filed, Defendants moved to bifurcate this case such that the parties would move forward with discovery and trial solely on the "nature and viability of Defendants' purported solar energy technology."[11] At base, Defendants asserted that if they could prove that their technology is "viable," the Court would have to enter judgment in their favor. If, instead, the Court determined

[8] Pl. Ex. 505 at 1.

[9] ECF Doc. 35 ¶ 1(a), Defendants' Claims and Defenses; *see also* ECF Doc. 22, Defenses.

[10] *See* 26 U.S.C. § 6700(a)(2)(A); ECF Doc. 2 ¶¶ 157-159; ECF Doc. 35 ¶ 2(a).

[11] ECF Doc. 90 at 2.

that the technology is not viable, Defendants believed that only then discovery and trial on the remaining issues in this case should move forward.[12]

This Court denied Defendants' motion.[13] The Court observed that the viability of Defendants' technology *is* a relevant issue in the case.[14] Specifically, "the technology's viability might be a 'material matter' about which the defendants made certain representations."[15] The Court rightly concluded, however, that this *relevant* issue would not be *dispositive* of any claim or defense in this litigation.[16] Therefore, Defendants' requested bifurcation would not fulfill the goals of bifurcating a case for trial.[17] Instead, bifurcation would result in "[t]wo separate phases of discovery; two separate sets of dispositive motions; two periods of trial preparation for both the litigants and the court; and two trials," which would "completely outweigh whatever degree of paring down bifurcation might achieve."[18]

C. Defendants moved to strike certain allegations from the complaint.

Four days after new counsel entered an appearance in this case, Defendants moved to strike certain paragraphs of the United States' complaint and prayer for relief against them.[19]

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[12] *See id*. at 4.

[13] ECF Doc. 158 at 5-6.

[14] *Id.*

[15] *Id.* at 5, *quoted in* ECF Doc. 173 at 3.

[16] ECF Doc. 158 at 5-6.

[17] *Id.* at 6.

[18] *Id.* (Bifurcation "would not be more convenient. It would not avoid prejudice. It would not resolve the issues more expeditiously. And it would not economize judicial or litigant resources.") (footnotes omitted)).

[19] *See generally* ECF Doc. 173 (filed on May 26, 2017); ECF Docs. 166-67, 169 (filed on May 22, 2017).

Defendants' support for their motion is their fundamental misunderstanding of the Court's order on their motion to bifurcate.

II. Defendants' motion to strike should be denied because the United States' allegations are material and pertinent to the issues to be tried in this case, and are not scandalous.

A court may strike from a complaint "any redundant, immaterial, impertinent, or scandalous matter" when a defendant moves to strike "before responding to the [complaint]."[20] A "redundant" allegation constitutes "needless repetition of other averments or which are foreign to the issue to be denied." [21] An "immaterial" allegation "has no essential or important relationship to the claim for relief or defenses pleaded."[22] An "'impertinent' allegation is neither responsive nor relevant to the issues involved in the action and which could not be put in issue or given in evidence between the parties."[23] A "scandalous" allegation "bears no possible relation to the controversy or may cause the objecting party prejudice," such as by improperly casting a party in "a derogatory light" [24] or by using "abusive and offensive language"[25].

Motions to strike "are not favored and, generally, should be denied" unless 1) it is clear that the allegations sought to be stricken have no possible relation to the claims and defenses at

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[20] Fed. R. Civ. P. 12(f)(2). Defendants do not argue that the allegations at issue are "redundant," so the United States will not address that basis for a Rule 12(f) motion.

[21] *Wilkerson v. Butler*, 229 F.R.D. 166, 170 (E.D. Cal. 2005), *overruled on other grounds, by Whittlestone Inc. v. Handi-Craft Co.*, 618 F.3d 970 (9th Cir. 2010), *as stated in Won Kyung Hwang v. Ohso Clean, Inc.*, No. C-12-06355 JCS, 2013 WL 1632697, at *22 (N.D. Cal. Apr. 16, 2013).

[22] *Wilkerson*, 229 F.R.D. at 170.

[23] *Id.*

[24] *Id.*

[25] *See Pola v. Utah*, 458 F. App'x 760, 763 (10th Cir. 2012).

issue, and 2) such allegations may cause significant prejudice to a party.[26] Any doubt about the relevance of the allegation subject to the motion to strike should be resolved in favor of the non-moving party.[27] "The Tenth Circuit has warned that courts should proceed with extreme caution in striking a pleading."[28] Courts and commentators have observed that a motion to strike relevant allegations is a "time waster[]," and filing one may be a "dilatory tactic."[29]

A. The United States' allegations about Defendants purported solar energy technology are highly relevant to the issues to be tried.

Defendants admit that the viability of Defendants' purported solar energy technology is relevant to the claims and defenses in this case, and quote this Court in doing so: "[T]he technology's viability might be a 'material matter' about which the defendants made certain representations."[30] As the United States explained in its opposition to Defendants' motion to bifurcate,[31] among the issues to be tried in this case is whether Defendants (1) organize or assist in the organization of a plan or arrangement, or participate in the sale of any interest in a plan or arrangement; and (2) make or furnish, or cause another to make or furnish, certain statements.

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[26] *Fed. Nat'l Mortg. Ass'n v. Milasinovich*, 161 F. Supp. 3d 981, 992-93 (D.N.M. 2016) (quoting 5C Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 1382 (3d. ed.2015)); *Thompson v. Washington Nat'l Ins. Co.*, No. 2:14-CV-00660-DN, 2015 WL 8346166, at *2 (D. Utah Dec. 8, 2015) (Nuffer, J.); *U.S. ex rel. Dye v. ATK Launch Sys., Inc.*, No. 1:06-CV-39 TS, 2008 WL 2074099, at *4 (D. Utah May 14, 2008) (Stewart, J.).

[27] *Sawo v. Drury Hotels Co.*, LLC, No. 11-CV-2232-JTM-GLR, 2011 WL 3611400, at *2 (D. Kan. Aug. 15, 2011).

[28] *Tiscareno v. Frasier*, No. 2:07-CV-336, 2012 WL 1377886, at *13 (D. Utah Apr. 19, 2012) (quotation omitted) (Waddoups, J.).

[29] *Fed. Nat'l Mortg. Ass'n*, 161 F. Supp. 3d at 994; *Pessin v. Keeneland Ass'n*, 45 F.R.D. 10, 13 (E.D. Ky. 1968); 5C Federal Practice and Procedure § 1382.

[30] ECF Doc. 173 at 3 (quoting ECF Doc. 158 at 5 ("The resolution [of this case] may, as defendants argue, be helped if there were a determination on the technology's viability. For instance, the technology's viability might be a 'material matter' about which the defendants made certain representations.")).

[31] ECF Doc. 95.

One such statement subject to penalty is a statement with respect to the securing of a tax benefit by reason of holding an interest in an entity or participating in a plan or arrangement that the person knows or has reason to know is false or fraudulent as to any "material matter."[32] Another such statement subject to penalty is a "gross valuation overstatement as to any material matter."[33] A gross valuation overstatement is "any statement as to the value of any property or services" if the value of the property or services is directly related to the amount of any tax deduction or credit and the stated value is more than 200 percent of the correct value of the property or services.[34]

"*Material matters* are those which would have a substantial impact on the decision-making process of a reasonably prudent investor and include matters relevant to the availability of a tax benefit."[35] Statements about "material matters" include those that "directly address[]" the tax benefits purportedly available to a participant in a tax scheme and those that "concern[] factual matters that are relevant to the availability of tax benefits."[36] Promoters of abusive tax schemes often make statements about both kinds of material matters: whether the object on which their scheme is based actually exists and/or works the way the promoters claim it does

[32] 26 U.S.C. § 6700(a)(2)(A).

[33] 26 U.S.C. § 6700(a)(2)(B).

[34] 26 U.S.C. § 6700(b)(1).

[35] *United States v. Campbell*, 897 F.2d 1317, 1320 (5th Cir. 1990) (emphasis added); *United States v. Buttorff*, 761 F.2d 1056, 1062 (5th Cir. 1985); *Anderson v. IRS*, 442 F. Supp. 2d 365, 373 (E.D. Tex. 2006) ("Material matters include matters relevant to the availability of a tax benefit.").

[36] *Campbell*, 897 F.2d at 1320.

(*e.g.*, "solar power modules;"[37] a cattle breeding partnership;[38] photographic master negatives and plates;[39] a jewelry distribution network[40]), such that the purported tax benefits that flow from buying into the scheme are lawful (or not).

As Defendants acknowledge, the state of their purported technology is one "material matter" that is relevant to some of the issues to be tried.[41] It is relevant to the issue of whether Defendants made statements (which they knew or had reason to know were false or fraudulent) to their customers, under § 6700(a)(2)(A), regarding whether their customers were in a trade or business related to the lenses. One of the facts relevant to whether a customer was in a trade or business is whether the customer engaged in the activity to make a profit. Therefore, if Defendants told customers to expect income from their lenses due to the production of energy, but Defendants knew, or had reason to know, that their technology was not in a state of sufficient readiness to generate such income at the time the statement was made, this Court could conclude that Defendants made a false or fraudulent statement as to a material matter and had engaged in conduct subject to penalty under § 6700(a)(2)(A).

Similarly, if Defendants told customers that their lenses qualify as "solar energy property" under § 48, but Defendants knew, or had reason to know, that their technology was not using solar energy to generate electricity, to heat or cool (or provide hot water for use in) a

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[37] *United States v. United Energy Corp.*, No. C-85-3655 RFP (CW), 1987 WL 4787, at *2-7, 11 (N.D. Cal. Feb. 25, 1987).

[38] *Van Scoten v. Comm'r*, 439 F.3d 1243 (10th Cir. 2006).

[39] *United States v. Petrelli*, 704 F. Supp. 122, 124, 126-27 (N.D. Ohio 1986).

[40] *Jackson v. Comm'r*, 966 F.2d 598 (10th Cir. 1992).

[41] *See* ECF Doc. 173 at 3 (quoting ECF Doc. 158 at 5).

structure, or to provide solar process heat for any purpose that Congress intended to incentivize, this Court could conclude that Defendants made a false or fraudulent statement as to a material matter and had engaged in conduct subject to penalty under § 6700(a)(2)(A). Facts about Defendants' technology will also assist the Court in determining the "correct valuation" of the lenses that Defendants sold and whether Defendants' statements of the lenses' value exceeded 200 percent of that amount, under § 6700(a)(2)(B).

For all of these reasons, the United States' allegations about Defendants' purported solar energy technology are material and pertinent.

B. The United States' allegations are not scandalous.

In a related argument, Defendants claim that the United States' allegations, including use of the word "scheme" and the phrase "abusive solar energy scheme," are pejorative and "unambiguous and unnecessary insult[s] to Defendants suggesting they are promoting fraudulent technology."[42] All of the United States' allegations, including the words "abusive" and "scheme" are used in the context of the United States' theory of the case: that Defendants are promoting an abusive tax scheme, which starts with purported solar energy technology, and should be enjoined from continuing to do so.[43] The allegations are not, in themselves, abusive or offensive.[44] At the appropriate time, the United States will show this Court the facts that support its allegations that Defendants' "scheme" is "abusive," including that "Defendants' purported 'disruptive' and

[42] ECF Doc. 173 at 2, 4.

[43] 26 U.S.C. §§ 6700, 7402, 7407; *see Countrywide Home Loans, Inc. v. Arbitration All. Int'l, LLC*, No. 204CV152 TS, 2004 WL 987131, at *2-3 (D. Utah Apr. 14, 2004) (Pead, M.J.).

[44] *See Pola*, 458 F. App'x at 763; *Wilkerson*, 229 F.R.D. at 170 (citations omitted).

'revolutionary' technology is a sham."[45] Defendants may dispute these allegations, and they are free to challenge the United States' theory of the case with facts and legal argument.[46] But Defendants' unsupported objections to these words are not a reason for this Court to take the drastic remedy of striking any of the United States' allegations.[47]

C. Defendants' motion to strike is untimely may be denied on that basis alone.

A party must move to strike material from a complaint within 21 days of service, and *before* answering the complaint.[48] Defendants answered the United States' complaint on January 21, 2016, nearly eighteen months ago.[49] This motion to strike is untimely and Defendants have offered no convincing reason why, if the allegations at issue are "immaterial, impertinent, or scandalous," they waited more than eighteen months to act. Discovery has been taken, and is nearly complete, on the issue of the viability of Defendants' purported solar energy technology.[50] The case is moving steadily toward final resolution on all claims and defenses. This untimely

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[45] ECF Doc. 2 ¶ 55.

[46] *See Countrywide Home Loans*, 2004 WL 987131, at *2-3.

[47] *See id.*; *c.f. L & B Dev. Co. Inc. v. Barnes Bancorporation*, No. 2:12-CV-01119 DN, 2013 WL 6858310, at *3 (D. Utah Dec. 30, 2013) (a defendant's "vehement" dispute with a complaint's allegations, absent specific examples of redundant, immaterial, impertinent, or scandalous allegations, were insufficient to strike a complaint) (Nuffer, J.). This is particularly true when Defendants themselves appear to be ambivalent (at best) about the words "abusive" and "scheme"; they move to strike some such allegations, but not all. *Compare, e.g.*, ECF Doc. 173 at 2 (moving to strike, among other paragraphs, ECF Doc. 2, Compl. ¶ 76(b), which contains the phrase "solar energy scheme") *with id.* (*not* moving to strike Compl. ¶ 76(c) (containing "solar energy scheme"); *compare id.* (moving to strike Compl. ¶ 56 (containing "abusive solar energy scheme") *with id.* (*not* moving to strike Compl. ¶ 14 (containing "abusive tax scheme"). They do not explain why they believe that only *some* such allegations are pejorative and/or insulting, but not all are.

[48] Fed. R. Civ. P. 12(a)(1)(A)(i), (f).

[49] ECF Doc. 22. In their answer, Defendants admitted to some of the allegations (either in full or in part) they now move to strike. *Id.* ¶ 17, 21-22, 29, 42, 48-49.

[50] *E.g.*, ECF Doc. 178 at 2 (seeking to take certain discovery out of time, including the depositions of the four Defendants with best knowledge of the purported solar energy technology at issue); ECF Doc. 37 ¶ 5 (deadline for expert disclosures and discovery not yet passed).

motion to strike initiating allegations should not be allowed to derail the case at this late date. The motion should denied for this reason alone.[51]

III. Conclusion

The United States' allegations against Defendants' are material and pertinent to the issues to be tried in this case, and are not scandalous. The United States will prove its allegations at the appropriate stage of this litigation. Defendants may present their own facts and law to contest the United States' positions. But Defendants have not shown, and cannot show, that the United States' allegations should be stricken from the complaint. Their motion should be denied.

[51] *Sterling Consulting Corp. v. Credit Managers Ass'n of California*, 252 F. App'x 915, 917 (10th Cir. 2007) (district court did not abuse discretion in denying as untimely a motion to strike an answer filed ten months after the answer was filed, when the moving party offered no "convincing explanation for the delay"); *c.f. Tiscareno*, 2012 WL 1377886, at *14 (evaluating, on the merits, a motion to strike that was "tardy by a significant margin," in exercise of discretion to reduce prejudice to the moving party).

Dated: June 8, 2017

Respectfully submitted,

/s/ Erin Healy Gallagher

ERIN HEALY GALLAGHER
DC Bar No. 985760
Email: erin.healygallagher@usdoj.gov
Telephone: (202) 353-2452
ERIN R. HINES
FL Bar No. 44175
Email: erin.r.hines@usdoj.gov
Telephone: (202) 514-6619
CHRISTOPHER R. MORAN
New York Bar No. 5033832
Email: christopher.r.moran@usdoj.gov
Telephone: (202) 307-0834
Trial Attorneys, Tax Division
U.S. Department of Justice
P.O. Box 7238
Ben Franklin Station
Washington, D.C. 20044
FAX: (202) 514-6770
ATTORNEYS FOR THE UNITED STATES

CERTIFICATE OF SERVICE

I hereby certify that on June 8, 2017, the foregoing document and its supporting exhibits were electronically filed with the Clerk of the Court through the CM/ECF system, which sent notice of the electronic filing to all counsel of record.

/s/ Erin Healy Gallagher
ERIN HEALY GALLAGHER