IN THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

UNITED STATES, Plaintiff, v. NANCY ZAK, CLAUD CLARK III, ECOVEST CAPITAL, INC., ALAN N. SOLON, ROBERT M. MCCULLOUGH, RALPH R. TEAL JR., Defendants.	)	Case No. 1:18-cv-05774-AT

UNITED STATES' MOTION TO STRIKE AFFIRMATIVE DEFENSES IN THE ANSWER FILED BY ECOVEST CAPITAL INC., ALAN N. SOLON, ROBERT M. MCCULOUGH, AND RALPH R. TEAL, JR.

On December 18, 2018, the United States filed the complaint in this case seeking to enjoin Defendants under 26 U.S.C. §§ 7402, 7407, and 7408 from organizing, promoting, and selling the "conservation easement syndication scheme" as described in the complaint. (ECF No. 1). On February 20, 2019, EcoVest Capital, Inc., Alan N. Solon, Robert M. McCullough, and Ralph R. Teal, Jr. (the "EcoVest Defendants") filed an answer to the United States' complaint.

(ECF No. 15). In their answer, the EcoVest Defendants raised seven "defenses" and included a reservation of rights or catch-all paragraph wherein they attempt to reserve the right to assert any other defense that may appear or become available. Because the EcoVest Defendants raised five defenses that are insufficient as a matter of law, including the reservation of rights paragraph, and improperly plead at least one of those defenses, the United States moves to strike them in an effort to streamline the claims and defenses in this case and avoid unnecessary discovery that may result from the defenses remaining in the pleadings.

BACKGROUND

On December 18, 2018, the United States filed its complaint in this case seeking an injunction under 26 U.S.C. §§ 7402, 7407, and 7408 for the six Defendants' roles in the organization, promotion, and sale of the "conservation easement syndication scheme." The conservation easement syndication scheme, as described in the complaint, is a highly structured scheme that often involves the use of multiple entities. As described in the complaint, the Defendants, including the EcoVest Defendants, directly and indirectly, solicit investors to purchase membership units of an LLC or other entity that is deemed a pass-through entity for federal tax purposes. That pass-through entity owns real property upon which a conservation easement is placed. After the conservation easement is executed, the

LLC reports a noncash charitable contribution resulting from the donation of the conservation easement and passes that deduction through to the investors who own LLC units. As alleged by the United States, the conservation easement scheme relies heavily upon the use of a pass-through entity, such as an LLC, to provide the investors with the tax benefits marketed as resulting from the transaction.

As alleged in our complaint, the six named Defendants have, since 2009, collectively, sold ownership units in at least 96 conservation easement syndicates to thousands of investors across not less than 45 states. These 96 conservation easement syndicates reported over $2 billion of federal tax deductions from the donation of conservation easements. Due to the amount of harm alleged by the United States, the large number of investors, and the highly structured nature of the transactions at issue, this is a complex case that will involve robust discovery.

The United States filed this suit pursuant to the injunction statutes of 26 U.S.C. §§ 7402, 7407, 7408. In all three injunction statutes, the focus is on Defendants' conduct and role in the transactions – including the organization, promotion, and sale of the conservation easement syndicates and the assistance, if any, provided in filing tax returns and attachments to those returns. The United States expects discovery in this case to focus on the statements and actions of all Defendants, including statements they made or caused others to make about the

structure of the transactions and/or statements they made about value. From the United States' perspective, this will require discovery of nonparties, including investors, financial advisors and broker-dealers, as well as the Defendants.

However, a number of the Ecovest Defendants' defenses raised in their answer attempt to shift the focus of this case to the IRS. For example, the EcoVest Defendants have raised laches, estoppel, and the statute of limitations. Because the EcoVest Defendants have not included facts that would indicate how they believe these defenses apply to the facts of this case, if these defenses are not stricken, the United States will be required to conduct discovery to ascertain the basis and facts applicable to each defense raised. This will prejudice the United States – although the extent of how much it will prejudice the United States will depend in part upon the discovery schedule that the Court will enter. Given the complexity of this case the time, resources, and efforts of the Court and all parties involved are better served by striking unnecessary clutter (in the form of insufficient defenses) from the case.

In their answer, filed on February 20, 2019, the EcoVest Defendants raised seven defenses: (1) failure to state a claim for relief; (2) plaintiff's claims are barred by the statute of limitations; (3) plaintiff's claims are barred by the doctrine of laches; (4) plaintiff's claims are barred by the doctrine of estoppel; (5) EcoVest

and the related defendants' actions were at all times justified and proper under applicable law; (6) disgorgement would violate the Excessive Fines Clause of the Eighth Amendment, and (7) plaintiff and/or its attorneys lack the statutory authority to seek the relief it requests, including at least the request for disgorgement. (ECF No. 15, at 54-55). The EcoVest Defendants also included a "catch-all" defense paragraph in which they "reserve the right to assert, and hereby give notice that they intend to rely upon, any other defense that may become available or appear during discovery proceedings or otherwise in this case and hereby reserve the right to amend their Answer to assert any such defense." (ECF No. 15, at 56).

For the reasons set forth below, the United States moves to strike the second, third, fourth, sixth, and seventh defense as well as the catch-all or reservation paragraph in the defense section.

DISCUSSION

Fed. R. Civ. P. 12(f) provides that a court may "strike from a pleading an insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." The court has broad discretion in disposing of a motion to strike. *Resolution Trust Corp. v. Youngblood*, 807 F. Supp. 765, 769 (N.D. Ga. 1992). While Courts generally disfavor motions to strike, if the allegations have no

possible relation to the controversy, may confuse the issues, or may cause prejudice to one of the parties, a court may grant the motion. *Wlodynski v. Ryland Homes of Florida Realty Corp.*, Civ. No. 8:08-00361-JDW-MAP, 2008 WL 2783148, at *1 (M.D. Fla. 2008); *see also*, *Luxottica Group, S.p.A. v. Airport Mini Mall, LLC*, 186 F. Supp. 3d 1370, 1374 (N.D. Ga. 2016).

A court may also strike an affirmative defense if it is insufficiently plead or insufficient as a matter of law. *Luxottica Group*, 186 F. Supp. 3d 1374-75. Fed. R. Civ. P. 8(b) requires a party to state in short and plain terms its defenses to each claim asserted against it. While an answer need not set forth a detailed statement of the affirmative defenses raised, a defendant may not simply make bare bones conclusory allegations. *Microsoft Corp. v. Jesse's Computers & Repair, Inc.*, 211 F.R.D. 681, 684 (M.D. Fla. 2002). The Court reviews affirmative defenses to ensure they provide fair notice of the nature of the defense on the grounds upon which it rests. *Navarro v. Santos Furniture Custom Design, Inc.*, 372 Fed. Appx. 24, 27 (11th Cir. 2010); *Federal National Mortgage Association v. Prowant*, Civ. No. 1:14-3799-AT, 2016 WL 5539644, at *2 (N.D. Ga. 2016). Affirmative defenses must amount to more than mere conclusions of law. *Id.* (citing *Shechter v. Comptroller of City of New York*, 79 F.3d 265, 270 (2d Cir. 1996)).

Even if an affirmative defense gives sufficient notice to the other side as to what the defense is, a defense can still be considered insufficient as a matter of law. A defense is insufficient as a matter of law when "(1) on the face of the pleadings, it is patently frivolous, or (2) it is clearly invalid as a matter of law." *Cox v. Stone Ridge at Vinings, LLC*, Civ. No. 1:12-02633-AT, 2012 WL 12931994, at *2 (N.D. Ga. 2012) (quoting *Microsoft Corp. v. Jesse's Computers & Repair, Inc.*, 211 F.R.D. 681, 683 (M.D. Fla. 2002)). Striking a defense that is insufficient as a matter of law may help remove "unnecessary clutter" from the docket and expedite litigation. *See, Aguilar v. La Campana Restaurant, Inc.*, Civ. No. 18-20015-TORRES, 2018 WL 1138301, at *1 (S.D. Fla. 2018) (quoting *Heller Fin., Inc. v. Midwhey Powder Co.*, 883 F.2d 1286, 1294 (7th Cir. 1989)); *Chattanooga-Hamilton County Hospital Authority v. Hospital Authority of Walker*, Civ. No. 4:14-0040-HLM, 2014 WL 12489763, at *7 (N.D. Ga. 2014).

With this motion, the United States is seeking to remove the clutter from this case and eliminate insufficient defenses that may otherwise impact the discovery and potential trial in this case. Specifically, the United States moves to strike the EcoVest Defendants' second, third, fourth, sixth, and seventh defenses and the reservation of rights paragraphs as insufficient as a matter of law. Furthermore, to the extent that the EcoVest Defendants' defenses are nothing more than conclusory

bare-bones allegations, those defenses are insufficiently plead and should be stricken.

I. The EcoVest Defendants' second, third, fourth sixth, and seventh defenses are insufficient as a matter of law.

A. Second defense: statute of limitations.

The EcoVest Defendants assert in the second defense that the United States' claims are barred by the statute of limitations (ECF No. 15, p. 55). The EcoVest Defendants do not cite to a statute which they allege contains a statute of limitations applicable to this case. Sections 7402, 7407, and 7408 of the Internal Revenue Code do not contain any time restriction or statute of limitations for which a suit under those sections must be brought. 26 U.S.C. §§ 7402, 7407, 7408; *see also, United States v. Moss*, 2017 WL 4682051, at *6 (M.D. Al. 2017); *United States v. Ogbazion*, 2013 WL 1721151, at *5 (S.D. Ohio 2013). None of the other code sections dealing with statute of limitations place a limit on injunction statutes under sections 7402, 7407, and/or 7408, and the companion penalty statutes, i.e., 6700 and 6701, likewise do not have statutes of limitation. *See also*, 26 U.S.C. §§ 6501, 6703; *In re MDL-731–Tax Refund Litig. Of Organizers & Promoters of Inv. Plans Involving Book Properties Leasing*, 989 F.2d 1290, 1300, n.2 (2d Cir. 1993); *Capozzi v. United States*, 980 F.2d 872, 877 (2d Cir. 1992); *Agbanc, Ltd. v. United States*, 707 F. Supp. 423, 426 (D. Ariz. 1988).

The well-established rule is that an action on behalf of the United States in its governmental capacity is subject to no time limitation, in the absence of congressional enactment clearly imposing it, and any statute of limitations sought to be applied against the government must receive a strict construction in favor of the Government. *United States v. Banks*, 115 F.3d 916, 919 (11th Cir. 1997) (quoting *E.I. du Pont de Nemours & Co. v. Davis*, 265 U.S. 456, 462 (1924), *cert. denied*, 522 U.S. 1075 (1998); *United States v. Alvarado*, 5 F.3d 1425, 1427-28 (11th Cir. 1993)). Because the code sections under which the United States brought this suit does not contain a statute of limitations, this Court should not construe one that bars this suit. Because the statute of limitations defense is insufficient as a matter of law, it should be stricken.

B. Third defense: laches

The EcoVest Defendants next assert that the United States' claims are barred under the doctrine of laches. The doctrine of laches is an equitable doctrine in the defendant must demonstrate: (1) a delay in asserting a right or a claim; (2) that the delay was not excusable; and (3) that there was undue prejudice to the party against whom the claim is asserted. *Kason Industries, Inc. v. Component Hardware Group, Inc.*, 120 F.3d 1199, 1203 (11th Cir. 1997). It is well-settled that the United States is not subject to the defense of laches in enforcing its rights, especially

where it is acting to enforce a public right. *United States v. Summerlin*, 310 U.S. 414, 416 (1940); *United States v. Moore*, 968 F.2d 1099, 1100 (11th Cir. 1992). The United States brought this suit in its role as a sovereign to enforce the internal revenue laws. The case law is clear that when the United States brings an enforcement action, such as this, to protect the public interest, laches is not a defense. *United States v. Arrow Transportation Co.*, 658 F.2d 392, 395 (5th Cir. October 8, 1981); *S.E.C. v. Silverman*, 328 Fed. Appx. 601, 605 (11th Cir. 2009). Accordingly, the defense of laches is insufficient as a matter of law and should be stricken.

C. Fourth defense: estoppel

The EcoVest Defendants' fourth defense states merely that "[p]laintiff's claims are barred under the doctrine of estoppel." The Eleventh Circuit has not foreclosed equitable estoppel against the United States completely, but in order to prove estoppel against the Government, the defendant must prove: (1) the traditional private law elements of estoppel must have been present; (2) the Government must have been acting in its private or proprietary capacity as opposed to its public or sovereign capacity; and (3) the Government's agent must have been acting within the scope of his or her authority. *United States v. Vonderau*, 837 F.2d 1540, 1541 (11th Cir. 1988) (citing *FDIC v. Harrison*, 735

F.2d 408, 410 (11th Cir. 1984)). Taxing is a sovereign function to which the defense of estoppel cannot be applied. *United States v. Qurashi*, Civ. No. 8:03-1002, 2004 WL 1771071, at *2-3 (M.D. Fla.) (citing, among other cases, *United States v. Walcott*, 972 F.2d 323, 325 (11th Cir. 1992)); *see also*, *Office of Personnel Management v. Richmond*, 496 U.S. 414 (1990). Because estoppel should not be a defense to actions by the United States in its capacity as a sovereign, such as in this case, it is insufficient as a matter of law and should be stricken.

If, however, this Court decides it is premature to decide this issue so early in the case, the EcoVest Defendants' fourth defense should still be stricken for its failure to provide notice as to the grounds on which the affirmative defense is based under Fed. R. Civ. P. 8. An affirmative defense is established only when a defendant admits the essential facts of a complaint and sets up other facts in justification or avoidance. *Will v. Richardson-Merrell, Inc.*, 647 F. Supp. 544, 547 (S.D. Ga. 1986). The EcoVest Defendants have not alleged facts that would justify their actions under the doctrine of estoppel. As such, the EcoVest Defendants' fourth defense should be stricken.

D. Sixth defense: disgorgement violates the Excessive Fines Clause of the Eighth Amendment

In their sixth defense, the EcoVest Defendants allege that the United States' claim for relief seeking disgorgement violates the Excessive Fines Clause of the Eighth Amendment. In determining whether a claim for disgorgement is an excessive fine in violation of the Eighth Amendment, the EcoVest Defendants must demonstrate that disgorgement is (1) a fine and (2) excessive. *See U.S. v. 817 N.E. 29th Drive, Wilton Manors, Fla.*, 175 F.3d 1304, 1309 (11th Cir. 1999); *United States v. Bajakajian*, 524 U.S. 321 (1998). A "fine" as contemplated by the Eighth Amendment is punitive in nature because at the time the Constitution was adopted, "the word 'fine' was understood to mean a payment to the sovereign as punishment for some offense." *Bajakajian*, 524 U.S. at 327 (quoting *Browning-Ferris Industries of Vt., Inc. v. Kelco Disposal, Inc.*, 492 U.S. 257, 265 (1989)). To determine if a fine is excessive, the court must turn to the principle of proportionality – the amount of the fine must bear some relationship to the gravity of the offense that it is designed to punish. *Id.* at 334.

Generally, disgorgement is a form of restitution measured by the defendant's wrongful gain. *S.E.C. v. Hall*, Civ. No. 17-13897, 2019 WL 103892, at *4 (11th Cir. Jan. 4, 2019) (quoting *Kokesh v. S.E.C.*, 137 S. Ct. 1635, 1640 (2017) (internal quotations omitted)). By its nature, disgorgement, as a form of restitution is not considered punitive because it relates to ill-gotten gains. *See, e.g., In re Bilzerian*,

153 F.3d 1278, 1283 (11th Cir. 1998); *S.E.C. v. Blackwell*, 477 F. Supp. 2d 891, 913-16 (S.D. Ohio 2007). Because it is not punitive, it cannot be considered a fine under the Eighth Amendment's Excessive Fines Clause. *See also, United States v. Philip Morris USA*, 310 F. Supp.2d 58, 63 (D.D.C. 2004); *cf. United States v. Melvin*, Cr. No. 3:14-00022, 2015 WL 7116737, at *13, n.21 (N.D. Ga. 2015) ("'[T]he Excess Fines Clause does not apply to restitution or disgorgement.'") (citation omitted), *reprt. & rec. adopted*, 143 F. Supp.3d 1354 (N.D. Ga. 2015). Regardless of whether disgorgement is considered a fine under the Eighth Amendment, because it is tied to the defendant's wrongful gain, disgorgement is not disproportional and therefore not excessive. *S.E.C. v. Metter* Civ. No. 16-526, 2017 WL 3708084, at *2 (2d Cir. 2017); *S.E.C. v. Jammin Java Corp.*, Civ. No. 2:15-08921 SVW (MRWx), 2017 WL 4286180, at *5 (C.D. Cal. 2017); *see also*, *In re Bilzerian*, 153 F.3d 1278, 1283 (11th Cir. 1998). The EcoVest Defendants' sixth defense is inconsistent with binding precedent and therefore insufficient as a matter of law. As such, it should be stricken.

E. Seventh Defense: Lack of Statutory Authority to Seek Relief, including Disgorgement

In their last numbered defense, the EcoVest Defendants claim that the United States, and/or its attorneys, lack the statutory authority to seek the relief requested, including at least, disgorgement. The EcoVest Defendants provide no

factual citations or basis for this claim; they provide only a bare bones conclusory allegation of the defense. Regardless, this defense is insufficient as a matter of law and contradicted by the statutory language of 26 U.S.C. § 7402 and case law interpreting it. Section 7402 encompasses a broad range of powers "necessary or appropriate" to enforce the internal revenue laws. *Brody v. United States*, 243 F.2d 378, 384 (1st Cir. 1957) ("It would be difficult to find language more clearly manifesting a congressional intention to provide the district courts with a full arsenal of powers to compel compliance with the internal revenue laws."); *United States v. Kaun*, 633 F. Supp. 406, 409 (E.D. Wisc. 1986) ("By its very terms, this statutory provision authorizes the federal district courts to fashion appropriate, remedial relief designed to ensure compliance with both the spirit and the letter of the Internal Revenue laws – all without enumerating the many, particular methods by which these laws may be violated or their intent thwarted."), *aff'd on other grounds*, 827 F. 2d 1144 (7th Cir. 1987); *United States v. Ernst & Whinney*, 735 F.2d 1296, 1299-1301 (11th Cir. 1984); *see also*, *United States v. ITS Financial, LLC*, 592 Fed. Appx. 387, 397 n.6 (6th Cir. 2014).

Courts, including the Eleventh Circuit, recognize that disgorgement is included within this broad range of powers encompassed in section 7402. *United States v. Stinson*, 729 Fed. Appx. 891, 898-99 (11th Cir. 2018); *United States v. St.*

Jean, Civ. No. 1:17-2648-ELR, 2018 WL 4178342, at *2 (N.D. Ga. 2018); *United States v. Mesadieu*, 180 F. Supp. 3d 1113, 1118-19 (M.D. Fla. 2016); *United States v. RaPower-3, LLC*, 343 F. Supp. 3d 1115, 1194 (D. Utah 2018). Further, the other relief requested in the United States' complaint is authorized under the broad range of powers in section 7402 and have been ordered by courts in other cases. *See, e.g., United States v. Benson*, 561 F.3d 718, 724-728 (7th Cir. 2009); *United States v. Miner*, Civ. No. 6:10-cv-1873-Orl-41DAB, 2014 WL 7361829, at *9 (M.D. Fla. 2014) (and the cases cited therein). The EcoVest Defendants' seventh defense is insufficient as a matter of law as it is contradicted by the very language of the statute itself and the cases interpreting it. As such, it should be stricken.

F. Unnumbered paragraph: reservation of all other defenses

In the last paragraph under the "Defenses" section, on page 56, the EcoVest Defendants "reserve the right to assert, and hereby give notice that they intend to rely upon, any other defense that may become available or appear during discovery proceedings or otherwise in this case and hereby reserve the right to amend their Answer to assert any such defense." A reservation of rights defense, such as this one, however, fails to assert a legal defense or plead the defense as envisioned by Fed. R. Civ. P. 8. *See, Branch Banking & Trust Co. v. Nat'l Fin. Servs., LLC*, Civ. No. 6:13-cv-1983-Orl-31TBS, 2014 WL 2019301, at *4 (M.D. Fla. May 16, 2014).

The EcoVest Defendants can, if it becomes necessary, amend their pleadings so long as it is done in accordance with the Federal Rules of Civil Procedure, the Local Rules of the Northern District of Georgia, and this Court's orders. Because the defense is insufficient as a matter of law and improperly plead, the reservation of rights defense should be stricken.

CONCLUSION

Because the EcoVest Defendants' second, third, fourth, sixth, seventh and reservation of rights defenses are insufficient as a matter of law, they should be stricken. Striking the defenses will eliminate the need for the parties to take discovery as to those defenses and remove the unnecessary clutter from the pleadings in this case. For the reasons set forth above as to each specific defense, the United States prays that this motion is granted and the defenses identified in this motion are stricken.

Dated: March 13, 2019

Respectfully submitted,

RICHARD E. ZUCKERMAN
Principal Deputy Assistant Attorney General

/s Erin R. Hines
ERIN R. HINES
FL Bar No. 44175
Email: Erin.R.Hines@usdoj.gov
Telephone: (202) 514-6619

Trial Attorney, Tax Division
U.S. Department of Justice
P.O. Box 7238
Ben Franklin Station
Washington, D.C. 20044
Facsimile: (202) 514-6770

Local Counsel:
BYUNG J. PAK
United States Attorney

_____
NEELI BEN-DAVID
ASSISTANT U.S. ATTORNEY
Georgia Bar No. 049788
Office of the United States Attorney
Northern District of Georgia
600 U.S. Courthouse
75 Ted Turner Drive, SW, Suite 600
Atlanta, Georgia 30303
Telephone: (404) 581-6303
Facsimile: (404) 581-4667

Email: Neeli.ben-david@usdoj.gov

*I certify that this motion has been prepared with one of the font and point selections approved by the court in LR 5.1C.

CERTIFICATE OF SERVICE

I hereby certify that on March 13, 2019, the foregoing document 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 and that I caused a copy of the foregoing docket-stamped documents to be mailed first class mail, postage prepaid to the following:

Nathan Clukey
Sidley Austin LLP
1501 K Street, N.W.
Washington, D.C. 20005
Attorney for Nancy Zak

Matthew Hicks
Caplin Drysdale
One Thomas Circle, N.W.
Washington, D.C. 20005
Attorney for Claud Clark, III

/s Erin R. Hines
ERIN R. HINES
Trial Attorney, Tax Division
U.S. Department of Justice