UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
20-cv-81205-RAR

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

COMPLETE BUSINESS SOLUTIONS GROUP, INC. d/b/a PAR FUNDING, *et al.*,

Defendants.
_____/

DEFENDANTS' JOINT MOTION FOR RECUSAL AND INCORPORATED MEMORANDUM OF LAW AND REQUEST FOR HEARING

Defendants Lisa McElhone, Joseph W. LaForte, and Joseph Cole Barleta ("Defendants"), by and through their attorneys, respectfully move for the recusal of the Honorable Rodolfo A. Ruiz ("Judge Ruiz") pursuant to 28 U.S.C. § 455(a).

I. INTRODUCTION

Defendants respectfully move for recusal given this Court's appearance of partiality in favor of the Receiver. This appearance of partiality has persisted in numerous court appearances conducted since July 2020 and culminated in the most recent status conference held on May 20, 2021, during which the Court: (1) allowed the Receiver to withhold evidence from Defendants for months; (2) allowed the Receiver to use and rely on this evidence to unilaterally allege untested and misleading claims against Defendants, including claims that mirror the SEC's allegations; (3) refused to permit Defense Counsel a fair and equal opportunity to respond during status conferences to the Receiver's claims; and (4) recently ignored its own ruling and allowed the Receiver to present facts and arguments without notice to Defendants. Consequently, as this Court has itself acknowledged, Defendants have been forced to litigate with "one hand tied behind their back." (December 15, 2020 Status Conference at, T. 93, 101.) ("Dec. 15 Status Conf.") This motion is not made lightly, but only after a careful examination of the record reflecting that the appearance of partiality is manifest and mandates recusal.

II. STATEMENT OF FACTS

1. September 8, 2020 Status Report and Conference

At this status conference, the Court invited the Receiver to exceed the text of its status report (DE 240) "for the edification of the investors, who are obviously waiting on bated breath to hear about how much of their principal is going to be returned." (September 8, 2020 Status Conference, T. at 40.) ("Sept. 8 Status Conf.") Counsel for the Receiver introduced a string of allegations erroneously suggesting troubling financial conditions for some of the merchants. (*Id.* at 41–44). What should have been a three-party exchange among the parties and the Court devolved into a two-party dialogue with the Court seemingly accepting every word uttered by the Receiver as not just accurate, but irrefutable, while ignoring Defendants' pleas for access to the documents and an equal opportunity to be heard. Essentially, the Court conducted an *ex parte* hearing with the Defendants' nominal presence.

Over Defendants' objections, the Court vouched for the Receiver and DSI, the Receiver's third-party vendor, as "the guys I've put in place." (*Id.* at 44.) The Court championed the Receiver's work and credited the Receiver's claims and conclusions about the financial condition of ten merchants DSI had concluded were simply never going to repay their debts to CBSG, dubbed the "Exception Portfolio." (*Id.* at 45–46.) Though only having heard from the Receiver, the Court pronounced that the Receiver had demonstrated that "the money that they were getting and the loans…. *may not have been on the up-and-up as much as had been advertised*." (*Id.* at 46) (emphasis supplied). The Court then accused Defendants of painting a "rosy picture" that the "numbers . . . don't support," and pointed to the DSI Report as its sole supporting evidence: "a perfect example of that." (*Id.*)

a. Defendants' Response (ECF 249)

In a filing on September 10, 2020, Defendants—still deprived by the Receiver of a single document notwithstanding multiple requests—responded to the Receiver's inaccurate claims, noting, among other things, that investors' regular interest payments had continued until the moment of the Receivership and would have continued absent the SEC's action. (DE 249) ("Defendants' Joint Response to Receiver's Status Report of September 8, 2020 (DE 240)").

2. The October Status Report and Conferences

As before, the Court again credited the Receiver's unrebutted (and, as Defendants still had received no documents, functionally unrebuttable) Report about CBSG. This included the

Receiver's claims that: (1) CBSG was financially unsound before the Receivership (October 7, 2020 Status Conference, T. at13) ("Oct. 7 Status Conf."); (2) the Receiver was impeded in collecting the accounts receivables because of purportedly poor underwriting, an SEC allegation, and poor record-keeping (*Id.* at 42–43); (3) "reloads" were improperly used to artificially prop-up merchant deals so that additional infusions of investor dollars would be needed to sustain the business (*Id.* at 38–39); (4) as a result of the reloads, the actual money received by CBSG daily was not 1.5 million but "a lot less" (*Id.* at 39); and (5) the high number of confessions of judgment was a tell-tale sign that the actual default rate was much higher than 1.2 percent, which, again, is an allegation in the SEC's complaint. (*Id.* at 13, 14, 39, 43.)

The Court relied on these claims by the Receiver and then chided Defendants—who still had not received the CBSG business records they requested and needed—for having promoted what the Court called "a misrepresentation of what was happening," a "fiction," and a "myth" of profitability. (*Id.* at 38–39.) Having fully adopted the Receiver's presentation, the Court accused Defendants of falsely claiming that "this place was printing money," and added, "the optics were of 1.5 or 1.2 million" but, in reality, because of the reloads, "this company was bringing in a lot less, 10 cents on the dollar almost. . ." (*Id.* at 38–39). The Court went further, accusing Defendants of pursuing "a figment of investor imagination, [in which] everyone here thinks that this all came to a halt when the SEC, the receiver, and the Court got involved" (*Id.* at 41), and contended that "[t]he underlying financials were not [] as advertised" (*Id.* at 14), and CBSG "was [not] going to last much longer," as "steady payments would have come crashing to a halt" even without the pandemic. (*Id.* at 41.) More concerning still, the Court accepted the Receiver's inaccurate claim that the number of confessions of judgments ("COJs") showed the actual default rate was much higher than the reported 1.2 percent, which is another SEC claim. (*Id.* at 13, 14, 39, 43.).

After summarizing the Receiver's position as though it were inarguable fact, the Court invited the Receiver—and *only* the Receiver—to comment on this "recitation of the situation." (*Id.* at 41.) Defense Counsel tried to speak and was muzzled until the hearing was nearly concluded. (*Id.* at 41, 113.) The Receiver and his counsel were then given additional time to expand upon their claims, including, among other things, that CBSG's "cash over cash default rate" was manipulated because CBSG was relying upon money it raised from investors to advance funds (*Id.* at 43); that the Top 10 Merchants were poorly underwritten debts of CBSG (*Id.* at 49); and that

Defendants' submission on the Big Ten Merchants was "continuing spin." (*Id.* at 49–52; *see* DE 249.)

The Court accepted these claims at face value, including the Receiver's claims regarding CBSG's underwriting and default rate—both allegations raised by the SEC—and even embellished the Receiver's excuses for failing to replicate CBSG's profitability: "This is something that I think is being lost on many investors . . . The Receiver is not going to show up at your storefront with a *baseball bat* asking for money . . . [he is] in place to do it legally." (*Id.* at 108) (emphasis added.)[1]

Recognizing the Court's apparent willingness to accept the Receiver's allegations before all the evidence was available to the Defense for review and rebuttal, Defense Counsel asked the Court to "keep an open mind, at least until all the evidence did come in." (*Id.* at 110–111) (emphasis added.) The Court, admittedly irritated by this request by counsel, dismissed his concern and informed him that he was fortunate the Court "let [him] speak," and then accused counsel of continuing the Defense "spin" by unfairly criticizing the Receiver's collections efforts to distract the Court from its task of getting investor money back:

> The reason why I take offense to that, is it goes back to the spin problem, because I've been trying to get to the truth on this case since day one. And I cannot have investors out there thinking that this entire case is a product of receivership delay."

(*Id.*, at 111–113.)

Bettina Schein, counsel for Joe Cole, then tried to correct the Receiver's inaccurate claim that CBSG did not maintain records of the merchants' outstanding balances. Ms. Schein advised that CBSG maintained a computer-generated website with a merchant portal for every merchant containing balances and other information, and that CBSG had more than 12 accountants and a set of QuickBooks that provided significant information about merchants' accounts, including what part of funds received were principal versus factoring fees. (*Id.* at 114–115.) Counsel reasserted that CBSG was collecting $1.5 million daily in July 2020, even after the pandemic began. (*Id.* at 116.) Counsel described CBSG's successful, profitable MCA relationship with some of the Top 10 Merchants critiqued by the Receiver as "fact" and not "spin." (*Id.* at 117.)

Before any other Defense attorney could speak, the Court rejected this argument out of

[1] The undersigned have seen no evidence in the record referencing the use of a baseball bat to collect merchant payments.

hand. After suggesting that Defense Counsel were engaging in more "narrative" by falsely suggesting that "the SEC and the receiver have gummed up an otherwise very successful company," the Court turned to the Receiver's counsel and invited him to disagree with Defense Counsel: "…what I just heard from Ms. Schein, Mr. Alfano, *I think you would agree is not what the receiver has uncovered in their diligence?*" (*Id.* at 118–119.) (Emphasis added.) Counsel for the Receiver was, of course, more than happy to agree that his own report was accurate. (*Id.* at 118–119) (emphasis added.)

When the Court next allowed Ms. Schein an opportunity to speak, at 5:00 p.m., it limited her to one minute and made clear that it wanted investors to "understand as much as they can about what's going on in the ground level"—but only from the Receiver: "So *I don't need another view, your view, of the financials*." (*Id.* at 122.) (Emphasis added.)

Alan Futerfas, counsel for Ms. McElhone, was permitted to speak briefly. Noting that it was 5:00 p.m., he appealed for a fair chance to rebut the Receiver's claims and reminded the Court that Defendants were powerless, having spent months trying to fend off the Receiver's claims, many of which overlapped with the SEC's claims, while the Receiver denied Defendant's access to CBSG's own business records:

> …My humble, humble suggestion is this. *We can't draw any conclusions*. There is discovery. There is–*and we need discovery. I don't have a piece of paper. They get up there and talk, I don't have a piece of paper*, because I served a discovery request and a regular response…
>
> …But I did want to get out there just this fundamental idea that here we are at the beginning of a litigation *that I don't have documents to, and I just started serving discovery demands on. And there is another side to this and should be another side.* And I think Your Honor appreciates that there are a lot of very sophisticated people who bet a lot of money on this company, who did a lot of due diligence and stand behind it.

(*Id*., at 129–131.) (Emphasis added.)

The Court persisted in asserting its disinterest in hearing any opposing viewpoints and assured the Receiver that he need not even concern himself with the arguments made by Defense Counsel: "there need be no reply to any Defense position or response to the Receiver's interim report from October 6th. It is simply to the Court's edification. . . I do not want the Receiver spending any time and money presenting any supplemental reports or clarifying the reports when faced with any sort of Defense response." (*Id.* at 131.) The Court even threatened to discontinue

the conferences—despite having deemed them useful to investors—if the Receiver's reports, teeming as they were with allegations of wrongdoing that mirrored the SEC's case, continued to be met with Defendants' "rebuttal positions," since this would not "assist anybody in getting to the real issues." (*Id.* at 133.)[2]

3. The December DSI Report and Status Conference

a. The Bradley Sharp DSI Declaration, December 13, 2020 (DE 426-1)

On December 13, 2020, the Receiver filed the Declaration of Bradley Sharp, CEO of DSI, (DE 426-1) ("The DSI Report") Sharp's Declaration characterized CBSG as financially unsound and, without actually using the phrase, averred that CBSG was a Ponzi scheme. (DE 426-1 at 3, ¶¶ 6–11) Notably, the Report also made other representations regarding CBSG and other Defendants that overlapped with the SEC's allegations, mentioning payments CBSG made to Defendants and other entities, all of whom the report inaccurately deemed "Insiders." (*Id.* at 2.) As before, the claims made in the DSI Report and Sharp Declaration were based on documents and evidence that the Receiver had withheld from Defendants, over their objections, for months. After the DSI Report appeared on the Court's electronic docket, Defendants immediately moved to postpone the conference scheduled just two days later on December 15th, reiterating their concerns regarding "fundamental fairness and due process," and requested sufficient time to respond to the DSI Report. (DE 430 at 1.)[3] The Court denied the request. (DE 431.)

b. The December 15, 2020 Status Conference

At the December 15, 2020 status conference, the Court immediately embraced the DSI Report as true, acknowledging that it caused a "sea-change" in the Court's perception and understanding of the "true nature" of CBSG. (Dec. 15 Status Conf., T. at 13–14.) The Receiver "staked [his] reputation" on its contents, saying that he and his accountant and consultants at DSI should be held "accountable" for its accuracy. (*Id.* at 14–15, 23, 31.) The Court acknowledged that Defendants had filed objections addressing the DSI Report's "flawed methodology" (*id.* at 14), but again precluded the Defense Counsel from speaking, stating at the outset that it would hear

[2] The Receiver filed status reports DE 240, 305, 358, 358-1, 426, 482, 482-1, 535, 577, 577-1. Defendants contested the Receiver's claims in multiple filings. *See, e.g.* DE 249, 355, 401, 430, 493, 602; *see also* DE 106, 148.

[3] Defendants pointed out that the DSI Report's financial claims were improbable and inconsistent with the many professional auditors and accountants who had reviewed the same raw data, including CPA James Klenk, who had submitted an affidavit in this case, and with CBSG's tax returns which showed operating revenues of $179 million on which Par had paid millions in taxes – revenues that the DSI Report concluded did not exist. (DE 430 at 2-3.)

only from the Receiver and would not "entertain argument" about either the DSI Report or the pending expansion motion. (*Id.* at 9–10.) "[W]e have to remember that this is a conversation between me and my receiver, an officer of the Court, and his due diligence and what it has generated in terms of reports for me to digest what is going on the ground in this business and in all the related Par Funding." (*Id.* at 14.) Throughout the hearing, the Court allowed "his" Receiver and his two attorneys to speak and argue the points made in the Receiver's status reports, including the DSI Report, completely uninterrupted.

Relying on the DSI Report by "my receiver, an officer of the Court," the Court then openly pronounced CBSG's business a "Ponzi" scheme even though the SEC had not even alleged as much in its filings: "[The DSI Report] . . . *makes it clear* that this was not a self-funding operation, meaning this operation could not, regardless of COVID-19, regardless of the SEC's involvement, that this was truly not a self-engineered or self-funding enterprise, it thrived off new money being put in from investors." [4] (*Id.* at 14, 15) (emphasis added.)

The Receiver, as before, was permitted ample time for a lengthy presentation in which he praised the "accuracy" of the DSI Report's analysis which inaccurately showed, using a cash-based analysis, that CBSG was unprofitable, since "more money has gone out to merchants than has come back" over the long term. (*Id.* at 16, 18–20.)

The Court explicitly sided with the Receiver, calling him "an extension of me," and again accused Defendants, albeit without pointing to any particular error in their facts or reasoning, of painting an inaccurate picture of CBSG's actual financial condition with "constant spin" and "alternate realities":

> THE COURT: . . . I share in the frustration that you have made clear in today's report that *we are dealing with alternative realities*. It's probably been the most frustrating part for the Court from the beginning . . . and now I have a declaration from Mr. Sharp, under oath. I have, at least at this point in the litigation, been able to get my hands around what I think are verifiable numbers and enough of a sample size in the nature of the loans and the profitability or lack thereof year-to-year to

[4] The unduly prejudicial reverberations from the Court's adoption of this claim cannot be overstated. When the SEC first addressed the issue of a Ponzi scheme, it advised the Court that it did not have evidence to support that claim. (*Id.* at 14-15.) Even after hearing the Receiver's report, the SEC advised the Court that it "had its own accountants and experts, and they will analyze the numbers." (*Id.* at 89.) In response, the Court reminded the SEC that "that the SEC got the receiver in here with me" and complained that "now the SEC couldn't run further away from the receiver." (*Id.* at 90-91.) The Court later added, "…I read Sharp's Report, and, I mean, as Mr. Stumphauzer put it eloquently, there are many definitions of a Ponzi scheme. Well this Court knows a couple and taking from Peter to pay Paul is one of them, and that is what it said in Sharp's entire Report. Now you [the SEC] don't want to call it that…" (*Id.* at 95.) In response to the Court's response to and adoption of the Receiver's Ponzi scheme claim, the SEC demurred and remarked, "we never said it was not a Ponzi scheme." (*Id.*)

> *get a true financial picture* as far as I can tell.
>
> *So I am similarly perturbed by what seems to be a constant spin* . . . And I think one of *the challenges we have had is to paint an accurate picture of this business* to all concerned parties, and I don't want any of the Defense lawyers to think that the Court is rushing to any conclusion. I think that I (T. 33) have attempted to allow this process to play out.
>
> By the same token, you have to understand that Defense lawyers are not litigating against my receiver. *My receiver is an extension of me. It's an extension of the Court. I take my obligations as overseer and supervisor of the receiver operation very seriously*. I know that it is, by nature of this business model and some of the difficulties of getting a true picture, it can sometimes be a costly endeavor, and I knew that going in, okay, but *a lot of what is being thrown against the wall here to me is not verifiable, it's not backed by numbers*. I have at least one clear picture emerging of this business and I think at some point the story that I hear that the receiver doesn't know what factoring is or that this is somehow a complicated business that makes it difficult to operate, *I think that argument is starting to fall apart quite a bit because I will confess that it doesn't take an economics major or CPA to look* at *Mr. Sharp's findings and figure out that* at *the very bottom, the model that we had here was not self-funding*, it just wasn't, and the loans were not over-performing. I don't even know if they can even say they were performing, period. *The amount loaned versus the amount recovered is pretty clear, it's pretty clear to the Court that this was not sustainable.*

(*Id.* at 32–33.) (Emphasis added.)

Without allowing the Defense to rebut the Receiver's claims, and despite knowing that the Receiver maintained sole possession of the CBSG business records that had been kept from Defendants for months, the Court nevertheless embraced the Receiver's claims and divulged its goal—to "shut down" any rebuttal of the Receiver's claims: "[W]e need to stop feeding the Court narratives that are not backed either by the credibility of lawyers and under oath, or verified statements or financials . . . let's actually contest it on merit, not on narrative, not on spin, because all that does is harm us in getting to the ultimate result in this case." (*Id.* at 34.) It added:

> *[H]ow can I shut this down* because I'm not going to sit here and allow a continued misinformation campaign from other parties confuse investors *when I have an officer of the Court appointed by me going through the numbers and now giving me an affidavit from DSI*, and they're telling me this is a gross, quote, gross mischaracterization of the financials.

(*Id.* at 34–36.) (Emphasis added.)

Finally, after giving the Receiver a months-long head-start within which to unilaterally

review and opine on CBSG's company financials and make inaccurate claims about Defendants, and then at times ignoring, muting, and denigrating Defendants for rebutting these claims, the Court challenged Defendants to provide a sworn CPA report,[5] with verified numbers, using the same financial data as used in the DSI Report to "see if any of the theories that have been repeatedly floated out by Defense Counsel every time I get a Receiver status report, are rooted in actual math." (*Id.* at 37.) The Court pledged to address any errors identified in the DSI Report by a Defense expert:

> *[L]et's get the same data in the same room with the Defense expert so that if there's a true problem with the methodology we can figure this out*. If there's something that Mr. Sharp is missing, if there's something that he wasn't aware of that is a collection prong for the benefit of investors, *let it be flagged by a Defense expert* or maybe some minutiae in the data that may have been missed because we all know it is a lot of numbers, a lot of data over several years, mistakes happen.

(*Id.* at 72.) (Emphasis added.)

4. The Glick Report and May 2020 Status Conference

a. <u>The Glick Report, April 15, 2021 (DE 535)</u>

Defendants met the Court's challenge to refute the Sharp Report with a sworn report by a credible, nationally recognized CPA. (*See* DE 535-1, Glick Report, DE 535;[6] DE 535-2, CV of Joel Glick). Using the same accounting records DSI reviewed, which finally had been made available to the Defense, Mr. Glick concluded that the Sharp Report applied a methodology that was fundamentally flawed and misleading, contrary to GAAP principles, and reached specific conclusions that were simply false. (DE 535) In other words, after the Court had repeatedly characterized Defendants' objections to the Receiver's characterizations of CBSG's financial condition as, among other things, "misleading" and "spin," Mr. Glick's analysis revealed that it was the Receiver's declarant who had misled and spun and engaged in a biased and flawed assessment of the company.

Finally challenged on the facts, the Receiver defensively acknowledged, for the first time, that the DSI Report was never "intended to serve as an expert report with respect to the underlying

[5] The Court's bias was further evident in the different bar he set for Defendants and Receiver: although Mr. Sharp was not a CPA, the Court challenged the Defendants to provide a rebuttal report with verified numbers prepared by a CPA.
[6] DE 535 is entitled: "Defendants' Joint Response to the Receiver's Quarterly Status Reports Dated December 13, 2020 and February 1, 2021."

action by the SEC" but, rather, was merely intended to provide "preliminary findings." (DE 577 at 14) (Receiver's Quarterly Report, May 3, 2021.)

b. The May 20, 2021 Conference

Notwithstanding its pledge to reassess the DSI Report for "problems with [its] methodology," or other mistakes brought to light by the Defense Report (Dec. 15 Status Conf., T. at 72), the Court engaged in no such reassessment or reevaluation and simply shrugged off the entire incident as "old ground." (May 20, 2021 Status Conference, T. at 36.) ("May 20 Status Conf.") Instead, the Court doubled down on its unilateral approach and reminded the Defense that these conferences were not intended for them to speak at all.

> I am [ ] not only [in] receipt of the [Sharp] report, but I also received and reviewed what I guess could be called the competing audit, for lack of a better word. I did review that independently. We're not really here today to argue anything on the merits of the case. I just want to just see how things are going in terms of the receiver, its collection efforts . . .

(*Id.* at 10.) Even after a credible sworn report analyzing the same financial data had been produced that refuted the Receiver's account and pointed out errors in its and DSI's accounting methodology, the Court dismissed the Glick Report as irrelevant to the Receiver's duties and declared that it would not alter the Court's view of CBSG's financial condition. Rather, the Court would consider the relevance of the Glick Report only much later, and only as to the SEC's allegations, and only if the report met the evidentiary standards of an expert report:

> We're not going to argue the merits, I just want to be very clear. The Court did look at what is really an expert issue. And that is the independent audit that's being conducted on the Defense side that I noted and I carefully studied and then I saw the somewhat brief response because the receiver, I think, appropriately did not want to get into a tit-for-tat on that issue because that's not really what the receiver reports are for, that's more of an expert issue down the line, and we'll get to that eventually. . .
>
> I think that there's some concerns there that are better left for a substantive hearing down the line, whether that's done in a *Daubert* context later perhaps or if it's just something that we do it *in limine*, but for now, that report is really not the issue of today's status. I just want to know how we're doing on trying to get our investors' money. I mean, I hate to be so blunt, but that's what matters to me and you guys on the investors that are listening, you have seen me expand the receivership. . .

(*Id.* at 14.)

The Court then allowed the Receiver to make an approximately three-hour long PowerPoint presentation, complete with exhibits, *not a slide of which the Defense had ever seen*, that went directly to the merits of the SEC case, including allegations about the Defendants' underwriting and use of investor proceeds. (*Id.* at 16–28, 44–96.)

The Defense objected to the Receiver's presentation and reminded the Court of its ruling on December 15, 2020 requiring the Receiver to file any papers it would rely on 14 days before any subsequent conference. (*Id.* at 28, 33, 81; Dec. 15 Status Conf., T. at 69–70.) Recognizing the importance of giving Defense Counsel notice to avoid another "gotcha" conference for which it was unable to prepare, the Court had issued a clear ruling in December:

> Now, to your earlier point about timing, I will pledge this to all of the Defense lawyers who are concerned about this that in the next setting that I have for a status conference, *my paperless order will have a deadline by which to submit any documents to be considered* at *the status conference, and I will do that with enough time so that if the receiver is submitting something for my review, that what we make sure happens is everyone sees that with enough time to file a response that I can digest before the status*. So going from here on out, I can tell you that I agree with you a hundred percent. *So that we don't have any sense of a gotcha or an inability to prepare, what we're going to do is we're just going to have a drop-dead deadline for anything you want to us discuss well before the actual status conference.* And I think if we do that, this won't happen again…

(*Id.* at 71.) (Emphasis added.)

Despite its December 15 ruling that "any documents to be considered at the status conference" would have to be filed 14 days beforehand to prevent another "gotcha" moment, the Court stated it was actually *not* interested in hearing Defense Counsel's view of the Receiver's presentation at the May hearing. (May 20 Status Conf., T. at 30.) The Court explained that due process was not at issue, even though the Court was listening to unrebutted claims suggesting that Defendants failed to use appropriate underwriting and misused investor proceeds, because the Court was making no rulings, the matter was not set for a "bench trial," and the case was not presently before a jury. (*Id.* at 37–38). Finally, it added that even if Defense Counsel had been given notice of the Receiver's presentation and responded, it would not have changed anything:

> If you wanted to put a rebuttal position out there, but there's not a situation where *had this PowerPoint, for example, had been advanced to you ten days ago that it would have changed anything today, because the only thing I'm going to hear today is I want to hear what they've found as an arm of the Court*, and if you want to file something after today that takes issue with these things or points out, as you believe, that the investors aren't getting a fulsome picture, you can point out what the issues

> are, I have no problem with that. I won't ask anybody to have to answer it, but if the SEC respond they may. I would not have the receiver spend time on that because I just don't want -- I want them to be focused on what they need to be doing, not in that litigation front.

(*Id.*) The Court, in fact, made clear that oppositions to the Receiver's filings—including Defendants' appeal of the expansion of the Receivership order—were nothing more than a "drain[]" on the Receiver's resources (*id.* at 31), and said, "I just don't know why in this status hearing I would be entertaining your version of events." (*Id.* at 38).

III. MEMORANDUM OF LAW

1. STANDARD OF REVIEW

A. The Code of Conduct for United States Judges

This Circuit maintains the position that "[t]he guarantee[s] to the defendant of a totally fair and impartial tribunal, and the protection of the integrity and dignity of the judicial process from any hint or appearance of bias is the palladium of our judicial system." *See United States v. State of Alabama*, 828 F.2d 1532, 1539 (11th Cir. 1987), *superseded by statute on other grounds by United States v. Florida*, 938 F.3d 1221, 1232 (11th Cir. 2019). Thus, to avoid any blemish on our judiciary, courts adhere to The Code of Conduct for United States Judges, Vol. 2A, Ch. 2, Canon 2 ("Judge Should Avoid Impropriety and the Appearance of Impropriety in all Activities"), which provides:

> **Respect for Law.** A judge should respect and comply with the law and should act at all times in a manner that promotes public confidence in the integrity and impartiality of the judiciary.

Given the significance of the appearance of impartiality to a fair tribunal, Congress passed a statute to adopt these principles. *See* 28 U.S.C. § 455(a).

B. Duty to Recuse Under 28 U.S.C. § 455(a)

The language in Section 455(a) is clear and unequivocal: "any justice, judge, or magistrate judge of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned." *Id.* In this Circuit, the "test for determining whether a judge's impartiality might reasonably be questioned is an objective one and requires asking whether an objective, disinterested, lay observer fully informed of the facts underlying the grounds on which recusal was sought would entertain a significant doubt as to the judge's impartiality." *See United States. v. South Florida Water Mgmt. Dist.*, 290 F. Supp. 2d 1356, 1359 (S.D. Fla. 2003) (citing

Parker v. Connors Steel Co., 855 F.2d 1510, 1524 (11th Cir. 1988)) (collecting cases).

Indeed, the concern over impartiality and need to promote confidence in the judiciary is so great that "what matters is not [just] the reality of bias or prejudice but its *appearance*." *Liteky v. United States*, 510 U.S. 540, 548 (1994) (emphasis added). Thus, recusal may be required even where "no actual partiality, bias, or prejudice for or against a party exists." *See South Florida Water Mgmt. Dist.*, 290 F. Supp. 2d at 1359; *see, e.g.*, *United States v. Kelly*, 888 F.2d 732 (11th Cir. 1989) (finding defendant was not required to show actual bias, because it was enough that "the average layperson would have doubts about any judge's impartiality" when considering comments made by judge).

The reason for this is "to promote confidence in the judiciary by avoiding *even* the appearance of impropriety whenever possible." *See Parker*, 855 F.2d at 1523 (quoting *Liljeberg v. Health Services Acquisition Corp.*, 486 U.S. 847, 860 (1988)) (emphasis added).[7] As such, "section 455 does away with the old 'duty to sit' doctrine and requires judges to resolve any doubts they may have *in favor* of disqualification." *See Kelly*, 888 F.2d at 745 (emphasis added); *see also In re Boston's Children's First*, 244 F.3d 164, 167 (1st Cir. 2001) ("if the question of whether § 455(a) requires disqualification is a close one, the *balance tips in favor of recusal*") (citations omitted) (emphasis added). Thus, once the standard is met, "the judge should disqualify himself despite his subjective belief in his impartiality."[8] *German v. Fed. Home Loan Mortg. Corp.*, 943 F. Supp. 370, 373 (S.D.N.Y. 1996).

Moreover, the amount of time a Court has presided over a particular case is not dispositive. *See South Florida Water Mgmt. Dist.*, 290 F. Supp. 2d at 1361 (rejecting the opposition's argument that the Court should deny the motion for recusal because the Court had years of experience overseeing the case and holding that "the Court cannot find . . . precedent in which knowledge and understanding regarding a case is a factor in considering a § 455(a) motion.").

2. <u>ARGUMENT</u>

[7] *See also Dobson v. Camden*, 502 F. Supp. 679, 680 (S.D. Tex. 1980) (explaining that "this standard is broad enough to require recusal not only where partiality is in fact present, but also where only the appearance of partiality is present) (citations omitted).

[8] *See Liljeberg*, 486 U.S. at 858 (1988) (explaining how Congress amended Section 455 to replace the previous subjective standard with an objective test); *In re U.S.*, 441 F.3d 44, 65 ("The judge does not have to be subjectively biased or prejudiced, so long as he *appears* to be so") (citation omitted) (emphasis added); *United States v. Fifty-One Items of Real Prop.*, No. CIV-92-1155, 1998 WL 36030318, at *2 (D.N.M. Sept. 14, 1998) ([I]n applying § 455(a), the judge's actual state of mind, purity of heart, incorruptibility, or lack of partiality are not the issue.") (Citation omitted.)

Recusal is Required Under Section 455(a) Because the Court's Impartiality Can Reasonably be Questioned.

THE COURT: "I don't need another view, *your view*, of the financials."

(Oct. 7 Status Conf., T. at 122.) ("Emphasis supplied.)

The Court has repeatedly made clear during status conferences in which the Receiver has cavalierly accused Defendants of wrongdoing—including wrongdoing alleged by the SEC—that it has no interest in considering the Defendants' views in opposition to the Receiver. Time and again, the Court reminded Defense Counsel that its arguments constituted nothing more than "spin"—an "alternate reality" from what the Court evidently accepted as reality—the Receiver's version of the events. (Dec. 15 Status Conf., T. 32-–33.) The Court's rationale was consistent and clear: because the Receiver is an officer of the Court, his claims, even those that mirror the SEC's allegations, are unassailable and the Defense's countervailing view must be false:

> *[H]ow can I shut this down* because I'm not going to sit here and allow a continued misinformation campaign from other parties confuse investors *when I have an officer of the Court appointed by me going through the numbers and now giving me an affidavit from DSI*, and they're telling me this is a gross, quote, gross mischaracterization of the financials.

(*Id.* at 34-–36.)

However, while the Receiver may be an officer of the Court, (*Id.* at 14), the Court cannot tether itself so closely to the Receiver that it fails to consider the possibility that the Receiver's claims—particularly those that impugn the Defendants and their company—could be mistaken. The Defendants' fundamental right to a neutral and detached judge supplants the Court's sole reliance on the Receiver, or the appearance of it, particularly on matters at issue in the litigation. "A fair trial in a fair tribunal is a basic requirement of due process." *Caperton v. A.T. Massey Coal Co., Inc.*, 556 U.S. 868, 872 (2009) (citing *In re Murchison*, 349 U.S. 133, 75 S.Ct. 623, 99 L.Ed. 942 (1955)).

> "This most basic tenet of our judicial system helps to ensure both litigants' and the public's confidence that each case has been fairly adjudicated by a neutral and detached arbiter. An appearance of impropriety, regardless of whether such impropriety is actually present or proven, erodes that confidence and weakens our system of justice."

See Hurles v. Ryan, 650 F.3d 1301, *opinion withdrawn and superseded*, 706 F.3d 1021 (9th Cir. 2013), *opinion withdrawn and superseded on other grounds*, 752 F.3d 768 (9th Cir. 2014).

This principle applies with equal force when a receiver or other court-appointed individual is the subject of the apparent bias. *See, e.g.*, *Wachovia Bank v. Tien*, No. 04-20834, 2011 WL 2111787, *1 (S.D. Fla. May 26, 2011) (granting recusal of Judge where the Judge and Receiver were partners at the same law firm and explaining that "although a receiver or special master is not technically a *party*, the Federal Rules of Civil Procedure incorporates the recusal standard from 28 U.S.C. § 455 for special masters) (emphasis in the original). Thus, when the Court appears to favor one side over the other—whether the favored party is a receiver or a party—significant doubts arise as to its impartiality, and the Court must recuse itself. *See In re U.S.*, 441 F.3d 44, 68 (1st Cir. 2006) (granting a motion for recusal where the judge's conduct appeared to have been against the government and in favor of the defendants).

Here, a lay observer would entertain significant doubts as to this Court's impartiality given its stated preference for the Receiver's view of the facts over that of the Defendants. Indeed, as explained below, lay observers—investors observing these conferences—openly expressed such doubts. Examples of the Court's unreserved acceptance of the Receiver's untested representations alleging Defendant malfeasance (over their objections), many of which are at issue in the Complaint, abound. The SEC has alleged that Defendants engaged in a scheme to defraud based on representations regarding, among other things, CBSG's underwriting practices, the financial condition and success of the company, and Defendants' purported use of investor proceeds. (DE 119, Amended Complaint.) Nevertheless, the Court adopted the Receiver's view of CBSG's "poor" underwriting (Oct. 7, 2020, Status Conf., T. at 42-–43; May 20 Status Conf., T. at 16-–28, 44-–96); default rate (Oct. 7 Status Conf., T. at 13-–14, 39, 43); and use of investor proceeds (*Id.* at 39-–41), among other allegations raised in the Amended Complaint. Not surprisingly, after hours of these unrebutted presentations, the Court began to express open support not just for the Receiver, but the SEC's case: "… this was never the kind of business that was generating *what investors were led to believe, which is partly why registration concerns were red flags for the SEC*." (Oct. 7 Status Conf., T. at 40–41) (emphasis supplied).

More troubling still, the Court unreservedly embraced multiple presentations by the Receiver and a third-party vendor, DSI, accusing Defendants of operating a Ponzi scheme, something even the SEC has not alleged. This occurred repeatedly under circumstances where

Defendants were not given a meaningful opportunity to respond. At times, Defendants were even instructed not to respond at all because, from the Court's perspective, the Receiver's presentation was unassailable even if it disagreed with the SEC's view of the evidence:

> I was told by the SEC that *it was not a Ponzi scheme at the time*, that they were uncertain . . . [and] the DSI Report goes to great lengths not to use that term. But looking at the way the snapshot that DSI has prepared. . .under protest by Defense Counsels who feel that it is a flawed methodology, but we have to remember that *this is a conversation between me and my receiver, an officer of the Court, and his due diligence and what it has generated in terms of reports for me to digest what is going on the ground in this business* and in all the related Par Funding businesses. It seems to me, based upon the report that some of the payouts or the funds that investors were receiving were essentially generated or the product of new money coming into these investments *that we maybe have had a sea-change in the true nature of this business* and that it is less about factoring and due diligence on loans, and more about taking from new investors to pay old investors. . .
>
> [The DSI Report] . . . makes it clear that *this was not a self-funding operation*, meaning this operation could not, regardless of COVID-19, regardless of the SEC's involvement, that *this was truly not a self- engineered or self-funding enterprise, it thrived off new money being put in from investors*.

(Dec. 15 Status Conf., T. at 14-–15.) (Emphasis added.)

The Court's use of the status conferences (via Zoom) to hear from the Receiver, and only the Receiver, became so pervasive that even some investors openly questioned the Court's partiality in the accompanying Zoom chat room:

> THE COURT: . . . I want to be very clear. Investors that are commenting right now that this Court is compromised, or that this Court has a problem with being fair and impartial, you know, I am disappointed that investing public would feel that way…

(May 20 Status Conf., T. at 101.)

And, when the Defense *was* given an opportunity to speak, the Court made clear that it had no intention of considering their view of the facts, and on this point, did not mince words:

> [Your objection] presupposes that the Court is interested in entertaining argument from both sides, which I'm not.

(Dec. 15 Status Conf., T. at 30.)

To be clear, the issue is not whether the Receiver is right or accurate in his representations, but the appearance of partiality created when the Court embraces "its" Receiver's claims before Defendants are given a meaningful opportunity to respond—particularly when those claims overlap with the SEC's allegations. During the May 20 status conference, Defense Counsel

objected that the Receiver's presentation went far afield of merely informing the Court on collections and devolved into more allegations of wrongdoing that overlapped with the SEC's allegations, which violated the Court's December 15 *ore tenus* ruling that "any documents to be considered at the status conference" be filed 14 days before the conference. (May 20 Status Conf., T. at 28; December 15, 2020 Status Conf., T. at 69-70). Despite its acknowledgment on December 15 that notice was necessary to allow the Defense to prepare, to avoid another "gotcha" moment, the Court allowed the Receiver to continue with his presentation in clear violation of its own Order. (*Id.* at 71.)

And while the Court has indicated that it has not made findings and that the Receiver's Reports have not "cloud[ed] the Court's view" (May 20, 2021, Tr. Status Conf., T. at 38), it is required to maintain impartiality during every hearing and every conference, every step of the way, regardless of whether it is issuing a ruling. *See SEC v. Collector's Coffee, Inc.*, No. 19-CV-4355, 2020 WL 8614089, at *3 (S.D.N.Y. Dec. 9, 2020) (granting a motion for recusal to "avoid any appearance of impropriety" where, even though no conflict had yet occurred, there was the possibility that the Court *would have been required to rule* on whether an asset freeze order prohibited the defendant from pursuing a malpractice action against the Court's former law firm) (emphasis supplied). Moreover, despite this Court's assurances that its view of the case has not been "clouded," the Court has repeatedly expressed support for and admitted it has been influenced by the Receiver's functionally unrebutted presentations:

- "The money that they were getting and the loans… may not have been on the up-and-up as much as had been advertised." (Sept. 8 Status Conf., T. at 46.)

- "[Defendants] have painted a "rosy picture" of this Par Funding operation, that I think the numbers, as they start to trickle out, don't support. And this is a perfect example of that with the [DSI] report today." (*Id.* at 47.)

- "I think it's important that we understand that the underlying financials were not only *not as advertised*, but it looked like *a lot of these defaults were already on the books* in terms of these confessions well before the pandemic grinded some of these businesses to a halt. (Oct. 7 Status Conf., T. at 14.) (Emphasis added.)

- "…the way I see it is McElhone has a piece of one of these entities, who has defaulted and has cut the deal, whether it's Kingdom Logistics or otherwise. Now, what ends up happening is you're making a loan, you're repaying the loan, but *guess what? She's loaning money to an entity she already owns a piece of. She's essentially lending money to herself or to an entity she has an interest in.* And so when you add that level to it, plus the fact that they are loaning as you're taking

> repayment, *it is a fiction. It is an absolute fiction* [Par] was making or generating 1.2 or 1.5 million dollars a day in repayment of merchant cash advance loans. *We have to eliminate this figment of investor imagination*, because everyone here thinks that this all came to a halt when the SEC, the receiver, and the Court got involved. And what I'm hearing is that there's default judgments and consents pre-COVID. And the way in which the math worked on at least the top 10, which is half the portfolio, *this was never the kind of business that was generating what investors were led to believe, which is partly why registration concerns were red flags for the SEC*." (*Id.* at 40–41.) (Emphasis added.)

- But looking at the way the snapshot that DSI has prepared. . .under protest by Defense Counsels…*[i]t seems to me, based upon the report that some of the payouts or the funds that investors were receiving were essentially generated or the product of new money coming into these investments that we maybe have had a sea-change in the true nature of this business and that it is less about factoring and due diligence on loans, and more about taking from new investors to pay old investors*." (Dec. 15 Status Conf., T. at 14–15).) (Emphasis added.)

The record is replete with examples of statements made by the Court accepting the Receiver's view that Defendants engaged in poor underwriting, misrepresented the default rate and financial condition of the company, and even engaged in a Ponzi scheme, all before Defendants were even given access to CBSG's financial and business records. During one such hearing in December, the Court even appeared to scold the SEC for not openly agreeing with the Receiver's now debunked Ponzi scheme claim. (*Id.* at 94-95.)

Given the Court's clear adoption of prejudicial representations made by the Receiver that intersect with the SEC case (and other alleged wrongdoing), and the displeasure the Court seems to direct toward anyone who objects to the Receiver's claims, a lay person would reasonably entertain significant doubts regarding future rulings touching on these issues. *Sentis Group, Inc. v. Shell Oil Co,* 559 F.3d 888, 904 (8th Cir. 2009) (citing *Liteky v. United States*, 510 U.S. 540, 555 (1994)) ("reassignment[9] may be necessary based solely on events transpiring in current court proceedings or on a court's statements or rulings where 'they reveal such a high degree of favoritism or antagonism as to make fair judgement impossible'") (emphasis supplied).

Shell Oil is instructive. There, the court found numerous instances of an appearance of partiality warranting recusal where the district court failed to provide the plaintiffs with a "meaningful opportunity to respond" to the defendants' lengthy presentation at a hearing;

[9] The court applied Section 455(a) standard to determine whether the court should order reassignment pursuant to 28 U.S.C. Section 2106. *Id.* at 904.

permitted the defendants to put on an hour-long PowerPoint presentation and then silenced the plaintiffs; and accepted as true only the defendant's mischaracterization of the issues surrounding the discovery orders. Because of the unmistakable appearance of partiality, the court held that "the reasonable man, were he to know all the circumstances, would harbor doubts about the judge's impartiality." *Id.* at 897, 904-905.

The similarities are striking. In addition to the numerous examples in the record where the Court failed to provide Defendants a "meaningful opportunity to respond," the Court has made it abundantly clear that on any issue raised by the Receiver, Defendants need not even weigh in:

> By the same token, you have to understand that Defense lawyers are not litigating against my receiver. *My receiver is an extension of me. It's an extension of the Court. I take my obligations as overseer and supervisor of the receiver operation very seriously*. . . . but *a lot of what is being thrown against the wall here to me is not verifiable, it's not backed by numbers*.

(Dec. 15 Status Conf., T. at 32–33) (Emphasis added.)

But even when the Defense did present the Court with verified numbers in the form of a sworn declaration of a nationally recognized CPA—the Glick Report—the Court dismissed it and advised Defendants that he preferred to simply "move on." (May 20 Status Conf., T. at 35-–36). The Glick Report—which the Court challenged Defendants to present—flatly contradicted the Receiver's claim that CBSG was financially unsound and unsustainable and explained that the DSI Report relied on improper methodology to assess profitability—a fact with which the Receiver did not even disagree. (DE 577 at 15.) And while the Court explained after the Glick report was filed that it preferred to move on and remain focused on recovering investors' dollars, it is undeniable that when the Receiver presented the Court with *its* DSI Report, the Court was more than willing to opine that CBSG operated as a Ponzi scheme based only on its review of their report. As far as Defendants know, the Court harbors that same opinion today.[10]

Again, the issue is not whether the Receiver was right or accurate in his representations, but the appearance of partiality created when the Court embraced his claims before Defendants were given a meaningful opportunity to respond—particularly when those claims overlapped with

[10] As this Court has itself recognized, "the Receiver acts under supervision of the court . . . for the court must independently approve the Receiver's legal and factual findings." *SEC v. Elliott*, 953 F.2d 1560, 1577 (11th Cir. 1992). Given this Court's penchant for adopting the Receiver's representations and disclosures as true and refusing to even consider opposing views challenging the Receiver's findings, even if such opposition is verified by an expert, a lay observer might also entertain significant doubts regarding whether this Court is capable of discharging that duty.

the SEC's allegations. And Defendants have been prevented from meaningfully responding in several significant ways. First, the Court has consistently given the Receiver unlimited time to present its claims and arguments while largely limiting the Defense to the final few minutes of these conferences and muzzling them when they attempt to interject an objection. Second, the Court has permitted the Receiver to withhold access to documents the Defendants needed to defend themselves from the very accusations being lodged against them by the Receiver. Third, even when the Defense has been permitted to speak, the Court has repeatedly made clear, both through its characterizations of the Defense's responses as "spin" and its express desire to "shut them down," that it does not appear interested in considering their views on matters raised by the Receiver, even when those matters intersect with the SEC's case. Fourth, during the May 20 hearing, the Court advised Defendants it is not even interested in affording them notice of the claims the Receiver plans to make at these status conferences, despite a prior ruling acknowledging that such notice was necessary to allow the Defense to prepare. (May 20 Status Conf., T. at 28; Dec. 15 Status Conf., T. at 69 –70). The Court then allowed the Receiver to continue with his presentation in clear violation of the Court's Order. (*Id.* at 71.)

Having failed to provide Defendants a meaningful opportunity to respond to the Receiver's claims of fraud and other wrongdoing, including allegations inextricably intertwined with the SEC's allegations, and embracing those claims as true, there can be no doubt that a lay observer would have reason to question the Court's impartiality. Indeed, this case presents the rare occasion where the objective and subjective meet: not only *would* a lay observer reasonably question the Court's impartiality, numerous lay observers—investors—actually *did* question the Court's impartiality. (May 20 Status Conf., T. at 101.) As in *Shell Oil Company*, recusal is necessary here to preserve the appearance and reality of impartial justice. *See Liljeberg*, 486 U.S. at 864 ("to perform its high function in the best way 'justice must satisfy the appearance of justice'") (citation omitted). If Section 455(a) requires disqualification in even a close case, it is necessary here. *In re Boston's Children's First*, 244 F.3d at 167 (1st Cir. 2001) ("if the question of whether § 455(a) requires disqualification is a close one, the balance tips in favor of recusal").

IV. Conclusion

This motion affords the Court the opportunity to foreclose the possibility of actual bias by recusing itself to avoid even the *appearance* of bias. For the foregoing reasons, the Court should enter an order of recusal.

CERTIFICATE OF CONFERRAL

Pursuant to Local Rule 7.1(a)(3), the undersigned has conferred with all parties and non-parties who may be affected by the relief sought in this Motion. Counsel for the Commission and Receiver object to the Motion.

REQUEST FOR HEARING

Defendants respectfully request, pursuant to Local Rule 7.1(b)(1), that a hearing be scheduled as to the issues raised in this Motion. A hearing would allow the parties to more fully clarify and explain their arguments. Defendants estimate that the time required for the hearing would not exceed 60 minutes.

Date: June 23, 2021

Respectfully submitted,

/s/ Joel Hirschhorn
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CERTIFICATE OF SERVICE

I hereby certify that on June 23, 2021, a true and correct copy of the foregoing was served via CM/ECF on all counsel or parties of record.

By: /s/ Joel Hirschhorn
Joel Hirschhorn