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

<p>UNITED STATES OF AMERICA,</p> <p>Plaintiff,</p> <p>vs.</p> <p>RAPOWER-3, LLC, INTERNATIONAL AUTOMATED SYSTEMS, INC., LTB1, LLC, R. GREGORY SHEPARD, NELDON JOHNSON, and ROGER FREEBORN,</p> <p>Defendants.</p>	<p>Civil No. 2:15-cv-00828-DN-EJF</p> <p>DEFENDANTS' MEMORANDUM REGARDING PLAINTIFF'S BURDEN UNDER 26 USC §§ 6700 AND 7408</p> <p>Judge David Nuffer Magistrate Judge Evelyn J. Furse</p>
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Defendants RaPower-3, LLC, International Automated Systems, Inc., LTB1, LLC., R. Gregory Shepard, and Neldon Johnson (hereinafter collectively "Defendants") respectfully submit this memorandum regarding Plaintiff's burden of proof at trial in proving fraud under 26 USC § 6700.

I. Argument

To obtain relief under Sections 6700 and 7408, the government must prove:

- (1) Defendant organized an entity, plan, or arrangement;
- (2) he made false or fraudulent statements concerning the tax benefits to be derived from the entity, plan, or arrangement;
- (3) he knew or had reason to know that the statements were false or fraudulent;
- (4) the false or fraudulent statements pertained to a material matter; and
- (5) an injunction was necessary to prevent recurrence of this conduct.¹

The issue is whether the Government need prove fraudulent statements under 26 USC § 6700 by clear and convincing evidence when Section 6700 specifically refers to “fraud” and the government alleges consistently that defendants’ statements are fraudulent instead of merely false. The Tenth Circuit has long held that the Government has the burden of proving fraud by clear and convincing evidence. And when Congress passed Section 6700, the meaning of fraud was well-established. Absent a statutory directive to the contrary, fraud should be given the same meaning as has been well established under the common law. Accordingly, to the extent Plaintiff seeks to prevail on the basis that Defendants' statements were fraudulent to any material matter, it must so demonstrate by clear and convincing evidence.

A. 10th Circuit Precedent Requires the Government to Prove Fraud by Clear and Convincing Evidence.

The 10th Circuit has long held that the government has the burden of proving fraud by clear and convincing evidence.² "Fraud implies bad faith, intentional wrong doing and a sinister motive." *Id.* "Fraud means 'actual, intentional wrongdoing, and the intent required is the specific

¹ United States v. Hartshorn, 751 F.3d 1194, 1198 (10th Cir. 2014).

² Zell v. Commissioner, 763 F.2d 1139, 1142 (10th Cir. 1985) (The IRS bears the burden of proving fraud by clear and convincing evidence.)

purpose to evade a tax believed to be owing."³ Fraud can be inferred from conduct which would likely have the effect of misleading or concealing.⁴

B. Current Status of Government's Burden Under 26 USC 6700 in the 10th Circuit.

An early decision in 1985 in the Western District of Oklahoma, punted on this issue. It stated that, at that time, the 10th Circuit had not provided guidance on the applicable burden, and there was considerable disagreement among the district courts.⁵ It held that it need not decide which burden applies in a §6700 action because in that instance the Government proved its case under either standard.⁶

The only Tenth Circuit Court of Appeals decision that provides authority on Plaintiff's burden in a 26 USC 6700 and 26 USC 7408 is *United States v. Hartshorn*, 751 F.3d 1194 (10th Cir. 2014). However, in *Hartshorn*, the defendant did not challenge the applicable burden. Rather, the Court of Appeals merely considered defendant's challenge to summary judgment regarding whether defendant's statements concerning tax treatment was incorrect and whether he knew of had reason to know the statements were false or fraudulent.⁷

The Court of Appeals only mentions the government's burden by citing to *United States v. Estate Pres. Servs.*, 202 F.3d 1093, 1098 (9th Cir. 2000), holding that the government must prove by a preponderance of the evidence the elements of Sections 6700 and 7408.⁸ Accordingly, the *Hartshorn* court did not have the benefit of briefing on the issue of whether plaintiff's burden of proof in a 6700 setting is preponderance of evidence or instead by clear and convincing when the government's evidence relies on fraud.

³ *Zell*, 763 F.2d at 1142-43.

⁴ *Heyen v. United States*, 945 F.2d 359, 364-65 (10th Cir. 1991) (citing *United States v. Walton*, 909 F.2d 915, 926 (6th Cir. 1990)).

⁵ *United States v. Lang*, No. CIV-84-3160-W, 1985 U.S. Dist. LEXIS 12924, at *12 (W.D. Okla. Dec. 11, 1985).

⁶ *Id.*

⁷ *United States v. Hartshorn*, 751 F.3d 1194, 1198 (10th Cir. 2014).

⁸ *Id.*

C. Guidance on this issue under *Neder v. United States*.

The United States Supreme Court in *Neder* discussed statutory interpretation of mail, wire, and bank fraud statutes to determine whether the government must prove materiality in proving fraud.⁹ In arguing against the materiality issue, the Government submitted “that because Congress has provided express materiality requirements in [26 USC § 6700] prohibiting fraudulent conduct, the absence of such an express reference in the fraud statutes at issue “speaks volumes.”¹⁰ The Court rejected this reliance as misplaced, stating that since the statute criminalized both false and fraudulent statements, and false statements (unlike fraudulent statements) do not require materiality, then Congress clearly intended to limit liability to false material statements.¹¹

The Third Circuit expounded on the practical application of the comment in *Neder*:

The *Neder* Court's comments indicate that it read the phrase "false or fraudulent" in a way that gave the two disjunctively connected terms separate meanings. If, as the Appellants suggest, the use of the phrase "false or fraudulent" were sufficient, by itself, to always require proof of materiality, then the *Neder* Court's statement that "the word 'material' limits the statutes' scope to material falsehoods" would be nonsensical; the scope of the statutes mentioned in *Neder* already would be implicitly limited to material falsehood even without the word "material." Therefore, in *Neder*, the Court must have given the disjunctively connected terms "false" and "fraudulent" separate meanings.¹²

Having established that the disjunctive terms in 26 USC § 6700 have distinctive meaning, the question now turns as to what is that meaning. Under the statutory interpretation directive in *Neder*, “It is a well-established rule of construction that “where Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms.”¹³

⁹ *Neder v. United States*, 527 U.S. 1, 20-23, 119 S. Ct. 1827, 1839-40 (1999).

¹⁰ *Neder*, 527 U.S. at 23 n.7, 119 S. Ct. 1827, 1840.

¹¹ *Id.*

¹² *United States v. Saybolt*, 577 F.3d 195, 200 (3d Cir. 2009).

¹³ *Neder*, 527 U.S. at 21-22, 119 S. Ct. 1827 (citing *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322, 117 L. Ed. 2d 581, 112 S. Ct. 1344 (1992) (quoting *Community for Creative Non-Violence v. Reid*, 490 U.S. 730, [*22] 739, 104 L. Ed. 2d 811, 109 S. Ct. 2166 (1989)).

"Where words are employed in a statute which had at the time a well-known meaning at common law or in the law of this country, they are presumed to have been used in that sense".¹⁴ And at the time Congress enacted 26 USC § 6700 in September of 1982, "actionable fraud had a well-settled meaning at common law."¹⁵

Accordingly, here the parties must presume that Congress intended to incorporate the definition of fraud and all its procedural implications unless the statute otherwise dictates.¹⁶ Because fraud need be proven by clear and convincing evidence in the 10th Circuit, the government bears this heightened evidentiary burden at trial if it intends to prove the elements on the basis of fraud.¹⁷

D. If Plaintiff's Seek to Prevail on the Basis of Fraud, then Its Burden is Clear and Convincing.

In each instance used in this case, Plaintiff attaches the disjunctive terms "false" and "fraudulent" and claim the overall conduct is accountable under 26 USC § 6700.¹⁸ Not once has Plaintiff divorced these terms. The terms, as used by the government and by statute, have a well-settled meaning at common law, whose meaning should be employed in this context, absent a contravening congressional directive. Fraud implies bad faith, intentional wrong doing, and a sinister motive. These allegations are a serious charge against the character of a defendant, where the very charge itself may have an instant defamatory effect long before the defendant has an

¹⁴ *Standard Oil Co. of N. J. v. United States*, 221 U.S. 1, 59, 55 L. Ed. 619, 31 S. Ct. 502 (1911)

¹⁵ *E.g. Neder* 527 U.S. at 22.

¹⁶ *E.g. Id.* ("We must presume that Congress intended to incorporate materiality 'unless the statute otherwise dictates.'").

¹⁷ *C.f. Carlson v. United States*, 754 F.3d 1223, 1229 (11th Cir. 2014) (Holding that the government must prove fraud by clear and convincing evidence in I.R.C. § 6701 violations even though 6701 does not contain the word fraud, but requires the government to prove "that the preparer actually knew the return understated tax. In other words, the IRS must prove that the preparer deceitfully prepared a return knowing it misrepresented or concealed something that understates the correct tax. This is a classic case of fraudulent conduct.").

¹⁸ Doc. 334 at pgs 37-66.

opportunity to exonerate himself at trial. For these reasons, establishing fraud demands a heightened pleading and evidentiary standard.¹⁹ Although no motion challenged the sufficiency of the Plaintiff's Complaint, they failed to plead fraud with particularity. They have consistently insisted they need only prove their claims by a preponderance. Therefore, the Court ought to instruct Plaintiff that Defendants' conduct is actionable under fraud only to the extent that the Government produces evidence of each of the elements of fraud and proves those allegations by clear and convincing evidence.

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¹⁹ See *Rich v. Touche Ross & Co.* (S.D.N.Y. 1975), 68 FRD 243, 20 Fed R Serv 2d (Callaghan) 292, FedSec L Rep (CCH) P95084. ("The requirement that allegations of fraud be pleaded with particularity stems from, among other sources, a concern that potential defendants be shielded from lightly made public claims or accusations charging the commission of acts or neglect of duty which may be said to involve moral turpitude... The need for this protection is most acute where the potential defendants are professionals whose reputations in their field of expertise are most sensitive to slander.")

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing **DEFENDANTS' MEMORANDUM REGARDING PLAINTIFF'S BURDEN UNDER 26 USC §§ 6700 AND 7408** was sent to counsel for the United States in the manner described below.

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