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

UNITED STATES OF AMERICA, *Plaintiff,* vs. RAPOWER-3, LLC, *et al*, *Defendants*.	**REPLY MEMORANDUM IN SUPPORT OF MOTION TO BIFURCATE** Case No. 2:15-CV-0828 DN Judge: Honorable David Nuffer Magistrate Judge Brooke Wells

Defendants RaPower-3, LLC; International Automated Systems, LLC; LTB1, LLC; and Neldon Johnson, ("Defendants") by and through their counsel of record, Justin D. Heideman, of the law firm Heideman & Associates, hereby submit this *Reply Memorandum in Support of Motion to Bifurcate*.

I. The key issue in this case is whether Defendants' solar technology is viable, and a finding on this point in favor of Defendants will resolve the entire litigation.

RaPower3 is the owner of proprietary technology involving the use of innovative solar lenses to capture sunlight and create heat, enabling the creation of electricity. In order to capitalize on this technological breakthrough, RaPower3 created a marketing strategy whereby it sells its

proprietary solar lenses to businesspeople who in turn lease the lenses to a third party, thereby generating revenue for the lens owner.

As part of its marketing, RaPower3 alerts potential buyers that there are potential tax advantages to owning and operating a solar lens leasing business, including a depreciation credit for purchased lenses and a solar energy tax credit. In all such marketing materials, RaPower3 expressly informs potential customers that the availability of such tax advantages is theoretical, and that each customer should consult with their own independent tax professional in determining whether to actually claim any particular tax deduction or credit.

The United States has brought the instant action to enjoin RaPower3 from making any representations regarding the potential tax benefits of the solar lens leasing business, arguing that the solar lenses marketed and sold by RaPower3 are not a viable product, are not capable of producing heat or electricity, and are instead merely a "sham" product with no inherent value created for the sole purpose of creating an "abusive tax scheme," whereby purchasers of the lenses can claim tax deductions and tax credits against their active income that is in excess of the amounts paid for the lenses.

In particular, the United States argues that the purchasers of the solar lenses cannot legitimately claim a depreciation tax credit for the purchased lenses because (1) the lens-leasing business is a sham; (2) there can be no "active" participation in the sham lens-leasing business justifying depreciation offsets against other active income from other sources; and (3) despite being personally liable for the purchase price of the lenses and pledging the lenses as collateral for the purchase price, purchasers of the lenses do not actually have any amount of money "at risk," because the purchase of the lenses is financed by RaPower3. The United States further asserts that the solar lenses are not capable of creating heat or energy, and accordingly are not

eligible for the solar tax credit.

In pursuit of its claims, the United States has taken numerous depositions and issued nearly a dozen subpoenas to individuals in several different states across the country. Critically, all of this discovery is directed towards documenting the specific representations regarding potential tax credits made to individual businesspeople and/or documenting the amounts paid by such customers and received by RaPower3 from sales of its proprietary solar lenses.

Critical to the purposes of this motion, virtually none of this time consuming, burdensome, and expensive discovery has been directed towards the threshold issue in this case upon which all of the United States' claims depend, i.e., whether or not RaPower3's solar lens technology is in fact a "sham," rendering representations regarding the potential tax benefits the promotion or marketing of an "abusive tax scheme."

Simply stated, the extensive discovery the United States has taken to date puts the cart before the horse. Discovery regarding the nature of the transactions entered into by each individual purchaser, the representations regarding potential tax benefits made, and the amounts paid and RaPower3 pursuant to such transactions is not only laborious, onerous, and patently duplicative, it is relevant only if, as the United States asserts, RaPower3's solar lens technology is in fact a sham. Indeed, all of the United States' arguments regarding the potential availability of depreciation and solar tax credits hinge on their assertion that the technology is in fact a sham.

It is for this reason that defendants have brought the instant Motion to Bifurcate. If RaPower3's solar lens technology is proven to be legitimate, then the discovery taken by the United States taken to date, and further discovery on the same issues, will be rendered moot. If in fact RaPower3's solar lens technology is valid, then each of the legal arguments the United States has made regarding the propriety of the depreciation and solar tax credits will, under its own

analysis, fail. Given this, bifurcation of discovery on the issues of the viability of RaPower3's solar lens technology and discovery regarding the specific transactions with individual customers who purchased the lenses and claimed such tax credits is eminently reasonable, proper, and in the interests of judicial economy and fundamental fairness.

However, not only is further discovery on these issues duplicative, and hence superfluous, it is entirely premature. This is because if the Defendants' solar lens technology is viable, Plaintiff's claims will necessarily fail. For these reasons, and as discussed more fully below, Defendant moto to bifurcate should be granted.

A. If the technology is viable the Court could determine the customers are engaged in a "trade or business."

Plaintiff argues that the Defendants' customers are not entitled to take depreciation deductions because the customers are not engaged in a "trade or business." However, if Defendant's technology is viable, the Court could readily determine that customers who bought and leased lenses are in a "trade or business" because the customers have bought the lenses in good faith and for the primary purpose of making a profit. 26 U.S.C. §§ 162, 183, 7701(o); *Nickeson v. Comm'r*, 962 F.2d 973, 976-77 (10th Cir. 1992.)

As cited by Plaintiff, under the economic substance test, a taxpayer has undertaken business activity in good faith if it has economic substance. 26 U.S.C. § 7701(o)(1); *See Blum v. Comm'r*, 737 F.3d 1303, 1310 (10 Cir. 2013) (for pre-codified transactions). A transaction has economic substance if 1) "the transaction changes in a meaningful way (a part from Federal income tax effects) the taxpayer's economic position," and 2) "the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction." Id. Relevant factors to the analysis include 1) whether the transaction is marketed "on the basis of projected tax benefits," 2) the transaction features "[a] grossly inflated purchase price set without bargaining," 3) a taxpayer

failed "to inquire into the potential profitability of the program," 4) a taxpayer retained "control" over activities related to or arising out of the transaction, and 5) the transaction featured "nonrecourse indebtedness." *Nickeson v. Comm'r*, 962 F.2d 973, 976-77 (10th Cir. 1992).

Defendants' customers will make a profit by leasing the solar lenses for the production of energy. Specifically, customers buy the lenses for $3,500.00 and receive yearly rent payments of $150.00 for 30 years totaling approximately $4,500.00. Thus, the transaction changes the customer's economic position in a meaningful way beyond the federal income tax benefits. The rents exceeding the value of the purchase price also demonstrates that the value of the lenses has not been inflated. In all actuality, the lenses could be worth much more. Additionally, the transaction has economic substance because the producers of the energy also plan to make a profit. Further, Defendants' customers have the satisfaction of promoting green energy, which is another substantial purpose for entering the transaction, beyond making a profit.

In addition, the customers retain control of the lenses, and can move them to another producer if desired. Further, the financed portion of the lenses is recourse debt because if the customer fails to pay the financed portion of the $3,500.00 payment for the lenses, Defendants can repossess the lenses, and the customers are required to pay the deficiency as determined by the value of the lenses when they are repossessed. Thus, Defendants meet the requirements of the economic substance test.

B. If the technology is viable, the Court could find that Defendants' customers could deduct depreciation for the lenses against non-passive income.

Plaintiff has erroneously argued that Defendants' customers could not deduct depreciation for the lenses against non-passive income because the customers did not materially participate in the business. However, if the technology is viable, the Court could easily find that Defendants' customers can deduct "business" expenses for the depreciation on the lenses from "ordinary

income." The Court could find that Defendants' customers materially participated because they retained control of where the lenses are leased, could move them to a new customer, and received commissions for selling additional lenses. All of these activities show they were engaged in both a business of leasing lenses, and selling lenses. Thus, the Court could find Defendants' customers materially participate in the operations, are engaged in a "trade or business," and are entitled to offset non-passive income with depreciation expenses from the lenses.

C. If the technology is viable, the Court could find that Defendants' customers could were entitled to claim solar energy credits, and the values of the lenses has not be over inflated.

Moreover, if the technology is viable, the Court could clearly find that Defendants' customers were entitled to claim a solar energy credit to reduce their tax liability. In addition, if the technology is viable, the lenses are most likely worth much more than $3,500.00, and therefore, the value of the lenses has not been inflated. Therefore, as demonstrated, this entire case could be resolved if the Court decided the threshold question of the viability of the technology. Plaintiff is putting the cart before the horse by not making this determination prior to seeking discovery from multitudes of people on the assumption it is not viable. Clearly, bifurcating the case to determine this issue will expedite the case to resolution.

II. The Court should focus on the standard for bifurcation.

Plaintiff's response is no different than its apparent litigation strategy. Defendant fails to address the most import issue first. Specifically, Plaintiff does not begin its analysis with the legal standard for a motion to bifurcate. Rather, prior to even broaching the applicable legal standard for bifurcation, Plaintiff exhausts sixteen pages of briefing creating prejudice against Defendants by alleging that Defendants' created a sham technology to promote an abusive tax scheme.

In determining whether to bifurcate, the Court should focus on the factors considered for bifurcation, which are: "(1) judicial economy; (2) convenience to the parties; (3) expedition; and (4) avoidance of prejudice and confusion." *Ecrix Corp. v. Exabyte Corp*. 191 F.R.D. 611, 613 (10th Cir. 2000); see also *In re Innotron Diagnostics*, 800 F.2d 1077, 1085 (Fed. Cir. 1986). Because Plaintiff's analysis begins with an apparent attempt to create prejudice against the Defendant, this reply brief will begin with element number 4, avoidance of prejudice and confusion, and end with the first element, judicial economy.

A. Avoidance of prejudice and confusion

Ironically, in contrast to the purpose of element four, Plaintiff initiates its response by attempting to create prejudice against the Defendant by alleging that the Defendant's technology is a sham, and that Defendant is in the same category as those "promoters of abusive tax shelters" who have used certain objects to promote a tax scheme. However, in the present case, it is not the Defendants promoting a tax scheme; rather, it is tax code that is promoting the development of solar energy technology, such as that being developed by the Defendants.

If the case is not bifurcated, the Plaintiff will likely approach a jury with the same type of degrading language and stereotyping that Plaintiff has approached this Court with. While the Court will likely not be swayed, such language will undoubtedly prejudice a jury against the Defendant.

In contrast, if the viabbility of the technology is determined in favor of the Defendants, the risk that Plaintiff will attempt to prejudice a jury is greatly reduced. In that event, the case will actually be decided fairly, and based on an objective application of the tax code, wherein the jury may fairly determine whether Defendants, and its customers, were entitled to the tax deductions and incentives at issue in this case. The issue of whether the solar technology is viable is crucial

to Defendants having an opportunity for a fair trial. Thus, this element undoubtedly supports the argument for a bifurcated trial.

B. Expedition of the resolution of the case

Further, because Plaintiff has already conducted discovery on a multitude of the Defendants' customers, Plaintiff already has ample information to understand the structure of the business transaction between RaPower-3 and its customers. Conducting further discovery on other customers at this stage will only result in obtaining duplicative information regarding the structure of RaPower3's business arrangement. The arrangement was essentially the same between RaPower3 and its customers, and obtaining the same information from every customer is not necessary. The facts surrounding the arrangement are not in dispute. The contracts between RaPower-3, and its customers, for lack of a better term, are what they are. The only important unknowns in regard to the structure of the transaction is whether the tax advantages cited could be utilized for the business arrangement as it was structured.

Thus, bifurcating the case to determine first whether the technology is viable is the key factual issue that will expedite the resolution of this case. Plaintiff's duplicative discovery efforts towards hundreds of customers across the country simply will not expedite the parties' resolution in this matter. Rather, Plaintiff's duplicative discovery efforts will only result in wasted time and wasted resources from flying around the country to conduct unnecessary depositions and other discovery.

C. Convenience to the parties and judicial economy

A determination on the viability of the technology will save countless man hours and resources for both Plaintiff and Defendants. Doing so first will save both parties from the substantial workload created from Plaintiff's request for information to over one hundred (100)

individuals.

Plaintiff's only argument in regard to convenience seems to be that generally "a single trial tends to lessen the delay, expense and inconvenience to all parties." Plaintiff's Opp., pg. 16. While this may be true in many cases, it is not true in all cases. It is especially not true in this case because Plaintiff is seeking to perform a multitude of depositions all across the country. These depositions so far have resulted in merely duplicative evidence that Plaintiff already has. Further depositions will result in the same duplicative information.

In determining whether to try issues and claims separately, or bifurcate the case, courts have broad authority and the decision should be based on the circumstances of the particular litigation. See *M2 Software, Inc. v. Madacy Entm't,* 421 F.3d 1073, 1088 (9th Cir. 2005)(district court had broad discretion to bifurcate case); see also *Ecrix Corp. v. Exabyte Corp*. 191 F.R.D. 611 (10th Cir. 2000)(trial court has discretion to decide whether to bifurcate a trial); see also *Easton v. City of Boulder*, 776 F.2d 1441 (10th Cir. 1985).

For circumstances like the present situation, the procedural rules provide for bifurcation when there are issues that could alleviate protracted or extensive discovery. See *Carlisle Corp. v. Hayes*, 635 F. Supp. 962, 967 (S.D. Cal. 1986).

As explained above, if Defendants' solar technology is viable, there is no significant need for Plaintiff's protracted and extensive discovery.[1] Plaintiff, however, disagrees that the viability of the technology issue will be completely dispositive. However, even if the issue is not completely dispositive, knowing whether the technology is viable will still facilitate a more speedy

[1] Plaintiff already admits that "[f]acts 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)." Plaintiff's Opp., ¶ 20. Additionally, Plaintiff admits that the facts about the viability of Defendant's technology "will be relevant to the issue of whether Defendants made false or fraudulent 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 or business related to the lenses." Plaintiff's Opp., pg. 19.

resolution.

The Court could then focus on whether Defendants' statements are fraudulent, and if those statements led to an abusive tax shelter.

Plaintiff already has enough information to understand the business relationship between Defendants and its customers. The information about the structure and the tax benefits that may be allowed are available on RaPower3's website. The Court could make these determinations with the information that is available, and without the need for further duplicative discovery by Plaintiff.

Therefore, regardless of how the threshold question is answered, this matter will be expedited by dealing with the key issue of whether the technology is viable first, before diving into the other issues. Bifurcation will expedite this seemingly endless litigation, and further judicial economy. Not bifurcating the case will only result in avoiding the key issue, and dragging out issues that are already known by allowing Plaintiff to engage in duplicative and protracted discovery.

CONCLUSION

Based on the foregoing and other arguments previously presented, Defendants respectfully pray this Court grant Defendants' motion to bifurcate.

SIGNED and DATED this 17th day of October, 2016.

HEIDEMAN & ASSOCIATES

/s/ Justin D. Heideman
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CERTIFICATE OF SERVICE

On this 17th day of October, 2016, I hereby certify a true and correct copy of the forgoing **REPLY MEMORANDUM IN SUPPORT OF MOTION TO BIFURCATE** was served on the following:

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