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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 **UNITED STATES' BRIEF ON DISGORGEMENT** Judge David Nuffer Magistrate Judge Evelyn J. Furse

Pursuant to this Court's Order dated March 8, 2018,[1] the United States submits its brief regarding the legal authorities for measurement and proof of disgorgement. For the reasons that follow, the proper measure of disgorgement is Defendants' gross receipts, as proved at trial, with no deduction allowed for any purported expenses of running the solar energy scheme. If such deductions were warranted (which they are not), Defendants would bear the burden of proving them.

I. Brief Factual Background

The United States will prove at trial that the solar energy scheme is, and has always been, a fraud. Neldon Johnson created and organized the solar energy scheme. He created, owns, and controls at least five entities that have sold so-called "solar lenses" or otherwise collected money from the solar energy scheme: IAS,[2] RaPower-3, LLC,[3] XSun Energy,[4] SOLCO I,[5] and Cobblestone Centre, LLC[6]. With the exception of IAS penny-stock sales, none of these entities generated revenue from any source other than the solar energy scheme.[7] Instead, they make

[1] ECF No. 324.

[2] Pl. Ex. 579, ECF No. 302-1, Designations from the Deposition of Neldon Johnson, vol. 1 ("Johnson Dep., vol. 1"), 35:1-36:9, 37:6-39:7, 41:4-9 (June 28, 2017); Pl. Ex. 540; Pl. Ex. 497.

[3] Pl. Ex. 682, ECF No. 302-5, Designations from the Deposition of RaPower-3, LLC ("RaPower-3 Dep.") 32:16-33:14; 36:14-39:16, 66:1-12, (June 30, 2017).

[4] *See generally* Pl. Exs. 208, 355-56; Pl. Ex. 581, ECF No. 302-2, Designations from the Deposition of International Automated Systems, Inc. ("IAS Dep.") 47:2-19 (June 29, 2017), Johnson Dep., vol. 1, 79:8-81:7, 82:8-10.

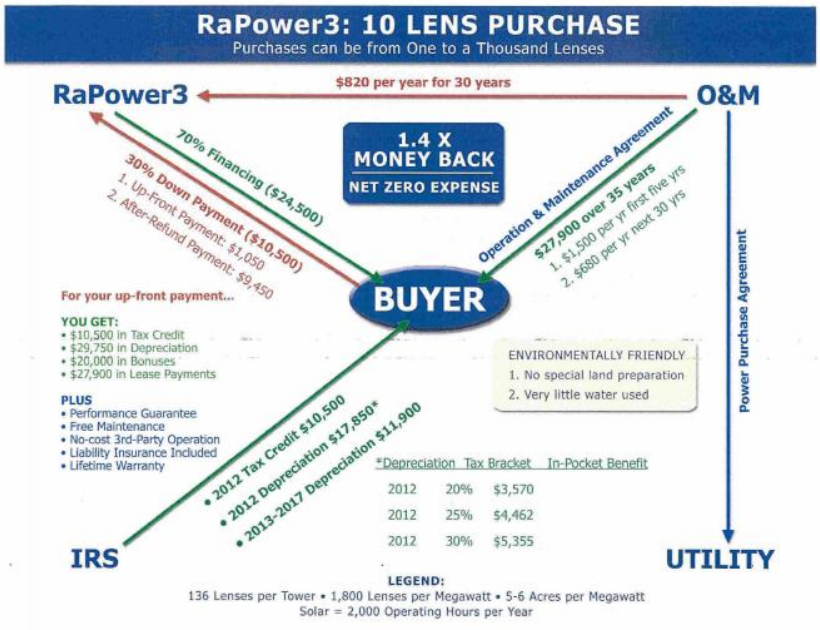
[5] Johnson Dep., vol. 1, 82:8-85:2, Pl. Ex. 673, ECF No. 302-3, Designations from the Deposition of LTB1, LLC, 78:22-79:5, 79:12-80:9, 81:12-21 (July 1, 2017); IAS Dep. 38:10-40:6, 45:4-21; Pl. Ex. 495; Pl. Ex. 693, ECF No. 303-1, Designations from the Deposition of Frank Frederick Lunn, IV, 140:22-142:20; Pl. Ex. 38; Pl. Ex. 325 at 1 ("All of our million dollar plus deals go through out SolcoI entity. RaPower[-]3 is the entity we use for lens purchases of less than a million.").

[6] Johnson Dep., vol. 1, 52:20-53:24, 74:1-14.

[7] RaPower Dep. 32:16-33:13, 54:2-55:4; IAS Dep. 47:2-9; Johnson Dep., vol. 1, 83:13-84:6.

money by selling purported solar lenses to customers, which the customers purportedly lease to LTB, LLC.[8] These transactions, however, are illusory. Although LTB is a company that exists only on paper and has never done anything, Defendants tell customers that LTB will operate and maintain the customer's lens for them, as part of a system that will generate electricity. Defendants tell customers that LTB will sell electricity to a third-party power purchaser, and then pay customers "rental income" for use of their lenses.

Defendants assure their customers that, by "purchasing" lenses, customers may claim a depreciation deduction and a solar energy tax credit on their federal income tax return. When customers follow Defendants' instructions, they greatly reduce or "zero out" their federal tax liability.[9] Defendants illustrated the idea of the scheme as follows[10]:

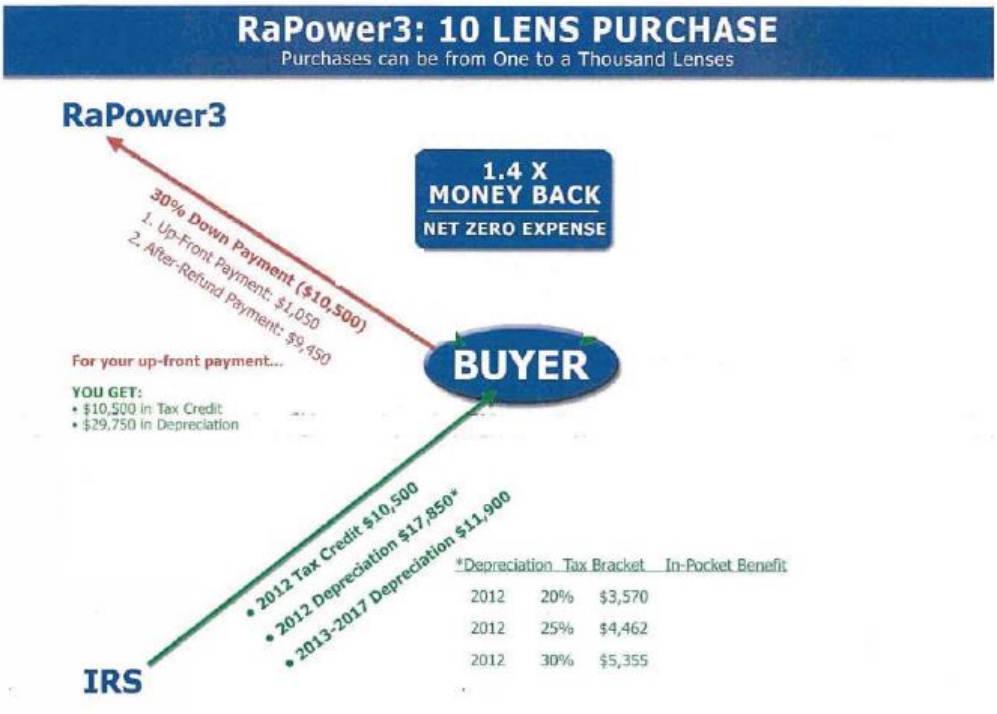


[8] LTB and Defendant LTB1, LLC, are indistinguishable.

[9] *E.g.*, Pl. Ex. 40 at 13.

[10] *E.g.*, Pl. Ex. 496.

But Defendants' purported technology has not worked, does not work, and will not work, to use solar radiation to generate electricity or other useable energy, much less any rental income from a third-party purchaser. The only money Defendants generated has come from the U.S. Treasury through their customers and into Defendants' pockets. An accurate diagram of the solar energy scheme, stripped of its false statements, looks like this:



Once the Treasury's money comes in to RaPower-3 (or another of Johnson's entities) through its customers, Johnson decides how much money should be paid from one entity to another, when to make such payments, and for what purpose.[11] He also directs that money from

[11] *E.g.*, RaPower Dep. 101:19-102:15; Pl. Ex. 507 at 35.

his entities be paid to himself and his family members.[12] Johnson also directed that R. Gregory Shepard be paid for his work to promote the solar energy scheme.[13] Shepard, in turn, paid his family members to assist him in promoting the scheme.[14] Like other people who sold lenses, Johnson also paid Shepard a commission for all lens sales in his "downline."[15]

Defendants encouraged people to "zero out" their taxes by buying more lenses[16]; the more lenses customers bought, the richer Defendants became. Therefore, we ask that this Court enjoin Defendants' continued violations of the internal revenue laws and interference with the administration of those laws. We also request that this Court order disgorgement, in the nature of restitution, of Defendants' gross receipts from their fraudulent conduct.

II. Disgorgement in this case should be measured by Defendants' gross receipts, not by Defendants' net profits, the tax harm, or any other amount.

A. Disgorgement is appropriately measured by Defendants' gross receipts.

We ask the Court to "exercis[e] the chancellor's discretion to prevent [Defendants'] unjust enrichment" from their fraud.[17] The United States, as the claimant for disgorgement, "has the burden of producing evidence from which the court may make at least a reasonable

[12] *E.g.*, Pl. Exs. 646-50, 743-44, 748; Johnson Dep., vol. 1, 13:24-14:2, 54:12-55:9, 81:12-21; 82:8-85:2; Pl. Ex. 681, ECF No. 302-4, Designations from the Deposition of Neldon Johnson, vol. 2, 206:6-21, 207:10-25, 217:22-218:18 (Oct. 3, 2017).

[13] *E.g.*, Pl. Ex. 745 at 3-4; Trial Testimony of Matthew Shepard and R. Gregory Shepard.

[14] Trial Testimony of Matthew Shepard and R. Gregory Shepard.

[15] IAS Dep. 146:6-146:9; Pl. Ex. 685, ECF No. 306-1, Designations from the Deposition of R. Gregory Shepard ("Shepard Dep.") 70:15-72:10 (May 22, 2017); Pl. Ex. 463; RaPower-3 Dep. 36:14-39:8, 48:8-49:15. By January 2015, Shepard had approximately one thousand people on his RaPower-3 email distribution list. Shepard Dep. 305:11-19.

[16] *E.g.*, Pl. Ex. 40 at 13.

[17] *SEC v. Commonwealth Chem. Sec., Inc.*, 574 F.2d 90, 95 (2d Cir. 1978).

approximation of the defendant's unjust enrichment."[18] The burden then shifts to Defendants to show that the United States' estimate is not a reasonable approximation.[19] "[A] claimant who is prepared to show a causal connection between defendant's wrongdoing and a measurable increase in the defendant's net assets will satisfy the burden of proof as ordinarily understood."[20]

Defendants bear the "risk of uncertainty" in calculating the amount that should be disgorged."[21] If the "reasonable approximation" of a defendant's unjust enrichment is "'at some unascertainable amount below an upper limit and when the uncertainty arises from the defendant's wrong, the upper limit will be taken as the proper amount.'"[22] Put another way, if "the true measure of unjust enrichment is an indeterminable amount not less than 50 and not more than 100, liability in disgorgement will be fixed at 100."[23]

Under some circumstances, a defendant "may be allowed a credit," that is, a reduction in the amount of its "wrongful gain" if the defendant shows that it spent money to "carr[y] on the

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[18] Restatement (Third) of Restitution and Unjust Enrichment § 51 cmt. i; *see id.* § 51(5)(d); *United States v. Stinson*, 239 F. Supp. 3d 1299, 1327 (M.D. Fla. 2017), *motion for relief from judgment granted on other grounds by*, No. 614CV1534ORL22TBS, 2017 WL 2493239 (M.D. Fla. May 21, 2017); *United States v. Mesadieu*, 180 F. Supp. 3d 1113, 1120-23 (M.D. Fla. 2016); *SEC v. Jones*, 155 F. Supp. 3d 1180, 1189-91 (D. Utah 2015) (Jenkins, J.) *superseded on other grounds by Kokesh v. SEC*, 137 S. Ct. 1635 (2017) (statute of limitations in 28 U.S.C. § 2462 applies to SEC claims for disgorgement).

[19] *SEC v. Curshen*, 372 F. App'x 872, 883 (10th Cir. 2010); *SEC v. Calvo*, 378 F.3d 1211, 1217-18 (11th Cir. 2004); *Jones*, 155 F. Supp. 3d at 1191-92; Restatement (Third) of Restitution and Unjust Enrichment § 51 cmt. i ("[T]he defendant is then free (there is no need to speak of 'burden shifting') to introduce evidence tending to show that the true extent of unjust enrichment is something less.").

[20] Restatement (Third) of Restitution and Unjust Enrichment § 51 cmt. i.

[21] Restatement (Third) of Restitution and Unjust Enrichment § 51(5)(d) & cmt. i. ("'Reasonable approximation' will suffice to establish the disgorgement liability of a conscious wrongdoer, when the evidence allows no greater precision, because the conscious wrongdoer bears the risk of uncertainty arising from the wrong."); *Calvo*, 378 F.3d at 1217-18 *Stinson*, 239 F. Supp. 3d at 1327.

[22] Restatement (Third) of Restitution and Unjust Enrichment § 51 cmt. i (quoting *Gratz v. Claughton*, 187 F.2d 46, 51-52 (2d Cir. 1951) (L. Hand, J.)).

[23] Restatement (Third) of Restitution and Unjust Enrichment § 51 cmt. i.

business that is the source of the profit subject to disgorgement."[24] The burden of proving that any credit should be allowed is properly on the defendant.[25] After all, any defendant's expenses, and the rationale for such expenses, are in the defendant's possession.

But when a defendant has *defrauded* the claimant "such a defendant will ordinarily be denied any credit for contributions in the form of services, or for expenditures incurred directly in the commission of a wrong to the claimant."[26] At trial, the United States will show that the goal of the solar energy scheme was to defraud the government and enrich Defendants. Therefore, no matter what expenses Defendants may have incurred, they should not be allowed to deduct them against their gross receipts. Instead, ordering disgorgement in the amount of each

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[24] Restatement (Third) of Restitution and Unjust Enrichment § 51(5)(c); *id.* cmt h ("The defendant will not be allowed a credit for the direct expenses of an attempt to defraud the claimant, even if these expenses produce some benefit to the claimant."); *accord Fifty-Six Hope Rd. Music, Ltd. v. A.V.E.L.A., Inc*., 778 F.3d 1059, 1076-77 (9th Cir. 2015).

[25] *SEC v. Aerokinetic Energy Corp*., No. 8:08-CV-1409-T-27TGW, 2010 WL 5174509, at *3 (M.D. Fla. Dec. 15, 2010), *aff'd*, 444 F. App'x 382 (11th Cir. 2011) ("Defendants request an offset of some $538,000 for claimed business expenses. The Magistrate found Defendants failed to substantiate their alleged business expenditures. The Court agrees. The unsworn and unexplained spreadsheet (Dkt.59, Ex. G) is insufficient to satisfy Defendants' burden of demonstrating that $555,000 is not a reasonable approximation of their ill-gotten gains."); *id.* at *4 ("How a defendant chooses to spend his ill-gotten gains, whether it be for business expenses, personal use, or otherwise, is immaterial to disgorgement. Defendants should not be permitted to offset the amounts wrongfully obtained from investors, even if some of the funds were spent in attempting to develop a legitimate business, as Defendants contend." (citations omitted)); *accord 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. Projaris Mgmt*., LLC, No. 13-CV-0849 RB/KBM, 2016 WL 7325661, at *4 (D.N.M. Aug. 23, 2016); *SEC v. Novus Techs*., LLC, No. 2:07-CV-235-TC, 2011 WL 2516938, at *2 (D. Utah June 23, 2011) (Campbell, T).

[26] Restatement (Third) of Restitution and Unjust Enrichment § 51(5)(c) & cmt. h ("The defendant will not be allowed a credit for the direct expenses of an attempt to defraud the claimant, even if these expenses produce some benefit to the claimant."). *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.");*Veros Farm Holding LLC*, 2018 WL 731955, at *4; *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 for the "expenses associated with this fraud.") (quotations omitted) (Kimball, J.).

Defendants' gross receipts will "simply return[] the [D]efendant[s] to the place [they] would have occupied had [they] not broken the law."[27]

Further, Johnson and Shepard should be held personally liable for the gross receipts taken in to their respective companies from the solar energy scheme. An individual may be held liable for what is, on its face, an entity's debt, when 1) there was "such unity of interest and lack of respect given to the separate identity of the corporation by its shareholders that the personalities and assets of the corporation and the individual are indistinct" and 2) "adherence to the corporate fiction [would] sanction a fraud, promote injustice, or lead to an evasion of legal obligations."[28] For example, a tax return preparer who collected fees for unlawful tax returns through his LLC was required to disgorge those fees, personally.[29] The court rejected his argument that "his LLC, and not he, received the tax preparation fees" and therefore he should be personally immune.[30] "Because [the preparer's] unjust enrichment was directly derived from utilizing his LLC as a conduit for improper and fraudulent tax return preparation, [the preparer was] ordered to disgorge those ill-gotten gains."[31]

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[27] *Kokesh*, 137 S. Ct. at 1644.

[28] *N.L.R.B. v. Greater Kansas City Roofing*, 2 F.3d 1047, 1052 (10th Cir. 1993); *United States v. Van Diviner*, 822 F.2d 960, 965 (10th Cir. 1987) (identifying factors to determine whether to pierce the corporate veil, including "whether a corporation is operated as a separate entity"; "commingling of funds and other assets"; "the nature of the corporation's ownership and control"; "use of a corporation as a mere shell, instrumentality or conduit of an individual or another corporation"; "disregard of legal formalities and the failure to maintain an arms-length relationship among related entities"; and "diversion of the corporation's funds or assets to noncorporate uses."); *see also United States v. Badger*, 818 F.3d 563, 572 (10th Cir. 2016) ("One can attempt to improperly escape a payment responsibility using any manner of entity, regardless of the formal connection between the two alter egos.").

[29] *Stinson*, 239 F. Supp. 3d at 1326.

[30] *Stinson*, 239 F. Supp. 3d at 1326.

[31] *Stinson*, 239 F. Supp. 3d at 1326 (quotation omitted).

Here, the purpose of each entity identified above was to perpetrate a fraud.[32] The facts at trial will show that: 1) Johnson and Shepard exercised complete control over their respective entities; 2) the only "business" activities of their respective entities were activities to perpetrate the solar energy scheme; 3) the only money their respective entities made was from the solar energy scheme; and 4) Johnson and Shepard accrued personal wealth, for themselves and their families, from their respective entities' gross receipts. Therefore, they may be ordered to personally disgorge their respective entities' gross receipts.

Last, "the total disgorgement of multiple defendants [should] be determined by the total amount of profit realized by those defendants."[33] Each defendant is properly jointly and severally liable for gross profits that are combined in some fashion, such as when one defendant transfers a portion of gross profits to another defendant who collaborated in the activity that led to a disgorgement order.[34] Therefore, for example, RaPower should be ordered to disgorge its total gross receipts from the solar energy scheme. Shepard should be ordered to disgorge *his* gross receipts from the solar energy scheme. To the extent that RaPower-3 transferred part of its gross receipts to Shepard, Shepard should be jointly and severally liable with RaPower-3 up to the amount of the gross receipts he received from RaPower-3. In this way, the disgorgement order will avoid double-counting or double collection for the amount of RaPower-3's gross receipts that were transferred to Shepard.

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[32] *See Boilermaker-Blacksmith Nat. Pension Fund v. Gendron*, 96 F. Supp. 2d 1202, 1218 (D. Kan. 2000) ("[P]laintiffs must show that defendants acted with intent to avoid payment to plaintiffs, or that their disregard of corporate formalities caused the companies to be less able to pay plaintiffs or otherwise caused injustice.").

[33] *SEC v. AbsoluteFuture.com*, 393 F.3d 94, 96 (2d Cir.), supplemented, 115 F. App'x 105 (2d Cir. 2004).

[34] *AbsoluteFuture.com*, 393 F.3d at 97; *JT Wallenbrock*, 440 F.3d at 1117.

B. Defendants should not be given credit for expenses they incurred to operate the solar energy scheme.

Because Defendants defrauded the United States, they should not be allowed any credit for expenses they incurred to operate the scheme. Any expenses they may claim to have incurred fall into one or more of the following categories: 1) costs of materials and construction of the "solar towers" and solar lenses; 2) commissions to individuals who sold lenses; 3) payments to Shepard or one of his entities for general promotional work for RaPower-3; and 4) other payments to Johnson or his family members. But the materials and construction costs were to create just enough of a realistic façade for Defendants to continue convincing people to buy lenses. The commissions were paid out solely to encourage people to sell more lenses and further enrich Defendants at the Treasury's cost. Payments to Shepard were for the same purpose. And the payments to Johnson and his family may have simply been for their enrichment; it is not clear what, if any, actual work they did – and even if they did perform some work, it was in furtherance of the solar energy scheme.

C. The appropriate measure of disgorgement is not the "taxes avoided by investors" in RaPower-3.

Further, the "taxes avoided by investors in Defendant RaPower" is not the appropriate measure for disgorgement. Because of the way Defendants promoted the scheme, the actual tax loss to the Treasury is likely greater than Defendants' gross receipts. The amount Defendants required customers to pay was $1,050 per lens (or, in the illustration above, $10,500 for ten lenses) – the same amount that Defendants told their customers they could claim as a solar

energy credit ("2012 Tax Credit $10,500").[35] The credit creates a dollar-for-dollar reduction in tax liability.[36] If the solar energy credit were the *only* tax benefit Defendants' customers claimed, the tax harm ($1,050 in solar energy credit per lens) might equal Defendants' gross receipts ($1,050 "down payment" from each customer for each lens).

But, as illustrated, Defendants also told customers that they could claim the *additional* tax benefit of a depreciation deduction for each lens ("2012 Depreciation $17,850").[37] The depreciation deductions from Defendants' customers amplified the harm to the Treasury from the solar energy scheme beyond "just" the $1,050 solar energy credit customers claimed per lens.[38] Although they claim that customers are allowed this "additional tax benefit," Defendants do not require customers to pay them any more than $1,050 per lens. Therefore, requiring Defendants to pay out the total harm to the Treasury from the solar energy scheme may exceed their gross receipts from the scheme. This would not be consistent with the principles of equitable disgorgement.

III. Conclusion

For all of these reasons, the proper measure of disgorgement is Defendants' gross receipts, as proved at trial, with no deduction allowed for any purported expenses of running the solar energy scheme.

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[35] *E.g.*, Pl. Ex. 496.

[36] *E.g.*, Pl. Ex. 128 at 5 (Line 53), 12-17.

[37] *See* Pl. Ex. 25; Pl. Ex. 40 at 13; Pl. Ex. 490 at 9-10; Pl. Ex. 531 at 3.

[38] *See* Pl. Ex. 752 at 2-3; Pl. Ex. 128 at 4 (Line 12), 7 (Lines 13, 28, 29, 31).

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on March 26, 2018, the foregoing document, along with its exhibits, was electronically filed with the Clerk of the Court through the CM/ECF system, which sent notice of the electronic filing to all counsel of record.

/s/ Erin Healy Gallagher
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