UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

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 LAFORTE, MCELHONE, AND COLE'S
REPLY IN SUPPORT OF THEIR MOTION TO STRIKE [D.E. 1224]

Defendants, Joseph LaForte, Lisa McElhone, and Joseph Cole Barleta (the "Defendants"), file this Reply in further support of their Motion to Strike [D.E. 1224] and in opposition to Plaintiff's Response [D.E. 1239], and as support therefore, state as follows:

1) Introduction

The SEC's Response presents a series of contradictory arguments in an effort to justify the fact that it improperly raised unpled liability allegations *for the first time* following the entry of the Consents. First, the SEC admits that its Motion for Final Judgment presents "unpled facts" and arguments pertaining to an alleged Ponzi scheme (D.E. 1239, p. 4, FN 1), but falsely asserts that these unpled allegations have been at issue since August 2020 (*id.* at p. 10). Second, the SEC repeatedly states that the liability phase of the case is over and that we are in the remedies phase, while strenuously arguing that it is free to raise new and unpled liability allegations as the central basis for the remedies it seeks. Finally, the SEC contends that Defendants will not be prejudiced by the unpled allegations because they can take discovery and introduce evidence in their Response to the Motion for Final Judgment, yet they contend that Defendants are not entitled to an evidentiary hearing (or

even a non-evidentiary hearing) on the Motion. None of these self-serving and contradictory assertions should be countenanced by this Court, which sits in equity.

As discussed herein, the SEC's efforts to introduce and rely on unpled Ponzi allegations at the "remedies phase" of the case violates the spirit of the Consents, which was to resolve liability issues by settlement and allow the Court make a determination regarding the disgorgement amount and penalties (if any) *based on the allegations of the Complaint* (which Defendants agreed would be accepted and deemed true solely for purposes of the Motion for Final Judgments). (*See* Consents at ¶ 5.). Tellingly, the SEC's 47-page Motion for Final Judgements dedicates exactly two sentences to the disgorgement calculation (D.E. 1214 p. 30), but it devotes several pages to Plaintiff's unpled Ponzi allegations – which the SEC cites as the justification for denying the Defendants any offset for legitimate business expenses in connection with the disgorgement calculation, and for seeking tier three penalties in excess of $100 Million! The result of raising these unpled liability allegations at this stage of the case is that the Court will be charged with determining the nature of Par Funding's business practices and any alleged wrongdoing by the Defendants – the very issues which were supposed to be resolved by the Consents.

Despite the SEC's arguments to the contrary, the Defendants will be deprived of due process and will be severely prejudiced if the SEC is permitted to shoehorn these critical unpled liability allegations into the "remedies phase" of the case. As discussed in the Motion to Strike, the Defendants never would have agreed to waive their right to a jury trial or to resolve the case on a motion (with only two-months allotted to conduct discovery and file a Response, and with a significantly lower burden of proof for the SEC) had they known the SEC intended to raise these unpled liability allegations as the basis for the disgorgement and penalty amounts it is seeking. (*See* Defendants' Affidavits, 1224-1, 1224-2 and 1224-3). For all of these reasons, and for the reasons discussed more fully herein, the SEC's arguments lack merit, and the Defendants' Motion to Strike should be granted.

2) The Court Has Inherent Power to Grant the Motion to Strike

As an initial matter, the SEC's argument that the Motion to Strike should be denied because Rule 12(f) applies to pleadings rather than motions is unavailing because Defendant's Motion to Strike *does not* rely on Rule 12(f) – which is simply "a codification of part of the district court's inherent power to manage pending litigation." *See Allapattah Servs., Inc. v. Exxon Corp.,* 372 F. Supp. 2d 1344, 1371 and n. 17 (S.D. Fla. 2005) (finding Plaintiff's Emergency Motion to Strike and for Sanctions was properly brought pursuant to Rule 12(f) as well as "this Court's inherent power to control the integrity of the judicial process and the conduct of the parties before it"). This Court can and should grant Defendants' Motion to Strike based on the exercise of its inherent powers. *See Alhassid v. Bank of Am., N.A.*, No. 14-CIV-20484, 2015 WL 11216720, at *2 (S.D. Fla. May 29, 2015) (in which the district court exercised its inherent powers to grant the defendant's motion to strike plaintiff's summary judgment motion, even though defendant had moved to strike pursuant to Rule 12(f)); *see also Fisher v. Whitlock*, 784 F. App'x 711, 714 (11th Cir. 2019) (holding the district court properly exercised its inherent power to manage its docket when it struck plaintiff's motion for reconsideration). Accordingly, Plaintiff's argument that the Court "must deny the Defendants motion as procedurally improper"[1] is wholly unsupported.

3) The SEC's Arguments That Defendants Will Not Be Deprived of Due Process as a Result of the Unpled Ponzi Scheme Allegations All Fail

Throughout the Response, the SEC repeatedly pronounces that the liability phase of the case is over and that we are now in the remedies phase. Inexplicably, the SEC believes this means that they are entitled to color outside the lines of the Amended Complaint and introduce unpled Ponzi scheme allegations which clearly go to liability. The SEC's contention that this is simply a "remedies" issue which the parties agreed to litigate as part of the Consents is false. As discussed in Defendants' Motion

[1] *See* DE 1239, p. 8.

to Strike, the introduction of unpled Ponzi scheme allegations at this stage of the case is extremely prejudicial and deprives the Defendants of due process, and the SEC's allegations to the contrary (discussed below) are without merit.

First, the SEC contends that the Defendants were on notice that it would raise Ponzi scheme allegations because they were told the SEC had concluded Par Funding was a Ponzi scheme on February 11, 2021. But the SEC fails to mention that it advised the Defendants it was going to amend its Complaint to assert the Ponzi allegations but chose not to do so after discussing the merits of those allegations (or the lack thereof) with Defendants' counsel. Specifically, on February 25, 2021, Defendants sent counsel for the SEC a letter urging the SEC to refrain from amending the Complaint until Defendants could provide a forensic accounting analysis and other documents demonstrating that Par Funding *was not* a Ponzi scheme. (*See* Exhibit A). The Defendants subsequently provided these materials, and the SEC abandoned its efforts to amend the Complaint to assert Ponzi allegations. The SEC made the deliberate decision not to amend its Complaint to add Ponzi-type allegations – a clear waiver of its claims on this issue. Furthermore, on at least one occasion, the parties disputed in open Court whether the SEC could refer to Par Funding as a Ponzi, and the Court stated that the SEC *could not* because it hadn't alleged or proven that allegation, and because it didn't go to any of the scienter, regulatory or disclosure issues which had been raised in the case. (*See* DE 1239-2, p. 205-207). The Defendants were entitled to rely on the statements of this Court and the SEC's subsequent decision *not* to amend the Complaint when they entered Consents stipulating to the allegations of the Complaint (but *not* to the unpled Ponzi allegations). They never would have agreed to a bifurcated settlement if they had known the SEC intended to ambush them with the unpled and previously abandoned Ponzi allegations.

Second, the SEC contends that the Defendants were not deprived of due process because they had an adequate opportunity to conduct discovery *prior to* entering the Consents, and they introduced

an expert report and other evidence demonstrating that Par Funding was not a Ponzi in the course of the litigation. But the fact that the Defendants previously submitted expert reports and voluminous evidence proving that Par Funding was a legitimate and profitable business does not mean that they had an adequate opportunity to conduct discovery on *specific allegations which were never pled at all*. The SEC's assertion that the Ponzi question "is not a complex issue"[2] is self-serving and false. In fact, this inquiry is document intensive and requires extraordinarily complicated calculations and experts. As the Defendants have attested, had they known these unpled allegations were going to be raised in the SEC's Motion for Final Judgements, they would not have agreed to enter the Consents and waive their right to a jury trial. (*See* DE 1224-1, 1224-2 and 1224-3).

Finally, the SEC's contention that the Defendants will not be prejudiced because they can conduct discovery relating to the new and unalleged Ponzi scheme allegations at this stage of the case is false. The Defendants have a two-month window to conduct such discovery and synthesize it into a Response brief – which pales in comparison to the time Defendants would have had (and would have devoted) to this issue had it been pled. Moreover, the SEC seeks to compound the prejudice to the Defendants by arguing that they are not entitled to an evidentiary hearing *at all* and are limited to the evidence they can introduce on the papers[3] – as opposed to requiring the SEC to prove these allegations by a preponderance of the evidence before a jury. Again, the Defendants would not have agreed to waive their right to a jury trial had the Ponzi allegations been pled – and they certainly would not have agreed to have this issue decided on a motion after limited discovery.[4]

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[2] DE 1239, p. 13.

[3] The SEC contends that the Defendants explicitly agreed that there would be no evidentiary hearing because their Consents state that the Court may determine the issues raised in the motion "on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence." (D.E. 1239, p. 2). Defendants strongly disagree. Nothing in the quoted provision of the Consents states that the Defendants may not request, or that the Court is precluded from conducting, an evidentiary hearing.

[4] Pursuant to the Consents, the motion is exempt from Rule 56 summary judgement standards, which further erodes the protections available to the Defendants with respect to the determination of this critical unpled issues.

4) The SEC's Argument That the Ponzi Allegations Goes to Remedies Is False

The Response asserts that the SEC's unpled Ponzi allegations are relevant because they go to the Defendants' scienter, which is an element of the remedies they are seeking. (*See* DE 1239, p. 11; "[t]he issue of using investor money to pay other investors is directly relevant to the SEC's claims and the [*sic*] scienter…"). But clearly, the SEC must prove that the Defendants had the requisite scienter *with respect to the violations and actions that were actually alleged* (*i.e.*, with respect to disclosure issues and misrepresentation issues which were alleged in the Amended Complaint). Here, the SEC's new and unpled allegations that the Defendants knowingly operated Par Funding as a Ponzi scheme *does not* go to their scienter with respect to the violations alleged in the Amended Complaint. Indeed, the Court expressly noted this at an August 21, 2021 status conference. (*See* DE 1239-2, p. 206, l. 19-24; "I don't expect anybody to [raise Ponzi allegations] in findings of fact or conclusions of law because it doesn't really go to the scienter issue, the regulation issue, the disclosure. This is really a disclosure problem, I think.") (Emphasis supplied).

5) The Defendants' Alternative Request to Vacate the Consents Can Be Granted

The SEC's Response to Defendants' alternative request that the Consents be vacated pursuant to Rule 60(b) is premised on the same arguments raised in opposition to the Motion to Strike (and fails for the same reasons). First, the SEC argues that the Consents should not be vacated pursuant to Rule 60(b)(1) or 60(b)(5) because the Defendants knew the unpled Ponzi allegations were at issue. As explained above, the SEC waived its Ponzi arguments when it deliberately elected not to amend its Complaint to assert those allegations (as it had threatened to do), and the Defendants did not know or believe that the SEC would seek to raise these unpled allegations in its Motion for Final Judgements following entry of the Consents.

Second, the SEC argues that the Consents should not be vacated pursuant to Rule 60(b)(3) because the Defendants cannot show misconduct by the SEC, or that such misconduct foreclosed a

full and fair presentation of the case. With respect to the first element, the SEC's decision to base their Motion for Final Judgments on unpled allegations of an insidious financial crime after entering Consents which were supposed to resolve liability issues supplies the required misconduct. Furthermore, the SEC's argument that Defendants should have insisted on adding provisions to the Consents that would have prohibited Plaintiff from raising these unpled liability allegations does not vitiate the SEC's misconduct in this regard (especially since the SEC is a government agency which is held to higher ethical standards than a private litigant). Simply put, bait and switch is not a responsible or appropriate government position. With respect to the second element, the misconduct did foreclose a full and fair presentation of these allegations. The Ponzi allegations were deliberately not pled after the SEC considered these claims and rejected adding them to the Complaint. This clear and unambiguous decision resulted in the Defendants waiving a jury trial and agreeing to more limited proceedings than they would have insisted on (and would have been entitled to), had they understood that these unpled allegations would nonetheless be placed at issue.

Finally, the SEC argues that the Consents should not be vacated pursuant to Rule 60(b)(6) – the catch-all provision which allows the Court to vacate for other reasons that justify relief. The SEC contends that Defendants have not presented grounds for such relief and simply want a "do-over." That is not the case. For all of the reasons articulated in the Motion to Vacate, the Defendants were shocked by the SEC's eleventh hour assertion of unpled Ponzi allegations which the SEC did not deem sufficient to add to the Complaint in this case. The Defendants will experience real prejudice and due process deprivations if those unpled allegations are allowed to stand as the cornerstone of the SEC's Motion for Final Judgments. Under these circumstances, the Court is empowered to grant the Defendants request to vacate the Consents pursuant to Rule 60(b)(6).

6) The Court Should Not Strike the Movants' Declarations

Contrary to the SEC's assertion, the Defendants' declarations should not be stricken because they are not inconsistent with their prior invocation of the 5th Amendment privilege against self-incrimination because the declarations go to a collateral issue and not to the direct issues in this case. *See United States v. Seifert*, 648 F.2d 557, 561 (9th Cir. 1980) ("Where a witness asserts a valid privilege against self-incrimination on cross-examination, all or part of that witness's testimony must be stricken if invocation of the privilege blocks inquiry into matters ***which are "direct" and are not merely "collateral."***) (citation omitted) (emphasis suplied). The Eleventh Circuit has explained that procedural issues that do not go to the merits of the case are collateral issues. *See McGahee v. Massey*, 667 F.2d 1357, 1363 (11th Cir. 1982) ("An attack on the voluntariness of a confession is directed at the circumstances surrounding the making of the inculpating statement (duress, physical force, environment); it does not speak to the merits of the confession.").

Here, similar to an attack on the voluntariness of a confession, the Defendants' declarations do not challenge the merits of the Consents, the allegations of the Amended Complaint, or any other merits issues that the SEC has been unable to investigate due to the Defendants' assertion of the 5th Amendment privilege. The declarations merely go to the collateral issue surrounding the entry of the Consents. Therefore, there is no basis to strike the declaration because there is no prejudice to the SEC. *See United States v. Martino*, 648 F.2d 367, 388–89 (5th Cir. 1981), *on reconsideration in part sub nom. United States v. Holt*, 650 F.2d 651 (5th Cir. 1981), *and on reh'g*, 681 F.2d 952 (5th Cir. 1982), *aff'd sub nom. Russello v. United States*, 464 U.S. 16 (1983) ("In Diecidue we noted that where a witness legitimately invokes the privilege, the testimony is to be struck only if the ***defendants' resultant inability to complete their questioning creates a substantial risk of prejudice. Generally, it is only when a witness refuses to answer questions on direct, as opposed to collateral issues, that his testimony is excised.***") (emphasis suplied). Thus, contrary to the SEC's assertion, the declarations

are proper and do not provide grounds for the SEC to depose the Defendants on issues pertaining to the merits of the case.

7) Conclusion

For all of the reasons stated in the Defendants' Motion and this Reply Brief, the Court should strike the SEC's unpled and unproven Ponzi scheme allegations, which were raised for the first time in the SEC's Motion for Final Judgments. Alternatively, if the Court is not inclined to strike the SEC's Ponzi scheme allegations, Defendants request that they be relieved from their Consents and the Judgements entered based on those Consents pursuant to Federal Rule of Civil Procedure 60(b), and that the case be restored to the active docket so that Defendants can have their day in court.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on May 18, 2022, I electronically filed the forgoing document with the clerk of the Court using CM/ECF. I also certify that the foregoing document is being served this day on counsel of record via transmissions of Notices of Electronic Filing generated by CM/ECF.

By: */s/ James M. Kaplan*
JAMES M. KAPLAN

EXHIBIT A

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BETTINA SCHEIN
OF COUNSEL

February 25, 2021

Amie Berlin, Esq.
United States
Securities and Exchange Commission
801 Brickell Avenue, Suite 1800
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Re: Securities and Exchange Commission ("SEC") v. CBSG d/b/a Par Funding, 20-cv-81205-RAR

Dear Ms. Berlin:

By correspondence dated February 11, 2021, you notified defense counsel in the above-referenced matter of your intention to seek permission to file a Second Amended Complaint. In discussions about the proposed amendments, you suggested that, in addition to other amendments, you would seek permission from the Commission to amend certain factual allegations about the financial soundness and profitability of Par Funding. More specifically, Your Office, if given permission, planned to make factual financial allegations asserting that representations to investors of the financial state of Par Funding were inaccurate and that, in fact, Par Funding made very little money on its portfolio of merchant funding agreements.

In our recent conversations about this matter, I requested that your Office withhold filing an Amended Complaint with those allegations because, among other things, the Defense strongly believes that such allegations are inaccurate and thus unfairly prejudicial, and because important new information will soon be available for Your Office's consideration about these very issues. Thus, I have requested that Your Office delay any such amendment until you have had an opportunity to review the information we seek to share with you. All defense counsel support the request made in this letter, that any amendment await the submission by the Defense of important financial information.

The SEC's Enforcement Manual states at the outset that "The values integral to" the SEC's mission include:

- Integrity: acting honestly, forthrightly, and impartially in every aspect of our work; and

- Fairness: assuring that everyone receives fair and respectful treatment, without regard to wealth, social standing, publicity, politics, or personal characteristics.

Since the inception of this case, July 27, 2020, the financial wherewithal of Par Funding has been the subject of intense debate and litigation. But until mid-January 2021, six months later, the Defense has been at an extraordinary disadvantage as it was denied the very documents the Receiver and others were claiming to rely upon in making various financial claims. Indeed, although the Defense engaged a highly regarded forensic accounting firm in August 2020, it was not until late January 2021 that the firm finally received just a portion of the relevant financial documents and could commence work. And, as you know, the materials necessary to any proper financial analysis of Par Funding are voluminous.

First, the SEC should recognize that Par Funding was a very complicated financial business. Par Funding was a Merchant Cash Advance (MCA) business that funded over 14,000 merchants from 2012 to 2020. Those merchants contracted to pay factoring fees that averaged 30% of the merchant receivables funded, and those amounts were often to be paid in 100 business days.[1] Many times those merchants would refinance an existing factoring agreement or obtain new funding to replace earlier funding. The calculation of the fees owed, particularly where there are multiple transactions with a merchant, are complicated and math intensive. In addition, most of the transactions occurred through multiple ACH processors. The ACH processors held payments for several days, and held cash balances, further complicating the math of the transactions. The Par Funding QuickBooks, finally obtained by the Defense in January 2021, revealed over 4.2 million accounting transactions, with the vast majority of merchant payments going through ACH processors.[2]

To properly account for and analyze this vast amount of financial data, Par Funding worked with accounting professionals at Full Spectrum Processing (FSP) in Philadelphia. FSP had over 70 full time employees, including over a dozen accountants, many of whom have advanced degrees in accountancy and two of whom were CPAs, including FSP's Financial Controller, James Klenk. The in-house accountants and the Controller were housed in separate offices from the sales and other business functions specifically in order to keep the accounting functions uninfluenced from any sales considerations.

But that was only part of Par Funding's accounting team. Par Funding hired Rod Ermel and Associates in 2014, an accounting firm out of Colorado Springs which knew and specialized in the

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[1] Par Funding's MCA business has been challenged in multiple courts in multiple jurisdictions without a finding that is it improper. As we have advised the Court, many merchants need funding on an immediate basis to purchase inventory or fund operating expenses and cannot wait weeks for a traditional bank to fund them. And many merchants would never receive traditional bank funding in any event.

[2] For apparent and obvious reasons, the MCA business can be quite profitable. Indeed, the SEC's initial Complaint alleges that the cost of funding can exceed 400% (ECF 1 at ¶¶ 1, 45), and an expert report submitted by the SEC as part of the Preliminary Injunction hearing claimed that the costs of funding can far exceed that amount. *See* SEC Exhibit 76, Expert report of Charles S. Lunden, at p. 7.

MCA business. The Ermel firm not only prepared tax returns, it also actively monitored the transactions through Par Funding. Ermel had live access to Par Funding's accounting server, letting their accountants work on the accounting files at the same time as staff in the Philadelphia office. The Ermel firm also provided regular taxation and accounting guidance and were critical in establishing best practices and financial strategy for Par Funding. They had regular weekly meetings with accounting personnel to review current accounting and transactions.

But there was yet more accounting and financial scrutiny. Par Funding voluntarily engaged two respectable accounting firms to conduct independent financial audits. As I advised during one of our calls, the first firm, Friedman LLP, wanted to use a projection to input merchant defaults for 2017 when the fiscal year had concluded and the actual numbers were available. The second auditing firm, Clifton Larson Allen, conducted a thorough audit for the year ending December 31, 2018. This audit had advanced to Quality Control when this action was filed in late July 2020. Needless to say, no firm, be it Rod Ermel & Associates, Friedman LLP or Clifton Larson Allen, and certainly not James Klenk, the Financial Controller, ever suggested financial impropriety or that the Par Funding's KPI's were inaccurate.

In fact and to the contrary, just recently produced in this case is a Form 1120 Return Summary for tax year 2019, red-marked by James Klenk, a CPA. It is attached hereto (and is under the Protective Order). That document clearly shows Mr. Klenk, in his own hand, checking off the itemized Total Income of $179,620,990 and recording a Net Ordinary Income of $95,542,457 for tax year ending December 31, 2019.

And, in addition to all of this, a number of sophisticated early purchasers of Par Funding notes had their own accounting personnel look at the books and records of Par Funding and conduct due diligence prior to purchasing the notes. Affidavits and Declarations recounting their access and examination of Par Funding's books and records were publicly filed early on in this case. Needless to say, if any of them or their accounting professionals had doubts or concerns about the financial soundness and profitability of Par Funding, they would not have purchased the notes.

All of this is set forth because we are very concerned that the SEC's proposed amended financial assertions will be wrong. The Defense and its forensic accounting team are well aware of the DSI Financial Report dated December 13, 2020 and that report, in our view, is flawed in several respects. To state things rather bluntly, the potential claims described as being added by the SEC to the Complaint can only be accurate if every single accounting professional who examined Par Funding's records and transactions – literally dozens of people – either had no idea what they were doing or were part of some massive secret conspiracy. Obviously, neither is true.

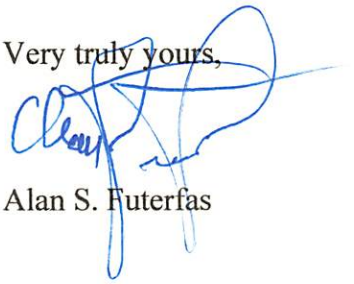
Based on financial information that it has finally started to receive in discovery, the Defense forensic accounting team is working expeditiously to issue a financial report that properly analyzes the financial condition of Par Funding. In addition, all parties to this litigation are shortly to receive, possibly today, significant amounts of data from the Ermel accounting firm. And, because the Receiver refused to waive privilege for many months, it is only now that both the SEC and the Defense are beginning to receive the vast trove of materials seized from Par Funding on or about July 26, 2020. Those materials may exceed 5 terabytes of data and will include thousands of emails highly relevant to

this analysis between Par Funding accounting personnel and Ermel and Associates and the outside auditing firms.

The Defense is requesting the opportunity to finish the first part of its forensic accounting analysis and provide this report and other information to the SEC so that it is fully informed before it commits to making potentially erroneous claims to the Court and the public. This filing should not be rushed, and it needn't be. We ask only that Your Office agree to review the information we wish to share with you - information highly relevant to the amended allegations it is considering – and we will work with you to ensure that any delay does not prejudice your ability to amend those allegations later, should you decide to do so after reviewing the information we present. If the SEC is truly interested in honesty, forthrightness and impartiality, it will delay adding new financial claims until the Defense has had that opportunity.

Thank you for your consideration of this letter.

Very truly yours,



Alan S. Futerfas

cc: All Defense Counsel