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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-EJF **DEFENDANTS' REPLY MEMORANDUM IN SUPPORT OF MOTION TO REINSTATE TRIAL BY JURY** Judge David Nuffer Magistrate Judge Evelyn J. Furse

I. Argument.

Plaintiff's Opposition starts from the assumption that Defendants have violated the laws of the United States. Defendants have not been found to be in the wrong. Defendants have not been found to owe any money to any party. Defendants' position is that they have followed the tax laws of the United States and they have been and are now victimized by an extremely expensive, time consuming, and burdensome witch hunt. Defendants have been accused of wrong doing here, yet

there is no existing authority that holds Defendants' conduct to be unlawful. Defendants are entitled to a fair opportunity to defend themselves against their accusers. An impartial jury ought to decide this case. Defendants followed the advice of counsel, have received and relied upon opinions from CPAs, attorneys and Enrolled Agents authorized by the IRS to prepare tax returns. Plaintiffs arrogantly assume only they are allowed to interpret the Internal Revenue Code. Plaintiff's damage demands constitute the very circumstances for which the right to a jury is fundamental in this country.

A. *Kokesh v. SEC* is Applicable Here.

In its opposition, Plaintiff contends that *Kokesh v. SEC* is inapplicable because (1) the Court expressly did not opine on whether "disgorgement" is a penalty in any other context (much less *all* contexts)" (2) that "the disgorgement the SEC sought in *Kokesh* has different characteristics that than the disgorgement we seek."[1] Each are addressed in turn.

1. The holding in *Kokesh* is controlling.

At no point have Defendants argued that *Kokesh* holds that disgorgement is a penalty in all contexts. Rather, Defendants' position has and remains that "[u]nder the principles articulated in *Kokesh*, the IRS disgorgement sought here is penal in nature."[2] These principles are: (1) "whether a sanction represents a penalty turns in part on 'whether the wrong sought to redressed is a wrong to the public, or a wrong to the individual' and 'the purpose is punishment and to deter others from offending in like manner' – as opposed to compensating a victim for his loss."[3] These principles are derived from non-SEC and non-statute-of-limitation cases, and apply to *all cases* where, as

[1] See Doc. 309 at pgs. 4, 6.
[2] Doc. 289 at pg. 7.
[3] *Kokesh*, 137 S. Ct. at 1642 (citing *Huntington v. Attrill*, 146 U.S. 657, 667, 13 S.Ct. 224 (1892).

here, a court is asked to determine whether "a sanction represents a penalty." Plaintiff has offered no reason why this Court should abandon the application of these principles here.

Plaintiff again misstates Defendants' position by stating that "Defendants argue that the disgorgement relief [Plaintiff seeks] in this case is identical to the disgorgement sought by the SEC in *Kokesh*."[4] At no point have Defendants argued the disgorgement sought in *Kokesh* and by Plaintiffs is "identical." Rather, Defendants argue that if this Court applies the principles enumerated in *Kokesh*, the outcome in this case would be the same.

2. Under the principles articulated in *Kokesh*, the disgorgement sought here is penal.

a. The United States is the "Aggrieved Individual."

Rather than concede this point to Defendants, Plaintiff argues that the disgorgement in *Kokesh* is dissimilar because the SEC sought disgorgement against a wrong committed to the public at large and not an aggrieved individual.[5] Plaintiff states that the "aggrieved individual" in this case is the United States. This argument, however, ignores both elementary civics principles and the clear directive in *Kokesh*.

First, it is axiomatic that the United States is *not* an individual, and an alleged harm against it is an alleged harm against its citizenry.[6] Second, per *Kokesh*, "SEC disgorgement is imposed by the courts as a consequence for violating public laws, i.e., a violation committed *against the United States rather than an aggrieved individual*."[7] Plaintiff supports this argument – yet again - with another opportunity to recite its litany of unproven allegations of Defendants violating public

[4] See Doc. 309 at pg. 7.
[5] Doc. 309 at pgs. 8-10.
[6] *See c.f. United States v. Stinson*, 239 F.Supp. 3d 1299, 1326 (M.D. Fla. 2017) ("By defrauding the IRS, [a tax return preparer] is in reality defrauding every law-abiding American, who, at not insubstantial effort, pays their due fund to the programs of the nation." (brackets in the original).
[7] See *Kokesh*, 137 S. Ct. at 1643 (emphasis added).

laws.[8] In sum, this fiction that the United States is an individual divorced from the public interest is not supported by logic nor law.

b. Disgorgement of gross receipts is not remedial.

Defendants have some difficulty responding to this point because this amount has only recently been discussed, and since it was initially discussed has been a moving target throughout the litigation.[9] Because Plaintiff did not allow any discovery related to its damages computation and disclosed only recently its latest theory of damages, Defendants *even as of the date of filing this memorandum*, are uncertain what Plaintiff's theory of damages and method of computation will be at trial. By their own admission, Plaintiff "chose one method of approximating Defendants' wrongful gain in its motion to freeze assets and appoint a receiver"[10] and then argue in this motion that "we will also show evidence of the outflow from the Treasury based, in part, on unlawfully claimed tax benefits from a subset of Defendants' customers."[11] Which of these theories, and others, Plaintiff ends up presenting at trial is anyone's guess.

In any event, disgorgement of gross revenues, without any accounting for profits, favors a finding that the disgorgement sought as punitive not remedial. The Court in *Kokesh* stated:

> The Government responds that SEC disgorgement is not punitive but a remedial sanction that operates to restore the status quo. It is not clear, however, that disgorgement simply returns the defendant to the place he would have occupied had he not broken the law. It sometimes exceeds the profits gained as a result of the violation. And, as demonstrated here, SEC disgorgement may be ordered without consideration of a defendant's expenses that reduced the amount of illegal profit. In such cases, disgorgement does not simply restore the status quo; it leaves the defendant worse off and is therefore punitive.[12]

[8] See Doc. 309 at pg. 9.
[9] This difficulty is summarized in Defendants' Motion In Limine to Exclude Testimony Regarding Damages Related to Disgorgement of Funds, Doc. 319.
[10] Doc 309 at pg. 10.
[11] *Id.* at pg. at pg. 11.
[12] *Kokesh v. SEC*, 137 S. Ct. at 1639.

The cases Plaintiff cited are all SEC disgorgement cases that were ordered "without consideration of defendant's expenses that reduced the amount of illegal profit."[13] In this case, as the Plaintiff cited, "disgorgement does not simply restore the status quo; it leaves the defendant worse off and is therefore punitive."[14]

C. There is No Prejudice to the United States.

As Plaintiff has eloquently stated: "When a party makes an untimely jury demand on an issue triable by jury, the court should grant it 'absent strong and compelling reasons to the contrary.'"[15] First, Defendants dispute that their jury demand is untimely (the demand was made at the onset of this case). But additionally, none of the reasons Plaintiff has cited are either strong or compelling enough to deny Defendants' fundamental right to a jury.

1. Defendants' Jury Demand is Not Untimely.

Plaintiff cannot assert that they were unaware of Defendants' desire for a jury trial in this case. They demanded one at the onset of this case.[16]. Defendants vigorously opposed Plaintiff's Motion to Strike the Jury Demand.[17] This Court refused to completely foreclose the right to a jury.[18] In fact, this Court stated that "[m]aintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming

[13] See Doc. 309 at pg. 11 citing the following SEC disgorgement cases: *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109, 1114 (9th Cir. 2006) ("[I]t would be unjust to permit the defendants to offset against the investor dollars they received the expenses of running the very business they created to defraud those investors into giving the defendants the money in the first place."); *SEC v. Veros Farm Holding LLC*, No. 1:15-cv-00659-JMS-MJD, 2018 WL 731955, at *4 (S.D. Ind. Feb. 6, 2018); *SEC v. Art Intellect, Inc.*, No. 2:11-CV-357, 2013 WL 840048 at *23 (D. Utah, Mar. 6, 2013) ("The amount of disgorgement should not include any offset for the operating expenses of [the defendant company, which was run as a Ponzi scheme].") (Campbell, J.); *SEC v. Smart*, No. 2:09cv00224, 2011 WL 2297659 at *21 (D. Utah June 8, 2011) (the purpose of "depriving a wrongdoer of unjust enrichment" would not be served if defendants "who defrauded investors" were allowed a credit against disgorgement of the "expenses associated with this fraud.") (quoting *JT Wallenbrock*, 440 F.3d at 1115)) (Kimball, J.).
[14] *Kokesh v. SEC*, 137 S. Ct. at 1639.
[15] Doc. 309, p. 10.
[16] Doc. 24.
[17] Doc. 32.
[18] Doc. 43.

curtailment of the right to a jury trial should be scrutinized with the utmost care. Based upon this timeless principle in our jurisprudence the court will allow Defendants to make a motion for a jury trial if penalties become part of this case."[19] It was not until Plaintiff filed its Motion to Freeze the Assets of Defendants Neldon Johnson, RaPower-3, LLC, and International Automated systems, Inc. and Appoint a Receiver ("Motion to Freeze Assets") (ECF 252) that Defendants learned of Plaintiff's intention to assert penalties by way of excessive "disgorgement". The motion was brought shortly after they learned of this new theory. It cannot be untimely.

The only theory ever previously asserted by Plaintiff regarding damages is what is described in its initial disclosures. "The United States seeks disgorgement of the proceeds that all defendants received for the gross receipts (the amount of which is to be determined by the Court) that they received from any source as a result of their conduct in furtherance of the abusive solar energy scheme described in the complaint, together with prejudgment interest thereon. The amount to be disgorged will be based on income information available to the IRS, income information in the possession of all defendants, and the financial records and accounts of all defendants and any business or agent that any defendant used as a conduit to collect transfer, or store any funds relating to the abusive solar energy scheme described in the complaint."[20] Stated in simple terms, the damage theory was only to disgorge funds that Defendants received.[21]

In Plaintiff's Motion to Freeze Assets, for the first time, Plaintiff has now identified new theories. Indeed, Plaintiff argues that they are "not limited" to that source of information to calculate damages. Now, Plaintiff alleges that it intends to also introduce evidence of the "outflow from the Treasury based, in part, on the unlawfully claimed tax benefits from a subset of

[19] *Id*.
[20] United States Initial Disclosures to All Defendants, attached as Exhibit 1.
[21] *Id*.

Defendants' customers."[22] Now, the damage calculation includes not only funds that Defendants may have received, but also revenue the government did not receive by way of the deductions purchasers of the lenses included on their own tax forms.[23] Instead of seeking to disgorge Defendants' alleged "ill-gotten gains" Plaintiff now seeks to recover its loss.[24] Those are two entirely different calculations. Plaintiff's calculation of over $47 million comes from the number of lenses produced and an average price per lens, not actual receipts. Defendants never received the benefit of purchasers' tax deductions for those lenses, purchasers did. Where Defendants did not monetarily gain anything from those deductions, inclusion of the amounts purchasers gained by using those deductions is not disgorgement, (because Defendants never received those funds) it is a penalty.

Had Plaintiff not made the argument in their Motion to Freeze Assets, Defendants would never have been apprised of this new theory of damages. It is this new damage calculation that finally identifies Plaintiff's intention to punish defendants and to seek penalties beyond the "equitable" disgorgement they previously claimed. Plaintiff cannot argue it is prejudiced when it was Plaintiff who only recently made the argument relevant and required Defendants to renew their initial jury demand.

Additionally, Plaintiff argues that the motion is untimely because the authority upon which *Kokesh* relies were available to Defendants at the time they filed their opposition to Plaintiff's

[22] See Doc. 309, p. 11).
[23] This new theory will require a very complex analysis. Not all buyers claimed a deduction. Not all who claimed the deduction were allowed to take it. Not all buyers paid, and therefore are not entitled to a deduction. Taxes have been paid on revenues by Defendants. Taxes have been paid by those from whom Defendants purchased materials and services. Taxes have been paid on payroll of Defendants. Taxes have been paid on bonuses given to RaPower customers. Expert analysis is required to compute a correct number for this theory, and Plaintiff has not designated such an expert and Defendants were unaware they needed to retain an expert to address the total tax benefits paid to the government which, Defendants believe, exceed all tax deductions claimed.
[24] Id., p. 12.

motion to strike the jury, and therefore should have been raised at that time.[25] This argument is not well taken. What Plaintiff fails to acknowledge, however, was that prior to the holding in *Kokesh*, there was a significant disagreement among the circuits whether SEC disgorgement was remedial or penal.[26] The Court granted certiorari to the United States Court of Appeals for the Tenth Circuit.[27] What Plaintiff fails to acknowledge is the authorities upon which *Kokesh* relies were also available to the Court of Appeals of the 10th Circuit on August, 23, 2016, when it decided that "the disgorgement order and injunction in this case are neither penalties nor forfeitures...."[28] At the time, the 10th Circuit held that SEC disgorgement was not a penalty. In sum, Plaintiff would require that Defendants have more command on 10th Circuit and U.S. Supreme Court case law authority than the 10th Circuit Court of Appeals, notwithstanding (1) a circuit split on the disgorgement issue *and* (2) litigating this case in a circuit that prior to *Kokesh*, had ruled that disgorgement was not a penalty.

2. Trial Schedule.

Plaintiff argues that because the trial is scheduled to begin in a month from now, that it is prejudiced from having to empanel a jury, that additional time will be required to prepare for the jury, and to seat a jury. Those are excuses not compelling reasons. Admittedly, it takes time to empanel and try a case to a jury. But the trial of the case to a jury is not so much more demanding than it would be to the Court. Empaneling a jury takes less than a day. And if Plaintiff really believes it cannot be sufficiently ready to try the case to a jury, it is within its rights to request this Court reschedule the trial to a date and time more convenient. Defendants are prepared to proceed with a jury as scheduled (although they do recognize that a time where the dates of trial could be

[25] Doc. 309 at pg. 11.
[26] *See Kokesh*, 137 S. Ct. at 1641.
[27] *Kokesh v. SEC*, 137 S. Ct. 810 (Jan. 13, 2017).
[28] *See SEC v. Kokesh*, 834 F.3d 1158, 1167 (10th Cir. 2016).

consolidated to a two week, instead of a two-month time period may create less of a hardship on a juror, splitting the time up may be less of a sacrifice than the dedication of a two-week block of time). In any event, any timing issues can be resolved by the Court.

3. The Right to a Jury Trial Outweighs Plaintiff's Complaints.

Plaintiff further argues that it is prejudiced because it prepared the case as though for a trial to the bench, and provide the example that the depositions were not video recorded. Video recording is a relatively new invention juxtaposed with hundreds of years of jury trials. Certainly, that is an insufficient reason to deny Defendants' right to a jury. The trial is still more than a month away, that is sufficient time to prepare jury instructions and voir dire questions. But again, if Plaintiff needs additional time, it is entitled to request that from the Court. The right to a trial by jury far outweighs any additional preparation a jury trial would require. Further, each party would be prejudiced in the same manner. Each would be required to prepare those documents. That is an insufficient reason to deny a jury in this case.

Dated this 6th day of March, 2018.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing **DEFENDANTS' REPLY MEMORANDUM IN SUPPORT OF DEFENDANTS' MOTION TO REINSTATE TRIAL BY JURY** was sent to counsel for the United States in the manner described below.

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