UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
WEST PALM BEACH DIVISION
CASE NO.: 20-cv-81205-RAR

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

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

Defendants.

DEFENDANTS' REPLY MEMORANDUM OF LAW TO THE SEC'S RESPONSE IN SUPPORT OF THEIR MOTION TO DISCHARGE THE RECEIVER

INTRODUCTION

Defendants respectfully submit this memorandum of law in Reply to the SEC's response to the Defendants' motion to Discharge the Receiver.

On July 13, 2021, the Defense moved to discharge the Receiver in light of overwhelming evidence of the positive financial condition of CBSG, contrary to prior reports issued by the Receiver, including the DSI Report. This motion drew upon, among other evidence, the two Glick reports and the CLA Audit Materials. (*See* DE 649) This evidence, now joined by the deposition testimony of CPA James Klenk, who still works for CBSG under the Receiver, demonstrates that the Receiver repeatedly misstated CBSG's financial position and wherewithal.

In opposing Defendants' motion for the discharge of the Receiver, the SEC never addresses the real issue. While Defendants were deprived of the evidence needed in July 2020 to oppose the granting of the receivership, they have that proof now. That proof is reliable, extensive and

overwhelming. The SEC's desire to avoid this issue is hardly surprising, because to address the truth now is to acknowledge the SEC's responsibility for seeking the Receivership in the first place and allowing it to continue, one year and counting, while the Receiver has cost hundreds of millions of dollars of revenue from Defendants' businesses and effectively ended them.

WHETHER THE RECEIVERSHIP SHOULD REMAIN IS RIPE AND NOT AN ISSUE FOR TRIAL

The issue before the Court is whether the Receivership should continue. That is not an issue for trial but an issue ripe for decision now. (*See* DE 662 at 3-4) The Court exercised its discretion to grant the Receivership expressly in order to preserve the status quo and protect the assets of CBSG for the benefit of the noteholders. This Court certainly did not grant the Receivership, and allow it to continue to this date, in a vacuum. Rather, at a time when the Defense had no records of CBSG to respond to inaccurate financial claims by the SEC and the Receiver, this Court was requested to, and did, make findings of fact about CBSG's financial condition, the soundness of its business model, and the propriety of appointing a Receiver to handle CBSG's merchant cash advance business and the preservation of its merchant portfolio.

Moreover, the Court has relied on the Receiver's representations about the financial wherewithal of CBSG to authorize the huge expansion of the Recievership on December 16, 2020, and order further expansions, including the seizure and sale of Defendant's personal property such as cars, watches and other personalty. Further, and importantly, the repetitive inaccurate claims about CBSG's financial condition acted to poison this Court against the company and the Defendants as exemplified by the contents of the December 15, 2020 status conference.

The SEC's position is that, while the Court can rely on factual assertions by the Receiver about CBSG's financial condition to enter Orders and make rulings against the Defendants, evidence that those assertions were inaccurate and/or misleading is not relevant to the Receiver's

duties or responsibilities, or to whether it misled the Court or the public, or to whether the rulings which relied upon those inaccurate facts should remain in force. This is a wholly unsupported proposition, and just stating it shows its invalidity.

The proof shows that the Receiver has failed to accurately and impartialy discharge his duties, or worse, misled the Court and public about the financial condition of CBSG, thus rendering a motion for his discharge ripe and actionable. This Court certainly has the authority to act, and to act now, to find that the current record fails to support continuing the Receivership any longer. It may well be the case that the proof now available to the Court to support discharging the Receiver is also relevant to issues at trial. (*See* DE 662 at 3-4) Indeed, the Defense evidence about the financial condition of CBSG will likely be valuable evidence to defend against the SEC's allegations in this case. But that certainly does not mean that this proof is limited to that use when it is clearly relevant right now to complete the record on which the Receivership currently exists.

The record has been, until recently, one-sided, for reasons repeatedly expressed. This Court made a decision to grant the Receivership based upon an entirely one-sided record of proof. That record was expanded further by the factual assertions of the Receiver concerning the financial condition of CBSG, culminating in the DSI Report. The factual record is overloaded with statements at status conferences expressing that the facts as asserted by the Receiver were compelling; that they justified the Receivership; and that the Receiver's inability to accumulate any additional money for the benefit of CBSG's noteholders was due to the financial instability of CBSG or worse, that CBSG was akin to a Ponzi scheme. And this Court has permitted the Receivership to continue to this day on the basis of that record.

The Court now has abundant proof that those factual assertions were inaccurate and misleading. The Court now has evidence that the Receiver ignored an ongoing top-notch audit that

was almost paid for and almost completed in July 2020 (the CLA audit) and, instead, paid huge amounts of money to utilize a non-CPA to generate a fatally flawed report (the DSI Report), in order, it appears, to confirm the inaccurate information the Receiver was telling this Court and the public. And the Receiver paraded that report around as if it were gospel and used it to seek, and obtain, the Receivership expansion of December 16, 2020, as well as numerous subsequent orders. Now the Court has the Reports of Joel Glick, including the powerful April 15, 2021 Report on the financial condition of the company, which have been previously addressed.

If that were not enough, the Defense recently took the deposition of James Klenk, the Financial Controller of CBSG since February 2018 and a CPA. He is still there today working under the auspises of the Receiver. To extent the Court needs even further proof of the financial condition of CBSG up until the Receivership in July 2020, Mr. Klenk puts the issue to bed. To start, he was hired to make CBSG GAAP compliant – and he did so. (Klenk Depo. at 9-10) CBSG is clearly not a Ponzi scheme. (*Id.* at 86) CBSG employed up to 17 employees doing accounting work including two CPA's – Mr. Klenk and a woman who was being certified as a CPA. (*Id*. at 13-14) CBSG was audited by two major accounting firms and its books and records were pored over numerous CPAs. Indeed, one email examining accounting minutia had seven (7) CPA's on the email who involved in the examination of CBSG's books and records. (*Id.* at 32-55) Then, there were sophisticated investors' accountants who not only examined the books and records of CBSG but received detailed financial statements from the company, including financial statements prepared in whole or in part by Mr. Klenk. (*Id.* at 57-65, 119-129, 173-175) And those financial statements are consistent with tax returns prepared by Rod Ermel and Associates, the company's outside CPA's, showing $75M in revenue in 2017; $123M in revenue and taxable income of $22M in 2018; and $179M in revenue and taxable income of $48M in 2019. (*See Id*. at 92-93, 120, 128,

134, 139, 154-57 and related Deposition Exhibits) And, by the way, Mr. Klenk verified that the Ermel firm indeed had a direct portal to the financial records of CBSG and used the company Quickbooks and data to prepare the tax returns. (*Id.* at 37, 93) Lastly, Mr. Klenk verified that CBSG had already paid CLA $200,000 for the 2018 audit and, by July 2020, the audit was almost complete and CLA was owed a balance of just $25,000. (T. 172)

In short, the evidence of CBSG's financial prowess is overwhelming. But more imnportantly for the instant motion, all of this evidence was available to the Receiver. It was available from Rod Ermel, the company's accountants; from CLA, which was almost finished with a comprehensive 2018 audit and was owed just $25,000 to complete; from Mr. Klenk, the Financial Controller; from the 17-odd accountants at CBSG; and from the tax returns and financial statements prepared by Mr. Klenk and others, including CPA's, and sent to potential investors. And it was available from a careful, qualified CPA examination of the books and records of the company.

It was the Receiver's job and duty and obligation to accurately and impartially advise this Court and the public of the true financial condition of CBSG. Having failed to do so, and worse, having provided inaccurate and misleading information to the Court and public for many months, the only appropriate resolution is discharge of the Receiver.

THIS COURT EXPRESSLY OFFERED TO CONSIDER SWORN PROOF REFUTING THE RECEIVER'S CLAIMS

The SEC's position also flies in the face of what the parties and the Court understood about Defendants' right to challenge the Receivership. At the December 15, 2020 status conference, the Court was so convinced of the claims made in the DSI Report that CBSG was a Ponzi scheme that the Court effectively dared the Defendants to disprove those claims and to prove that DSI's methodology was incorrect.

> "[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. . . .*[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.)

The Court openly expressed the belief that Defendants could not counter the DSI Report's allegations and that it was time to "shut this down . . .the continued misinformation," from the Defense that contradicted the Receiver's Report. But the Court's offer was crystal clear: it pledged to address any errors identified in the DSI Report if Defendants provided a sworn CPA report,[1] with verified numbers, using the same financial data as used in the DSI Report.

> *[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.

[1] We note that the DSI Report was not evidence from a CPA.

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

And the Defense did so. The CPA's findings at Berkowitz Pollack Brant ("BPB") are contained in the Glick Report (DE 535). The Glick Report showed that there was, indeed, a devastating "problem" with the methodology used by Bradley Sharp. The methodology used is entirely – and fundamentally - wrong. (*See id.*) The DSI Report is not GAAP compliant. The Glick Report concludes that the DSI Report improperly used a cash basis analysis to claim, erroneously, that CBSG was not profitable. "A forensic analysis of CBSG data using an accrual basis method of accounting reveals that CBSG was profitable, earning hundreds of millions of dollars in top-line revenue that was ignored by DSI." (DE 535 at ¶ 16, *citing id.* at ¶¶ 52-54.) The DSI Report leads to ridiculous conclusions- i.e., that a company reporting operating revenues of $179 million, on which it paid millions of dollars in taxes, had income of only $6 million dollars on a cash basis. (*See* DE 649 at 14 n. 20 *citing* DE 430 at 2-3) The DSI Report was "incorrect" when it claimed that "CBSG could not have made principal and interest payments to the investors without additional funds from the investors." (DE 535 at ¶ 38)(emphasis added)

As previously described to this Court, the Glick Report methodically refuted the fundamental claims of the DSI Report and the Receiver about the profitability and sustainability of CBSG (DE 649 at 4-5). The Glick Report used correct GAAP accounting methodology to calculate revenue and profitability; not the DSI Report's non-GAAP compliant cash basis, which is worthless. And the Glick Report analyzed the entire CBSG merchant portfolio, not the DSI Report's extrapolation from a nonrepresentative subset (the so-called "Exceptions Portfolio"), that excluded half of the merchant portfolio. Among the conclusions of the Glick Report:

i. CBSG was highly profitable for years, earning hundreds of millions of dollars in top-line revenue between 2012 and 2019. (DE 535-1 ¶¶ 88, see ¶¶ 50-59)

ii. CBSG's factoring, i.e., the profit made on every dollar used in funding of merchant cash advances ("MCA"), was highly profitable for years, resulting in a blended factor rate of 1.399, determined by reviewing all MCA deals that CBSG funded. (*Id.* ¶¶ 28, 82-87)

iii. CBSG's use of "reloads" – providing new funds to existing merchant clients which were used to pay down their debt – meant higher fees, resulting in higher revenue for CBSG. The DSI Report's claim (unsupported by data or an understanding of GAAP accounting), that CBSG's reloads were "excessive" or somehow an indication of a merchants' inability to repay, was baseless. (*Id.* ¶¶ 18, 64-66, 73-86) Moreover, only 14.4% of CBSG's merchants received reloads. (*Id.* ¶ 73 chart)

iv. Investor funds were not used to pay consulting fees to Defendants. (*Id.* ¶¶ 31-37)

v. CBSG's underwriting had a very conservative approval rate of 17 percent for underwriting applications. (*Id.* ¶¶ 39-42)

(DE 649 at 4-5, citing DE 535-1; DE 535 at 3-4)

The Court made a promise to consider credible evidence rebutting the Receiver's claims. And the Court made this promise in the context of the December 15th status conference which was devoted to assessing the quality of the Receiver's reporting on the financial condition of CBSG and its work on behalf of the noteholders to preserve CBSG's assets. The Receiver, as well, recognized that his right to remain depended upon the accuracy of his reporting about CBSG. He

expressly staked his reputation in the accuracy of the DSI Report and insisted that he be "held accountable for what we say" in the DSI Report. (*Id.* at 21, 31)

On this crystal clear record, the SEC is simply wrong when it attempts to characterize the proof of the Receiver's conduct of the Receivership as somehow not relevant to whether he should be discharged. The Defense has satisfied – overwhelmingly - the Court's challenge. The Court promised to consider evidence that refuted the Receiver's numbers and methodology. Having made that commitment, the Court cannot help but find, upon a fair consideration of all the proof now assembled, that the Receiver's claims about CBSG's financial conditions were false, and, moreover, that the Receiver has performed abysmally as a steward over a once highly profitable company that employed over 70 people by liquidating its assets and shutting down its business.

The SEC does not even attempt to confront the record of the Receiver's poor stewardship, including Receiver-caused losses of over $180,000,000 and the evidence of propagating a wildly false narrative about CBSG's financial condition for months on end, upon which this Court made substantial rulings extremely detrimental to the Defendants and to the company. The Defense does not need to prove a vendetta to establish an overwhelming basis to discharge the Receiver. The Court has the discretion to grant a Receivership; and to end one. The Court's rulings based on the Receiver's information were not subject to the rules of evidence. Indeed the false DSI Report is not an expert report, was not subject to *Daubert*, and none of the Receiver's presentations or status reports, which went on for hours, were subject to the rules of evidence.

Finally, the Defense is not claiming that "the Receiver should be removed because the SEC did not assert that CBSG was Ponzi scheme." (SEC Response at 5) The Receiver should be removed because he has pursued a course of liquidation and destroying a thriving business while misrepresenting to the Court and public, again and again, that CBSG's business was actually a

mirage, its profits were a mirage, its multimillion dollar merchant portfolio was a mirage, and his pursuit of deep discount settlements and the liquidation of a thriving business were the only and best course possible for CBSG's noteholders. The proof now before the Court shows that this narrative was misleading at best and the Receiver had to know, or should have known, and certainly had the means to know, that the narrative provided to the Court and public was grossly inaccurate.

CONCLUSION

For the foregoing reasons, this Court should Discharge the Receiver.

WHEREFORE, Defendants Lisa McElhone, Joseph W. LaForte, and Joseph Cole Barleta respectfully request that this Court grant their Motion to Discharge the Receiver.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on August 6, 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