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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' MOTION TO REINSTATE TRIAL BY JURY** Judge David Nuffer Magistrate Judge Evelyn J. Furse

I. Background.

1. On January 25, 2016, Defendants RaPower-3, LLC, International Automated Systems, Inc., LTB1, LLC, and Neldon Johnson timely demanded that this matter be tried by jury, pursuant to the 7th amendment of the United States Constitution.[1]

[1] See ECF Doc. 24.

2. On February 22, 2016, Plaintiff moved to strike Defendants' jury demand on the basis that "the relief sought in this case is equitable in nature."[2]

3. Defendants unsuccessfully opposed the motion, and on May 2, 2016, this court entered an order striking Defendants' jury request.[3]

4. In June 2017, in a unanimous decision, the Supreme Court of the United States held in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), held that SEC disgorgement is a penalty because "[i]t is imposed as a consequence of violating a public law and it is intended to deter, not to compensate."[4]

5. On November 17, 2017, Plaintiff moved to freeze the assets of the defendants "to ensure that sufficient funds are available to satisfy any judgment the Court might enter against these Defendants with respect to [Plaintiff's] disgorgement claim."[5]

6. As of the date of filing this motion, Plaintiff has not withdrawn its disgorgement claim.

II. Argument.

The Seventh Amendment provides that, "in Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved . . . ."[6] The Seventh Amendment right has been strictly upheld throughout U.S. judicial history. As explained in *Dimick v. Shiedt*, "[m]aintenance of the jury as a fact-finding body is of such important and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care."[7]

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[2] See ECF Doc. 31 at pg. 1.
[3] See ECF Doc. 43.
[4] 137 S. Ct. at 1644.
[5] See ECF Doc. 252 at pg. 2.
[6] *Tull v. United States*, 481 U.S. 412, 417, 107 S. Ct. 1831, 1835 (1987).
[7] 293 U.S. 474, 486 (1934).

Historically, civil penalties are a type of remedy at common law that could only be enforced in courts of law.[8] It follows, therefore, that a party is entitled to a jury where the remedy sought is one that could only be enforced in courts of law.

In this case, for the reasons stated *infra*, the type of disgorgement Plaintiff seeks is penal in nature. This conclusion is based on the United States Supreme Court's holding in *Kokesh v. SEC*[9], which found that SEC disgorgement is a penalty thereby implicating the applicable 5-year statute of limitations applicable to penalties. By analogy, the same principles that governed the penal classification of SEC disgorgement applies equally here. Therefore, because disgorgement is a penalty as sought in the manner sought by Plaintiff, Defendants are entitled to a jury.

A. Defendants are entitled to a jury because under the reasoning of *SEC v. Kokesh*, the disgorgement sought by Plaintiff is a penalty.

1. *Kokesh v. SEC*; an overview.

Recently, the United States Supreme Court unanimously resolved a disagreement among the Circuits over whether disgorgement claims in SEC proceedings are subject to the 5-year statute of limitations.[10] The limiting statute is only implicated if SEC disgorgement is a fine, penalty, or forfeiture.[11] Therefore, the controlling question before the Court was whether SEC disgorgement constituted a penalty thereby invoking the 5-year limitation statute.[12]

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[8] *See Tull v. United States*, 481 U.S. 412, 422, 107 S. Ct. 1831, 1838 (1987) ("A civil penalty was a type of remedy at common law that could only be enforced in courts of law. Remedies intended to punish culpable individuals, as opposed to those intended simply to extract compensation or restore the status quo, were issued by courts of law, not courts of equity.").

[9] 137 S. Ct. 1635 (2017).

[10] *Kokesh*, 137 S. Ct. at 1641.

[11] *Id.* at 1642.

[12] *Id.*

a. The Court's Historical Construction of the term "Penalty."

The Court began by discussing what state actions constitute a penalty.[13] It reasoned that "[a] 'penalty' is a 'punishment', whether corporal or pecuniary, imposed and enforced by the State, for a crime or offen[s]e against its laws."[14] This definition gives rise to two principles:

> (1) "whether a sanction represents a penalty turns in part on 'whether the wrong sought to be redressed is a wrong to the public, or a wrong to the individual'"
>
> and;
>
> (2) "a pecuniary sanction operates as a penalty only if it is sought 'for the purpose of punishment, and to deter others from offending in like manner'—as opposed to compensating a victim for his loss."[15]

The Court then discussed several instances where it applied these principles in construing the term "penalty." In *Brady v. Dal*, the Court held that damages under copyright law are not penal in nature. The Court noted that because the statute gives the right of action solely to the private individual (the copyright owner) rather than the public generally to enforce a wrong, the damages recoverable did not constitute a penalty.[16] Second the Court observed that because "the whole recovery is given to the proprietor, and the statute does not provide for a recovery by any other person", the damages recoverable do not constitute a penalty.[17] In sum, by providing a compensatory remedy for a private wrong, the statute did not impose a "penalty."[18]

Next, the Court discussed how it utilized the same principles in the past in construing the statutory ancestor to the limiting statute at issue. In *Meeker v. Lehigh Valley R. Co.*, the Court refused to apply a 5-year limitations period to an order that required a railroad company to

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[13] *Id.*
[14] *Id.* (citing *Huntington v. Attrill*, 146 U.S. 657, 667, 13 S. Ct. 224, 36 L. Ed. 1123 (1892)).
[15] *Id.*
[16] *Id.* (citing *Brady*, 175 U.S. 148, 154.)
[17] *Id.*
[18] *Id.*

refund and pay damages to a shipping company for excessive shipping rates.[19] The Court held that the "words 'penalty or forfeiture' in [the statute] refer to something imposed in a punitive way for an infraction of public law."[20] The Court in *Meeker* further reasoned that a penalty does "[n]ot include a liability imposed [solely] for the purpose of redressing a private injury… Because the liability imposed was compensatory and paid entirely to a private plaintiff, it was not a 'penalty' within the context of the statute of limitations."[21]

b. SEC disgorgement constitutes a penalty when applying the foregoing principles.

Applying the foregoing principles to SEC disgorgement, the Court went on to hold that the disgorgement sought squarely constitutes a penalty within the meaning of the limiting statute.[22] First, the Court observed that "SEC disgorgement is imposed by the court as a consequence for violating what we described in *Meeker* as public laws" because the violation for which the remedy is sought "is committed against the United States rather than an aggrieved individual."[23] The Court also stated that an enforcement action may proceed "even if the victims do not support or are not parties to the prosecution."[24] The Court also relied on the Government's concessions that "[w]hen the SEC seeks disgorgement acts in the public interest, to remedy harm to the public at large, rather than standing in the shoes of particular injured parties."[25]

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[19] *Id.* at 1642.
[20] *Id.* (brackets in original).
[21] *Id.* (brackets in original); *see also* *Gabelli v. SEC*, 568 U.S. 442, 451-52, 133 S. Ct. 1216 (2013) ("[P]enalties" in the context of §2462 "go beyond compensation, are intended to punish, and label defendants wrongdoers").
[22] *Id.* at 1643.
[23] *Id.*
[24] *Id.*
[25] *Id.* at 1643 (citing Brief for United States at 22); *see, e.g.*, *SEC v. Rind*, 991 F. 2d 1486, 1491 (CA9 1993) ("[D]isgorgement actions further the Commission's public policy mission of protecting investors and safeguarding the integrity of the markets"); *SEC v. Teo*, 746 F. 3d 90, 102 (CA3 2014) ("[T]he SEC pursues [disgorgement] 'independent of the claims of individual investors' in order to 'promot[e] economic and social policies'").

Second, the Court found that SEC disgorgement is imposed for punitive purposes. It noted that in one of the first cases where the SEC sought disgorgement, the court emphasized the need "to deprive the defendants of their profits in order to . . . protect the investing public by providing an effective deterrent to future violations."[26] In the years that followed this first case, the Court observed, "it has become clear that deterrence is not simply an incidental effect of disgorgement. Rather court have consistently held that '[t]he primary purpose of disgorgement orders is to deter violations of security laws by depriving violators of their ill-gotten gains.'"[27]

Finally, the Court stated that in many cases, SEC disgorgement is not compensatory because the "disgorged profits are paid to the district court, and it is 'within the court's discretion to determine how and when and to whom the money will be distributed."[28] Indeed, "Courts have required disgorgement 'regardless of whether the disgorged funds will be paid to such investors as restitution.'"[29] The Court could not identify any statutory command requiring district courts to distribute the funds to victims.[30] To further support this conclusion, the Court relied on prior precedent: "when an individual is made to pay a non-compensatory sanction to the government as a consequence of a legal violation, the payment operates as a penalty.[31]

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[26] *Id.* at 1643 (quoting *SEC v. Tex. Gulf Sulphur Co.*, 312 F. Supp. 77, 92 (S.D.N.Y. 1970)).

[27] (quoting *SEC v. Fischbach Corp.*, 133 F. 3d 170, 175 (CA2 1997); *see also SEC v. First Jersey Securities, Inc.*, 101 F. 3d 1450, 1474 (CA2 1996) ("The primary purpose of disgorgement as a remedy for violation of the securities laws is to deprive violators of their ill-gotten gains, thereby effectuating the deterrence objectives of those laws"); *Rind*, 991 F. 2d, at 1491 ("'The deterrent effect of [an SEC] enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits'").

[28] *Id.* at 1644 (citing *Fischbach Corp.*, 133 F. 3d at 175).

[29] *See Fischbach Corp.*, 133 F.3d at 176.

[30] *Id. at 1644*.

[31] *Id.* (citing *Porter v. Warner Holding Co.*, 328 U.S. 395, 402, 66 S. Ct. 1086, 90 L. Ed. 1332 (1946) (distinguishing between restitution paid to an aggrieved party and penalties paid to the Government).

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

Applying the foregoing principles readily demonstrates that the type of disgorgement sought in this instance by the IRS constitutes a penalty. First, IRS disgorgement is imposed by the courts as a consequence for Defendants' alleged violation of public laws. The Plaintiff's pleadings and motions undeniably support this justification for the remedy they seek here. In support of their motion to freeze assets, the United States argued repeatedly that the "public interest in enforcing the internal revenue laws" justifies its request for an asset freeze, and that any disgorgement order would be worthless without an order freezing assets necessary to satisfy such an order.[32] In its reply memorandum to strike defendants' timely jury demand, the United States stated that it brought this action "to disgorge the defendants' ill-gotten gains" under the authority in 26 USC 7408 and 7402 to issue orders of injunction and disgorgement "as may be necessary or appropriate for the enforcement of the internal revenue laws."[33] Indeed, Plaintiff has no other legal basis to seek disgorgement other than as a penalty for the Defendants' alleged violation of public laws. Additionally, like an SEC action, the United States may prosecute this current action even if, as in this case, the alleged victims "do not support or are not parties to the prosecution."[34]

Second, Plaintiff's disgorgement claim is imposed for punitive purposes. The government seeks to deprive Defendants of their alleged "ill-gotten gains" to provide an effective deterrent to future violations.[35] The deterrent effect of SEC disgorgements is not dissimilar than the IRS

[32] ECF Doc. 252 at pgs. 8-9.
[33] See ECF Doc. 33 at pgs. 3-4 (emphasis added).
[34] *See Kokesh*, 137 S. Ct. at 1644.
[35] *See United States v. Barwick*, No. 6:17-cv-35-Orl-18TBS, 2017 U.S. Dist. LEXIS 191626, at *11, 120 A.F.T.R.2d (RIA) 6599 (M.D. Fla. Oct. 13, 2017) (citing *United States v. Stinson, 239 F. Supp. 3d 1299, 1326 (M.D. Fla. 2017)*) ("Disgorgement in the amount of a defendant's 'ill-gotten gains' constitutes a 'fair

disgorgement sought here. Like an SEC action, the deterrent effect sought by the IRS imposing disgorgement would be greatly undermined if violators were not required to disgorge profits. And since sanctions imposed "for the purpose of deterring infractions of public laws are inherently punitive because deterrence is not a legitimate nonpunitive governmental objection," the disgorgement sought by Plaintiff here is not remedial as it has claimed but instead punitive.[36]

Third, the disgorgement sought here is not compensatory. In its motion and pleadings, Plaintiff has repeatedly stated that the disgorged funds shall be paid to the United States.[37] In this case, if ordered, the Defendants would pay any disgorgement amount directly to this court or directly to Plaintiff. Furthermore, like SEC actions, there is nothing in any statute cited by Plaintiff that would require the disgorgement remedy to reimburse any person who purchased lenses.

Finally, Plaintiff's disgorgement claim is not remedial because it does not return to the parties to the status quo. Normally, disgorgement is limited to profits (i.e., ill-gotten gains). In this case, Plaintiff is requesting 100% of the gross receipts of monies paid to Defendants without any offsets of costs.[38] By demanding all of the gross receipts, Plaintiff's request becomes punitive on its face because it does not account for deductions of costs incurred related to the

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and equitable' remedy as it reminds the defendant of its legal obligations, serves to deter future violations of the Internal Revenue Code, and promotes successful administration of the tax laws.").

[36] (See ECF Doc. 31 at pg. 2; ECF 33 at pgs. 1, 3, 5).

[37] See ECF Doc. 2 at pg. 43 ("That this Court, under § 7402(a), enter an order requiring all Defendants to disgorge to the United States the gross receipts (the amount of which is to be determined by the Court) that Defendants received from any source as a result of the abusive solar energy scheme described herein, together with prejudgment interest thereon.")

[38] See ECF Doc. 31 at pg. 2 ("…ordering that the defendants disgorge all gross receipts that they received from any source as a result of the abusive solar energy scheme."); see also ECF Doc. 2 at pg. 43; see also ECF Doc. 252 at pg. 13 (computing a disgorgement amount of $47,461,050, derived from the sale of 45,201 lenses in the amount of $1,050 each.); see *Kokesh*, 137 S. Ct. at 1644-445 (2017) ("As a general rule, the defendant is entitled to a deduction for all marginal costs incurred in producing the revenues that are subject to disgorgement. Denial of an otherwise appropriate deduction, by making the defendant liable in excess of net gains, results in a punitive sanction that the law of restitution normally attempts to avoid") (citing *Restatement (Third)* §51, Comment h, at 216).

revenue. Indeed, the proceeds were largely used in furthering research and development by Mr. Johnson that resulted in developing and proving patented components for a solar energy plan.[39]

3. Because the disgorgement sought here is punitive, Defendants are entitled to a jury.

Prior to the 2017 decision in *Kokesh*, this Court struck Defendants' timely jury demand because it determined that the "relief sought is equitable in nature."[40] While doing so, however, the Court also 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 curtailment of the right to a jury trial should be scrutinized with the utmost care."[41] It follows that if the question of a jury is a close call, then the court should error on the side of caution.[42] This Court further stated that "[b]ased 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."[43]

B. The Calculation of Disgorgement is a Fiction based on Erroneous Assumptions.

The damages sought by the government under the guise of "disgorgement" is not tied to a loss experienced by the government or tax benefits wrongly obtained by buyers of solar lenses. Rather, the only calculation the government has provided to defendants in support of a damage

[39] The expert reports from both Plaintiff and Defendants have demonstrated the extent the solar lenses and other components of the solar energy production has progressed in both research and development as well as completed components.
[40] See ECF Doc. 43 at pg. 2.
[41] See *Id.*.
[42] *C.f. Jacob v. New York City*, 315 U.S. 752, 62 S. Ct. 854, 854 (1942) ("the Supreme Court noted that "[a] right so fundamental and sacred to the citizen, whether guaranteed by the Constitution or provided by statute, should be jealously guarded by the courts.'").

[43] *Id.* at pgs. 2-3 (citing *Dimick v. Schiedt*, 293 U.S. 474, 486 (1935)).

claim is based on a factiously calculated number of lenses registered to buyers.[44] In its motion to freeze assets and appoint a receiver, the government extrapolates from a discovery document that approximately 45,201[45] lenses have been sold to consumers and that a contractually determined price for the lenses of $1050 per lens was received by RaPower-3. Plaintiff bases its disgorgement penalty on that calculation only. Not on any amount of revenue lost by the IRS or any tax refund payments to lens purchasers.

Given that the penalty the government seeks in its pleadings sounds like damages or a fine, a jury should decide the entitlement to damages.

C. 26 U.S.C. § 6700 Refers to a Penalty.

To the extent the government is allowed to vary the basis on which it claims a recovery from Defendants, should that variance sweep to include the penalty provision of 26 U.S.C. § 6700, a jury would be appropriate to determine the extent of such a penalty.

Under section 6700, the government is allowed "a penalty equal to $1000 or, if the person establishes that it is lesser, 100 percent of the gross income derived (or to be derived) by such person from such activity. Plaintiff has failed to make clear whether it is seeking recovery under section 6700 and whether it believes a penalty under section 6700 is equitable only, but based on the reasoning in *Kokesh*, infra, and the language of the statute, a jury should be in order to determine the penalty sought in this case.

[44] Doc. 252. US Motion to Freeze Assets and Appoint Receiver, page 9.
[45] The government seems to claim the number of lenses sold by RaPower-3 is calculable from a list of serial numbers for lenses that was produced in discovery as JOHNSON000001-JOHNSON000190. See, Doc. 246.

III. Conclusion

For the reasons stated above, Defendants respectfully submit that by seeking disgorgement in the manner that it has, the United States has clearly made penalties a central part of this case. For this reason, Defendants are entitled to have the jury reinstated.

Dated this 9th day of February, 2018.

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CERTIFICATE OF SERVICE

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

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