Denver C. Snuffer, Jr. (#3032) denversnuffer@gmail.com
Steven R. Paul (#7423) spaul@nsdplaw.com
Daniel B. Garriott (#9444) dbgarriott@msn.com
Joshua D. Egan (#15593) Joshua.d.egan@gmail.com
NELSON, SNUFFER, DAHLE & POULSEN
10885 South State Street
Sandy, Utah 84070
Telephone: (801) 576-1400
Facsimile: (801) 576-1960

Attorneys for Defendants

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' MEMORANDUM REGARDING PROPER BASIS FOR DISGORGEMENT AND PARTIES' RESPECTIVE BURDENS** Judge David Nuffer Magistrate Judge Evelyn J. Furse

Pursuant to this Court's Order dated March 14, 2018, Defendants submit this memorandum supported by legal authorities on the following issues: (1) measuring disgorgement by the amount of (a) taxes avoided by investors in RaPower (b) gross profit of RaPower; (c) net profit of RaPower; (d) income of individual defendants from RaPower: and (2) who, in the event net profit is the proper measure, bears the burden of proof on expenses RaPower incurred in its business.

A. Disgorgement Generally

Disgorgement is an equitable remedy intended to prevent unjust enrichment.[1] The government has the burden of establishing the disgorgement amount. To be entitled to disgorgement, the plaintiff must produce a reasonable approximation of the defendant's ill-gotten gains.[2] Once a plaintiff satisfies its obligation to prove a reasonable approximation, the burden shifts to the defendant to show that the plaintiff's estimate was not a reasonable approximation.[3]

B. A Finding of Fraud or Wrongdoing is a Threshold Issue.

As a preliminary matter, there must be a "relationship between the amount of disgorgement and the amount of ill-gotten gain," and a district court may not order disgorgement of an amount obtained without wrongdoing or obtained during a period where there is no record evidence of fraud.[4] Stated differently, a party is not unjustly enriched if the gains he acquired flow from any legitimate business activity. As plaintiff, the government bears the burden of persuasion that a defendant is guilty of wrongdoing prior to a disgorgement order issuing. If the government fails to meet its burden, disgorgement is unavailable.

C. Gross Revenues as Measurement

In SEC disgorgement cases, courts have ordered disgorgement from defendants where all of the defendant's conduct was fraudulent or the defendant's illegitimate activity is indecipherable from his legitimate activity.[5] However, Plaintiff has the burden of producing the disgorgement amount to a reasonable approximation. This evidence generally involves the review and presentation of banking records, defendant's tax returns showing gross revenues, and fees earned

[1] *Porter v. Warner Holding Co.*, 328 U.S. 395, 399, 66 S.Ct. 1086, 1090, 90 L. Ed. 1332 (1946))); *SEC v. Monterosso*, 756 F.3d 1326, 1337 (11th Cir. 2014) (per curiam).
[2] *See S.E.C. v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004).
[3] *S.E.C. v. Lauer*, 478 F. App'x at 557.
[4] *C.F.T.C. v. Sidoti*, 178 F.3d 1132, 1138 (11th Cir. 1999).
[5] *S.E.C. v. Lauer*, 478 F. App'x 550, 557 (11th Cir. 2012); s*ee S.E.C. v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004).

in preparing fraudulent tax returns on a taxpayer's behalf.[6] Without sufficient evidence to reach a reasonable approximation, courts will deny plaintiff's request.

In *United States v. Stinson*[7], a case involving disgorgement of fees earned from the fraudulent preparation of tax returns, the district court held that the government's proposed disgorgement amount was not a reasonable approximation of defendant's ill-gotten gains. There, the government request for disgorgement was broken down into five categories. The court refused to order all fees from all categories because:

> "...the Court cannot discern whether fees from categories (1) and (2), which includes years 2011-2014, are duplicated in categories (3), (4), (5), and (6) because those categories include fees from the same years. It is not a reasonable approximation to seek disgorgement from Stinson for twice the amount of fees for the same tax returns."[8]

In sum, the *Stinson* court held that the government had failed to carry its burden in providing a reasonable approximation of defendants' ill-gotten gains and restricted its award only to the amount proven (categories 2-3) explaining that the government had not shown that fees in the later categories were distinct from categories (1) and (2).

In *United States v. Mesadieu,*[9] another fraudulent tax-preparer case, the court declined to accept plaintiff's proposed disgorgement amount as a reasonable approximation of defendants' ill-gotten gains. In *Mesadieu*, the government relied on a random sampling of returns which defendant tax preparer had assisted with filing. The government then relied on ***expert testimony*** to estimate the number of non-compliant returns from the random sampling.[10] The court was unimpressed. It found that the government had access to all returns filed by defendants on behalf of taxpayers, and held that it was not inordinate or impractical for the government to review each return to determine

---

[6] *United States v. Barwick*, No. 6:17-cv-35-Orl-18TBS, 2018 U.S. Dist. LEXIS 32289, at *3 (M.D. Fla. Jan. 25, 2018) (testimony regarding review of tax returns which included an inflated EITC amount, non-existent business, and fabricated unreimbursed business expenses and fees earned by defendants in preparing these returns)
[7] 239 F. Supp. 3d 1299, 1329 (M.D. Fla. 2017).
[8] *Id*.
[9] 180 F. Supp. 3d 1113, 1118 (M.D. Fla. 2016).
[10] *Id*.

the number of non-compliant returns, from which it could associate fees improperly earned.[11] In that case expert opinion was insufficient to justify a speculative award.

D. Net Revenues as Measurement for Disgorgement.

A court's power to order disgorgement is not unlimited. It extends only to the amount the defendant profited from his wrongdoing.[12] Any additional sum is impermissible as it would constitute a penalty.[13] Funds returned to customers or investors is a proper deduction to measure net-revenue subject to disgorgement.[14]

Generally, a defendant is not allowed to deduct business expenses from the disgorgement amount when the business was created and run to "defraud investors."[15] By extension, a defendant should be allowed to deduct business expenses to the extent that it can show that the business was not created to defraud investors.[16] Accordingly, defendants submit that Plaintiff bears the burden of establishing defendants created RaPower solely to defraud investors, and that all of RaPower's business expenses were associated with the alleged fraud prior to a finding that RaPower is not entitled to deduct its business expenses from any potential disgorgement award. Here Defendants' business investment and effort in developing solar technology preceded the tax credit incentives adopted by Congress by many years.

E. Injury to Treasury is an Illegitimate Measurement of 7402(a) Disgorgement.

Only recently, Plaintiff has added a new category of damages – "injury to the Treasury." This is allegedly calculated by adding all of the deductions used by nonparties who have purchased

---

[11] *Id.* at 1122.
[12] *S.E.C. v. ETS Payphones, Inc.*, 408 F.3d 727, 735 (11th Cir. 2005).
[13] *Id.*
[14] *SEC v. United Am. Ventures, LLC*, No. 10-CV-568 JCH/LFG, 2012 U.S. Dist. LEXIS 51978, at *17 (D.N.M. Mar. 2, 2012)(deducting from disgorgement award the amount repaid to investors as "interest payments"; see also *S.E.C. v. Haligiannis.* 470 F. Supp. 2d 373, 384-85 (S.D.N.Y. 2007) ("[D]istributions must be subtracted because they did not unjustly enrich defendant.").
[15] *SEC v. JT Wallenbrock & Assocs.*., 440 F.3d 1109, 1114 (9th Cir. 2006).
[16] *See id.* ("Neither the deterrent purpose of disgorgement nor the goal of depriving a wrongdoer of unjust enrichment would be served were we to allow these defendants — who defrauded investors ... to 'escape disgorgement by asserting that expenses **associated with this fraud** were legitimate.'") (emphasis added).

lenses from RaPower-3, and then, with the help of their own tax advisors, claimed a deduction. There is no evaluation of those deductions on an individual basis. There is no attempt to identify the actual loss to the treasury, only the amount of the deduction. This is not an appropriate basis for a disgorgement amount by any measure. First, the extent to which the Treasury is allegedly damaged is not a measure of any defendant's alleged ill-gotten gain. Any alleged injury to the Treasury is appropriately categorized as damages, subject to all disclosure requirements under Rule 26[17] and entitling RaPower to the jury it originally demanded in this case.[18]

Second, adopting Plaintiff's "injury to the Treasury" theory of disgorgement leads to absurd results, entirely inconsistent with the line of disgorgement cases. Specifically, Plaintiff seeks a disgorgement amount of over $50,000,000 consisting of estimated gross revenues from lens sales. It also claims that the U.S. Treasury has been injured approximately $30,000,000. If the $30 million is added to the alleged gross revenues number, then Defendants would be subject to a disgorgement award that greatly exceeds the amount any Defendant allegedly profited from the alleged wrongdoing. This would be reversible error.[19]

F. Income of Individual Defendants as a Basis for Disgorgement.

The proper measurement of disgorgement is the amount an individual profited from wrongdoing and there must be a "relationship between the amount of disgorgement and the amount of ill-gotten gain."[20] Accordingly, the income of individual defendants is germane to a disgorgement amount only to the extent the government can show that it is income derived solely

[17] Plaintiff did not pray for these type of damages in their Complaint. (See ECF 2). Plaintiff did not identify or provide a calculation of these type of damages in their Initial Disclosures. (See ECF 337-1). Defendants have asked this Court to limit this category of damages because of those failures. (See ECF 319). This type of damages require an expert opinion. Having failed to timely disclose any expert, Plaintiff should be limited from providing this category of damages.
[18] See Defendants' Motion to Reinstate Jury. (ECF 289).
[19] *ETS Payphones, Inc.*, 408 F.3d at 735. ("A court's power to order disgorgement is not unlimited. It extends only to the amount the defendant profited from his wrongdoing... Any additional sum is impermissible as it would constitute a penalty.)
[20] *C.F.T.C. v. Sidoti*, 178 F.3d 1132, 1138 (11th Cir. 1999).

from the illicit or fraudulent activities of the individual and is not a compounding calculation of amounts already included in the disgorgement calculation for the entities.[21] Here all amounts claimed against individual Defendants are derived from and also included in the total shown for RaPower and constitutes an improper doubling of the claim. In simple terms, all money from lens sales comes in through RaPower. RaPower then uses those proceeds to purchase materials to build the solar systems and also to pay commissions due under the sales program. Therefore, all funds paid to Neldon Johnson, R. Gregory Shepard, and after 2010 to IAS[22], identified in Plaintiff's exhibits 736, 737, and 738 comes directly from RaPower. To include those disbursements to the individual defendants as well as the income to RaPower requires a double counting of the same funds and a double recovery to the Plaintiff[23] – which is improper for this Court to include in any disgorgement, should disgorgement be found proper. RaPower alone is the only party whose gross revenues should be counted.[24] Likewise, RaPower's costs of business are permitted off-sets to reduce any claim against them.

G. The Government's Methodology for Proving Disgorgement.

The government has stated that it will rely on the testimony from two Department of Justice paralegals to testify regarding summaries of voluminous evidence.[25] Ms. Perez prepared Pl. Ex. 752, which purports to summarize the contents of "at least 1,643 tax returns that Defendants' customers filed with the IRS."[26] Her testimony will include "the total depreciation and solar tax credits that the Defendants' customers claimed, applied the average tax rate to the depreciation to

[21] See *Mesadieu*, 180 F.Supp at 1122 (refusing to award disgorgement amount when government failed to distinguish legitimate gains from illegitimate gains).
[22] IAS sold lenses in 2009, but in 2010 those sales were transferred to RaPower and thereafter all sales were conducted by RaPower alone.
[23] The government has also failed to account (reduce) for other sources of income for these parties during the relevant time period. The extent of that error, however, is difficult to determine without seeing the government's source documents and how they were selectively used to reach their calculated results.
[24] Further, RaPower did not collect on all sales. What was "booked" and what was "collected" are decidedly different numbers. Collections were much lower.
[25] ECF Doc. 329.
[26] *Id*. at fn. 14.

demonstrate the tax loss (harm to the Government)" and the tax credits taken as a reduction to the taxpayers' liability.[27] Determining and applying an "average tax rate" by definition requires the opinion of an expert, involving selecting and applying a hypothetical "average" rather than a mere summary. Experts were to be identified last year and reports from experts were to be provided September 15, 2017. None of the analysis or opinions of these government witnesses were timely disclosed, and Defendants will be given a limited 3-hour deposition opportunity the Friday before trial begins on Monday.

It is one thing that the government believes it can analyze 1,643 or more tax returns to theorize on the damage caused by Defendants' business activities, but it is another thing for Defendants to respond to those assumptions, see the calculations, and verify the accuracy of the summary or other testimony over a weekend. The government has the manpower and the institutional knowledge and resources to digest that information (which it did over a period of years, since this case was initiated in 2015). The summaries were not disclosed until February 23, 2018. Defendants do not have the same manpower and resources to match the government. Defendants are prejudiced by being ambushed with the data and expert summary calculations on the eve of trial.

Worse still, the government blocked Defendants' efforts to glean the information that would have led to an understanding of Plaintiff's proof of disgorgement. In June, 2017, Plaintiff successfully moved to quash Defendants' deposition notice to The US Department of Justice, Tax Division[28]. After being told that "Defendants shall not depose any representative of the United States Department of Justice, Tax Division" [Doc. 196 – Order Granting Motion for Protective Order] Defendants believed no lawyer would be allowed to testify in this case about any aspect of liability or damages. Defendants expected DOJ personnel would argue Plaintiff's legal position,

[27] *Id*.
[28] Doc. 170.

but not testify substantively. Now Plaintiff discloses it intends to present two paralegals—representatives of the US Department of Justice, tax division—to testify as to the DOJ's work-product in accumulating, analyzing and calculating the amounts for Plaintiff's claim of disgorgement. Defendants were given no notice, and provided no discovery of their calculations, work-product or summaries. Defendants have not been given any opportunity to question the methodology employed by Plaintiff's paralegals; cannot have their own expert dissect the summaries to determine whether they are accurate; cannot now retain an appropriate expert to address and counter the assumptions, calculations or analysis done by Plaintiff's DOJ employees. Defendants are powerless to refute, rebut or respond to the analysis that Plaintiff has been working on for a year or more and which was kept hidden until the eve of trial. Depositions for 3-hours the last business day before trial begins is not enough to cure this abuse and prejudice.

If Defendants would have had the time to review the disclosures, analyze the presentation and have an expert advise Defendants on Plaintiff's theory of disgorgement, Defendants would be prepared to respond to Plaintiff's evidence with evidence of commissions paid for work performed in the RaPower businesses; taxes paid on commissions by individual taxpayers, operation expenses for RaPower and its affiliates; taxes paid by vendors from whom purchases were made, and much more. Each individual tax payer has unique financial circumstances, ranging from income levels, tax brackets, deductions, tax credits, etc. Now, there is not time for Defendants to prepare a defense to the ambush. Defendants will do what they can, but anticipate the government will object and the Court will sustain the conjecture and quick calculation testimony Defendants attempt to use to address this irregular and improper surprise.

The DOJ ambush, supported by the Court, appears to foreshadow a complete, albeit temporary, success at the upcoming trial. The better approach would, of course, be to either bar the evidence at trial or continue the trial and afford Defendants the opportunity to conduct

discovery, hire an expert, and present a defense to the previously concealed damage theories and claims they are now expected to address at trial.

DATED THIS 26TH DAY OF MARCH, 2018.

NELSON SNUFFER DAHLE & POULSEN

/s/ Denver C. Snuffer, Jr.
Denver C. Snuffer, Jr.
Steven R. Paul
Daniel B. Garriott
Joshua D. Egan
Attorneys for Defendants

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing **DEFENDANTS' MEMORANDUM REGARDING PROPER BASIS FOR DISGORGEMENT AND PARTIES' RESPECTIVE BURDENS** was sent to counsel for the United States in the manner described below.

Erin Healy Gallagher
Erin R. Hines
Christopher R. Moran
US Dept. of Justice
P.O. Box 7238
Ben Franklin Station
Washington, DC 20044
Attorneys for USA

Sent via:
_____ Mail
_____ Hand Delivery
_____ Email: erin.healygallagher@usdoj.gov
erin.r.hines@usdoj.gov
christopher.r.moran@usdoj.gov
X Electronic Service via Utah Court's e-filing program

/s/ Denver C. Snuffer, Jr. .
Attorneys for Defendants