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

UNITED STATES, Plaintiff, v. NANCY ZAK, et al. Defendants.	))))))))))	Case No. 1:18-cv-05774-AT

UNITED STATES' REPLY IN SUPPORT OF ITS MOTION TO STRIKE AFFIRMATIVE DEFENSES OF THE ECOVEST DEFENDANTS

On March 13, 2019, the United States filed a motion to strike six defenses raised in the answer filed by EcoVest Capital, Inc., Alan N. Solon, Robert M. McCullough, and Ralph R. Teal, Jr. ("the EcoVest Defendants"): (1) statute of limitations; (2) laches; (3) estoppel; (4) disgorgement violates the Eighth Amendment Excessive Fines Clause; (5) lack of statutory authority for the relief requested, including disgorgement; and (6) a reservation of rights defense. ECF No. 24; ECF No. 15, at 54-55. Each of these are insufficient as a matter of law.

On March 27, 2019, the EcoVest Defendants filed a memorandum in opposition to the United States' motion. In their motion, the EcoVest Defendants assert that these "black-letter legal doctrines" may apply in this case and that the

Court should deny the United States' motion so that they can have the opportunity to demonstrate those defenses. But the EcoVest Defendants ignore the cases cited by the United States in its motion. Instead, the EcoVest Defendants selectively cite portions of legal analysis from cases that, if read in context, do not negate the conclusion that the six challenged defenses are insufficient as a matter of law.

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 against Defendants for their roles in the organization, promotion, and sale of the "conservation easement syndication scheme." The "conservation easement syndication scheme" at its most basic, involves Defendants selling interests in tracts of land to taxpayers looking for large tax deductions. In the arrangement, the taxpayers then get inflated appraisals of those tracts of land and grant conservation easements on that land. The resulting inflated charitable deductions are then split among the taxpayers. In this case, the United States seeks to enforce the internal revenue laws and enjoin Defendants from continuing to engage in the conservation easement syndication scheme. As alleged in the Complaint, the Defendants have collectively been responsible for at least 96 conservation easement syndicates since 2009 that have been sold to thousands of investors and resulted in over $2 billion of federal tax

deductions claimed by the syndicates. The focus of this case is whether Defendants' conduct is enjoinable under the pertinent statutes. The United States intends to prove that this Court should stop Defendants' misconduct and order them to disgorge their ill-gotten gains.

DISCUSSION

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

Where a defense is insufficient as a matter of law, it should be stricken to eliminate the unnecessary delay and expense of litigating it. *Resolution Trust Corp. v. Youngblood*, 807 F. Supp. 765, 769 (N.D. Ga. 1992). Although motions to strike are generally disfavored, courts grant such motions when a defense is insufficient as a matter of law. *See, e.g.*, *Luxottica Grp., S.p.A. v. Airport Mini Mall, LLC*, 186 F.Supp.3d 1370, 1374 (N.D.Ga. 2016); *Cox v. Stone Ridge at Vinings, LLC*, 2012 WL 12931994, at *1 (N.D.Ga. 2012).

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*, 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)). In its motion to strike, the United States discussed why the challenged defenses are

insufficient as a matter of law. The EcoVest Defendants' opposition fails to disprove the United States' position for any defense, as discussed below.

A. The statute of limitations defense is insufficient as a matter of law.

To reiterate, there is no statute of limitations in the Internal Revenue Code for injunction suits brought under §§ 7402, 7407, or 7408 or for enforcement of civil penalties under § 6700. *See* ECF No. 24, at 8-9; 26 U.S.C. §§ 6501, 6700, 6703, 7402, 7407, 7408; *see also, U.S. v. Moss*, 2017 WL 4682051, at *6 (M.D. Al. 2017); *U.S. v. Ogbazion*, 2013 WL 1721151, at *5 (S.D. Ohio 2013); *In re MDL-731–Tax Refund Litig.*, 989 F.2d 1290, 1300, n.2 (2d Cir. 1993); *Capozzi v. U.S.*, 980 F.2d 872, 877 (2d Cir. 1992); *Agbanc, Ltd. v. U.S.*, 707 F. Supp. 423, 426 (D. Ariz. 1988). The EcoVest Defendants do not dispute this contention.

Instead, the EcoVest Defendants assert as a defense, the five-year limitation period contained in 28 U.S.C. § 2462. To support the application of the § 2462 limitation period, they cite to Supreme Court's opinion in *Kokesh v. SEC*, 137 S.Ct. 1635 (2017). However, as explained in the United States' opposition to Zak's Motion to Dismiss, *Kokesh* is inapposite. ECF No. 47, at 24-27. The disgorgement at issue in this case: (1) redresses a wrong committed against the United States in its collection of taxes; (2) will be paid to the victim – the United States Treasury; and (3) is remedial in nature because it restores the parties to the status quo in a

manner that is consistent with the law of restitution.[1] As such, disgorgement in this case, and generally under § 7402, is distinguishable from the disgorgement sought in SEC contexts.

The EcoVest Defendants cite two cases to support their request that this Court extend the holding of *Kokesh* to disgorgement sought under 26 U.S.C. § 7402. ECF No. 43, at 6. But, neither case considers this type of disgorgement. Further, these cases do not actually consider whether 28 U.S.C. § 2462 applies to disgorgement or other equitable action sought outside of the securities context and provide no basis for the court to extend the reasoning in this case. *See, e.g., FTC v. J. William Enters., LLC*, 283 F.Supp.3d 1259, 1262 (M.D.Fla. 2017) (refusing to extend the holding of *Kokesh* to an action requesting equitable relief under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b)).

In the first case cited by the EcoVest Defendants, *U.S. v. Luminant Generation Co.*, 905 F.3d 874, 884-85 (5th Cir. 2018), the Fifth Circuit was determining whether the United States could sue for *penalties* and injunctive relief

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[1] As noted in its opposition to Zak's motion to dismiss, even if the IRS were to audit Defendants' customers and able to recover some or all of the tax loss caused by Defendants, the IRS is still a victim and harmed because the IRS is forced to devote *substantial* resources to identifying Defendants' scheme and customers. ECF No. 47, at 27, n.14 (collecting cases).

for violations of the Clean Air Act (CAA) that accrued more than five years before the date the suit was filed. But in that case, the parties did not dispute that 28 U.S.C. § 2642 applied to CAA enforcement actions. *Luminant*, 905 F.3d at 881 (citation omitted). Instead, the parties disputed what event(s) trigger the running of the statute of limitations. The Fifth Circuit did not use *Kokesh* as a rationale for applying 28 U.S.C. § 2642 to CAA enforcement actions. The Fifth Circuit parsed through the relief sought and found that while the legal remedies were barred by the statute of limitations in 28 U.S.C. § 2642, the equitable remedies were not. *Luminant*, 905 F.3d at 885-86 (citing the long-standing proposition that the government, acting in its sovereign capacity, is subject to no time limitation in the absence of clear Congressional intent).

In the second case cited by the EcoVest Defendants, *CFTC v. Gramalegui*, 2018 WL 4610953, at *30 (D.Col. 2018), the court was asked to determine whether the CFTC was entitled to relief in the form of "civil monetary penalties, disgorgement, restitution, and injunctive relief." *Gramalegui*, at *26. The district court determined that 28 U.S.C. § 2462 applied to the civil monetary penalty (which the Court found to be imposed principally for punitive purposes), but did not directly address whether 28 U.S.C. § 2462 applied to disgorgement as the CFTC had limited its requests to revenues earned within five years of filing suit.

Id. at *29. In finding however, that 28 U.S.C. § 2462 applied to the restitution sought by the CFTC, the court focused on the characteristics of the restitution – finding that it was not merely compensatory but also served as punitive purposes.

But neither of those cases decided the characteristics of disgorgement sought under § 7402 of the Internal Revenue Code. Sensing this lack of direct applicability, the EcoVest Defendants attempt to invoke the title of section 6700, "Imposition of penalty" as a basis for characterizing disgorgement in this case as a penalty or for superimposing 28 U.S.C. § 2462 on the Internal Revenue Code. Such an attempt must be denied absent clear and express consent from Congress – which the EcoVest Defendants cannot demonstrate. In fact, Congress has made the purposes of these statutes abundantly clear: these statutes were enacted to attack abusive tax shelters at their source: the organizer and salesman. S. Rep. 97-494, Vol. 1 at 266. Congress has had multiple opportunities to impose a statute of limitations and has elected not to do so. *United States v. Banks*, 115 F.3d 916, 919 (11th Cir. 1997) (quotation and citations omitted). As such, the statute of limitations defense is insufficient as a matter of law and should be stricken.

B. The defense of laches is insufficient as a matter of law and should be stricken.

The EcoVest Defendants do not dispute the well-settled proposition laid out in *U.S. v. Summerlin*, 310 U.S. 414, 416 (1940), that the United States is not

subject to the defense of laches in enforcing its rights, especially when acting to enforce a public right. Instead, the EcoVest Defendants cite to the court's commentary in *U.S. v. Delgado*, 321 F.3d 1338, 1349 (11th Cir. 2003) that there are exceptions to the general rule that laches does not lie against the Government. But in citing to this note in *Delgado*, the EcoVest Defendants ignore the context of the court's commentary and the fact that the court did not find an exception applied in that case. The *Delgado* court cautioned that "laches should not be used to prevent the Government from protecting the public interest." *Id.* (citation omitted). Tax enforcement serves to protect the public interest – as does restoring funds to the U.S. Treasury after they are unlawfully taken through an abusive tax scheme.

The EcoVest Defendants do not provide one instance of laches being applied to the Government in a tax enforcement suit. Instead, they cite to cases involving the EEOC or cases from other circuits. EEOC cases are distinct from tax cases. The EEOC, as its authority has evolved, acts at the behest of and for the benefit of specific individuals while also seeking to vindicate public interest in preventing employment discrimination. *Gen. Tel. Co. of the Northwest, Inc. v. EEOC*, 446 U.S. 318, 326 (1980) (citing *Occidental Life Ins. Co. of California v. EEOC*, 432 U.S. 355, 368 (1977)). The EEOC essentially has a dual-role of public interest and acting on behalf of specific individuals.

The United States, when pursuing tax enforcement actions, does not have a dual-role like the EEOC. And nothing about the EEOC cases alters the conclusion that laches cannot be applied in this context. *U.S. v. Summerlin*, 310 U.S. 414, 416 (1940); *U.S. v. Moore*, 968 F.2d 1099, 1100 (11th Cir. 1992); *U.S. v. Arrow Transportation Co.*, 658 F.2d 392, 395 (5th Cir. October 8, 1981); *SEC v. Silverman*, 328 Fed. Appx. 601, 605 (11th Cir. 2009). The EcoVest Defendants fail to provide any rationale for disturbing this well-settled proposition.[2]

C. The estoppel defense is insufficient as a matter of law and should be stricken.

Once again, in opposing the United States' motion to strike the estoppel defense, the EcoVest Defendants provide rationale from cases that have no bearing on whether estoppel, in the Eleventh Circuit, can be applied against the United States. Instead, the EcoVest Defendants cite to cases from the Ninth Circuit –

[2] It also bears pointing out that the United States alleged this conduct has been ongoing since 2009 – and that EcoVest became involved when it was formed in 2012. This pattern of conduct and the length of time that it has been occurring is an aspect of how the United States intends to prove the full extent of the harm to the government, but the allegations contained in the complaint, when taken as true for the purposes of this motion, alleges conduct that occurred to 2018. The United States fails to see how conduct that is ongoing and has occurred within the last year can constitute "unreasonable delay" as a matter of law which is a necessary element of laches.

which have employed estoppel against the government. While courts in the Ninth Circuit may permit estoppel claims against the United States acting in its public capacity, that does not change the standard in the Eleventh Circuit. *U.S. v. Qurashi*, 2004 WL 1771071, at *2-3 (M.D. Fla.) (citing, among other cases, *U.S. v. Walcott*, 972 F.2d 323, 325 (11th Cir. 1992)).

The EcoVest Defendants rely upon *Chiles v. Thornburgh*, 865 F.2d 1197, 1202 (11th Cir. 1989) for the implication that this court must accept the validity of their estoppel defense in ruling on this motion to strike. However, in *Chiles*, the Eleventh Circuit was reviewing whether the district court correctly dismissed a case for a lack of standing. A motion to strike serves a different purpose – to determine whether a defense is insufficient as a matter of law. The Court is determining whether the theory has legal viability – and therefore must determine whether the theory is valid, not assume it is.

The United States also moved to strike the estoppel defense as insufficiently plead. ECF No. 24, at 11. The EcoVest Defendants disagree. ECF No. 43, at 13. The EcoVest Defendants do not provide any analysis for how their estoppel defense satisfied the pleading requirements, but merely cites to one instance where estoppel was pleaded in a similar fashion and not struck. *Cox*, 2012 WL 12931994, at *5. However, none of the facts alleged in the Complaint support the EcoVest

Defendants' estoppel defense. If the purpose of notice pleading is to allege the defense and the basic facts for such a defense, then the EcoVest Defendants should be required to include those basic facts in their answer. Such facts are hinted at by the EcoVest Defendants in their opposition. *See*, ECF No. 43, at 9, referencing "dozens of projects and scores of IRS filings." Regardless, the EcoVest Defendants' estoppel defense is nothing more than a bare-bones conclusory allegation that fails to provide adequate notice of the estoppel defense. As such, it is insufficiently pled and should be stricken.

D. Disgorgement does not violate the Eighth Amendment and as such, the defense asserting such is insufficient as a matter of law and should be stricken.

As laid out in its opposition to the motions to dismiss filed by Zak and Clark, for disgorgement to violate the Excessive Fines Clause of the Eighth Amendment, the EcoVest Defendants must demonstrate that disgorgement is (1) a fine and (2) excessive. ECF Nos. 47, at 29-31; 50, at 16-19. *See also*, *U.S. v. 817 N.E. 29th Drive, Wilton Manors, Fla.*, 175 F.3d 1304, 1309 (11th Cir. 1999); *U.S. v. Bajakajian*, 524 U.S. 321 (1998). The EcoVest Defendants argue that because the Supreme Court held that disgorgement is a penalty for purposes of 28 U.S.C. § 2462 in *Kokesh*, then disgorgement must also be considered a "fine" under the Eighth Amendment.

But, the EcoVest Defendants' reliance on *Kokesh* is once again misplaced. *Kokesh* does not stand for the proposition that disgorgement is a penalty in all contexts – the only holding the Court made was that SEC disgorgement constituted a penalty under 28 U.S.C. § 2462 and thus implicated a five-year statute of limitations. *See, U.S. v. Rapower-3, LLC*, 294 F.Supp.3d 1238, 1240-41 (D. Utah. 2018), *appeals pending*, Nos. 18-4119, 18-4150 (10th Cir.). Whether something is a "fine" for purposes of the Eighth Amendment is a separate inquiry. Disgorgement under § 7402 should not be confused with penalties available under § 6700 as they are two separate and distinct remedies with different purposes. Here, disgorgement seeks to restore the *status quo ante* by restoring funds to the U.S. Treasury that were improperly paid out as a result of Defendants' conduct. *See also*, ECF No. 47, at 28-29. Disgorgement does not transform into a fine in this context merely because § 6700, a penalty statute, exists and is relevant to this suit.

As noted in our motion to strike – which the EcoVest Defendants do not dispute – courts have declined to decide the issue of whether disgorgement is a fine. Instead, these courts assume, *arguendo*, that disgorgement operates as a fine because they can conclude that the Eighth Amendment is not violated based on the second prong – of whether disgorgement is excessive. The cases cited by the United States – and the EcoVest Defendants – conclude that disgorgement is not

excessive when it is tied to a defendant's wrongful gain, like it will be in this case. *SEC v. Metter*, 2017 WL 3708084, at *2 (2d Cir. 2017); *SEC v. Jammin Java Corp.*, 2017 WL 4286180, at *5 (C.D. Cal. 2017); *see also, In re Bilzerian*, 153 F.3d 1278, 1283 (11th Cir. 1998); *U.S. v. Melvin*, 2015 WL 7116737, at *13, n.21 (N.D. Ga. 2015) ("'[T]he Excessive Fines Clause does not apply to restitution or disgorgement.'") (citation omitted), *reprt. & rec. adopted*, 143 F. Supp.3d 1354 (N.D. Ga. 2015).

The EcoVest Defendants cite no cases where disgorgement was excessive – or any case in which disgorgement has been found to violate the Eighth Amendment. A defense, like this one, is invalid as a matter of law when prior decisions foreclose that defense. As such, the Eighth Amendment defense should be stricken.

E. The United States has statutory authority to seek the requested relief, including disgorgement and as such, the EcoVest Defendants' seventh defense should be stricken.

The EcoVest Defendants do not dispute that § 7402 authorizes disgorgement.[3] Instead, they argue that the United States seeks to use disgorgement

[3] The EcoVest Defendants address only whether the monetary relief, in the form of disgorgement, is outside the statutory authority of § 7402. As such, the United

under § 7402 as "an end-run around the statutory limits Congress imposed [under § 6700 penalties]." ECF No. 43, at 11. But, as discussed previously, disgorgement under § 7402 and penalties under § 6700 serve different purposes. *See also*, ECF No. 47, at 28-29. The mere fact that proving § 6700 conduct is prerequisite for injunctive relief under § 7408, which at issue in this case, does not alter the characteristics of the disgorgement sought here.

The EcoVest Defendants attempt to transform the disgorgement characteristics by asserting that the United States "neglected" to cite § 6700 in its disgorgement claim. However, a cite to § 6700 to support disgorgement would be improper; § 6700 does not authorize a full arsenal of equitable powers. Disgorgement is however, authorized under § 7402. *See, e.g.*, *U.S. v. Stinson*, 729 Fed.Appx. 891, 898-99 (11th Cir. 2018); *U.S. v. RaPower-3, LLC*, 343 F. Supp. 3d 1115, 1194 (D. Utah 2018), *appeals pending*, Nos. 18-4119, 18-4150 (10th Cir.).

The EcoVest Defendants' attempt to invoke the rationale behind the D.C. Circuit's opinion is *Loving* is also misplaced. *Loving v. IRS*, 742 F.3d 1013, 1020

States assumes that the EcoVest Defendants have abandoned their argument that other relief is not statutorily authorized and will not address it further.

(D.C. Cir. 2014). *Loving* dealt with a regulatory regime – not a remedy authorized by statute. *See also*, ECF No. 47, at 28-29; ECF No. 50, at 23-24.

F. The reservation of rights defense is insufficient as a matter of law.

The EcoVest Defendants state that their reservation of rights paragraph is "harmless and consistent with the Federal Rules" and "courts in this district have declined to strike such simple reservations of rights." ECF No. 43, at 12. However, the EcoVest Defendants ignore that there are other instances in this district when such a defense has been struck. *See, e.g.*, *Luxottica*, 186 F.Supp.3d at 1374. There is a procedure under the Federal Rules of Civil Procedure and the Local Rules for amending their answer if need be – it is not through a "reservation of rights" defense in the answer.

CONCLUSION

The EcoVest Defendants' second, third, fourth, sixth, seventh and reservation of rights defenses are insufficient as a matter of law. United States requests that this Court grant its motion and strike their second, third, fourth, sixth, seventh and reservation of rights defenses.

Dated: April 10, 2019

Respectfully submitted,

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*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 April 10, 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 counsel of record.

/s Erin R. Hines
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