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.
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LISA MCELHONE'S, JOSEPH LAFORTE'S AND JOSEPH COLE BARLETA'S RESPONSE IN OPPOSITION TO THE SECURITIES AND EXCHANGE COMMISSION'S AMENDED OMNIBUS MOTION FOR FINAL JUDGMENTS

I. INTRODUCTION

The SEC's Omnibus Amended Motion (D.E. 1252) seeks to recover $226 Million in disgorgement and $100 Million in penalties from Lisa McElhone ("McElhone") and Joseph LaForte ("LaForte") with additional sums exceeding $18 Million in disgorgement and penalty demanded from Joseph Cole Barleta ("Cole"). The Omnibus Motion is as long on rhetoric and audacity as it is short on analysis. Although the Supreme Court of the United States makes crystal clear that disgorgement, as an equitable remedy, cannot exceed a defendant's net profits, the SEC pays lip service to that concept and, rather than seeking to calculate any defendant's net profit, focuses instead on what it contends are the remaining amounts owed to investors – which it presents as a calculation seeking to establish the difference between the amount of money raised from investors and the amount of money paid back, before making minor adjustments based on disgorgement received from certain other individuals. The SEC's analysis is flawed in a number of material respects. In particular, the analysis utterly fails to even attempt to show what any of the answering defendants (referred to collectively as the "Defendants") realized as net profits.

Second, although the Supreme Court mandated that courts must deduct legitimate business expenses before ordering disgorgement – astonishingly, the SEC fails to recognize even one single dollar in legitimate business expenses! According to the Expert Report of Joel Glick, Par's books and records (the very same books and records relied upon by the Receiver in his supporting Declaration to the Omnibus Motion) reflects more than 4.2 Million book entries between 2012 and 2020. Notwithstanding, the SEC apparently believes that all of those entries – and all of the transactions that underly those entries – were somehow accomplished without creating even a single dollar of legitimate business expenses.

This taking of shortcuts and overreaching has typified the SEC's approach to this entire case from its very inception and continues to the present. Further examples of the SEC's cynical perspective permeate the Omnibus Motion. For example, the SEC suggests that approximately $550 Million was raised from investors and approximately $300 Million was repaid and offers the Receiver's Declaration in support of those figures. In fact, as the Receiver's counsel admitted in open court before the magistrate-judge just one week ago, the Receiver's reports reflect different numbers for those items – numbers which are the product of a much more detailed analysis <u>and numbers which are more favorable to the Defense</u>. Notwithstanding the fact that the SEC represents the government of the United States petitioning this court sitting in equity, the SEC has refused to even acknowledge these lower and more accurate numbers – let alone accept them.

This cynical approach to playing fast and loose with the facts is further evidenced by the SEC's contentions that LaForte, Cole and even McElhone are each responsible for *all* of the alleged misrepresentations and omissions that were the proximate cause of the sale of approximately $550 Million in investor notes. And yet, as recently as yesterday, the Philadelphia Inquirer reported that the SEC reached a settlement with Mr. Vagnozzi's lawyer – who agreed to pay a penalty and forfeit his privilege to appear before the commission – based on his making the same material misrepresentations and omissions (in investor meetings – podcasts and videos that did not include the Defendants) that the SEC now attributes to these answering Defendants. The SEC simply can't have it both ways nor should they be permitted to speak out of both sides of their mouth in any proceeding before a Court of the United States – let alone one sitting in equity.[1]

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[1] "Dean Vagnozzi's Lawyer John Pauciolo settles with SEC for $125,000 in Par Funding Case", https://www.inquirer.com/business/par-funding-sec-vagnozzi-lawyer-pauciulo-settlement-20220707.html - published July 7, 2022.

Not content with its outsized and unsupportable demand for more than $235 Million in disgorgement from these three answering Defendants, the SEC goes on to demand that the Court impose a hundred million dollars in penalties against McElhone and LaForte and an additional $5 Million penalty against Cole. Although recent jurisprudence makes it clear that permissible penalties: a.) are divided by tier; b.) are differentiated by level of egregiousness; and c.) are limited to a maximum amount which may be assessed for each violation, the SEC provides absolutely no calculation to support its demands. Specifically, the SEC provides no indication of the number of violations it believes are supported by the record in this case; treats all of the answering Defendants as though they were one for purposes of assessing the maximum penalty without ever acknowledging the numerous material facts which differentiate the conduct of these Defendants; and fails to even pay lip service to anything other than a tier 3 penalty. In point of fact, the Defendants all had different roles and functioned in different ways. There is simply no justification (and the SEC surely offers none) to assess a $50 Million penalty against both McElhone and LaForte. In order to justify a penalty of this magnitude, the SEC would have needed to demonstrate more than 250 separate violations on behalf of each of McElhone and LaForte. There is no record evidence which establishes that number of violations when the SEC has identified only a small handful of misrepresentations (e.g., failure to disclose LaForte's criminal history; failure to accurately describe Par's underwriting platform; etc.) none of which are causally related to any loss. To the contrary, Par's record of providing premium rates of return to its investors for 8 consecutive years (until the time that it was effectively shut down by this Court's injunction) is indisputable.

At the end of the day, the Omnibus Motion essentially picks up where the SEC's initial filings left off – a series of inflammatory statements and overreaching demands that are factually

inaccurate and equitably unsupportable. But inflammatory statements and overreaching demands are not proxies for hard evidence and precise calculations. The laws of the United States and the binding precedent of this Circuit will accept only the latter as a basis for this Court to exercise its sound discretion before ordering any amount of disgorgement or penalty.

II. ANALYSIS OF THE RECEIVERSHIP ESTATE

The SEC's Omnibus Motion avoids any discussion of the assets under Receivership – which total nearly $600 Million by the Receiver's count. However, these figures cannot be ignored for at least two reasons. First, the value of the Receivership evidences Par's[2] profitability and success as a company (and counters the SEC's false narrative that Par was an illegitimate business that never turned a profit, which is central to its demands for disgorgement and penalties). Second, contrary to the SEC's contention, there is no question that Receivership assets must be applied to the disgorgement judgements against McElhone and LaForte. Accordingly, this Court should take note of the assets under Receivership – which are worth more than double the $239,718,888 in disgorgement the SEC seeks from the Defendants – at this stage of the proceedings.

The SEC's disgorgement calculation for McElhone and LaForte is not based on the profits they received individually (which the SEC states are at least $100 Million). Instead, the SEC seeks disgorgement from them in an amount equal to Par's "ill-gotten gains" (allegedly $226,471,877). The SEC calculates this figure by taking the total amount raised from noteholders minus principal

[2] Complete Business Solutions Group, Inc. d/b/a Par Funding is referred to throughout this brief as "Par" or "CBSG." The following companies which were affiliated with Par and/or owned by McElhone, LaForte or Cole are referred to by the following abbreviations: Eagle Six Consultants ("ESC"), Heritage Business Consulting, Inc. ("HBC"), Full Spectrum Processing, Inc. ("FSP"), Recruiting & Marketing Resources ("RMR"), Contract Financing Solutions ("CFS"), Capital Source 2000, Inc. ("CS 2000") Fast Advance Funding LLC ("FAF") and the LME 2017 Family Trust ("LME").

and interest that has been repaid, and then subtracting the disgorgement amounts sought or obtained from Cole and Abbonizio.[3] This sum represents Par's net proceeds from the issuance of promissory notes, and the SEC incorrectly contends that this is the proper measure of disgorgement in this case.[4]

The Receiver's most recent quarterly report reflects that the total value of the Receivership property is $593,517,364[5] – more than twice the amount needed to cover the disgorgement the SEC is seeking. Indeed, the Receiver's report reflects that the MCA receivables for Par, FAF, CFS and CS 2000 are $354,000,000. *Id.* at pg. 6. Even if these receivables are discounted by 30%, they will still be more than sufficient to cover the full disgorgement amounts the SEC is seeking. The other assets identified by the Receiver include: a cash balance of $103,533,364; $38 Million in receivables owed to ESC and HBC; a jet airplane with a book value of $6.3 Million; and over $60 Million in real estate holdings (this value is based on purchase price, and does not capture the undeniably significant gains in value given the current real estate market).[6]

In its motion, the SEC contends that the issue of whether the funds or assets the Receiver has collected can be used to satisfy the disgorgement amount will not be ripe until the Court has entered Final Judgements against the Defendants. This is wrong, as there is no question that the

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[3] The SEC declines to deduct the disgorgement amounts sought or obtained from Vagnozzi, Gisas and Furman for reasons that are not adequately explained in its Omnibus Motion.

[4] As discussed further herein, the Defendants dispute the SEC's exorbitant and inequitable disgorgement calculation which – among other failings – provides no credit for the legitimate expenses of Par's business under *SEC v Liu*. As discussed herein, Par was a legitimate and successful business that had over 75 employees at its peak. Indeed, the Receiver continues to nominally operate Par – at a cost of approximately $1 Million a month without generating any new MCA business – and has rehired 15 Par employees to help continue the company's operations. Under these facts, the SEC's contention that Par's legitimate business expenses do not need to be considered under *Liu* should not be countenanced by the Court.

[5] *See* DE 1223-1, pgs. 6-7, Receiver's chart reflecting assets and estimated values.

[6] *Id.* at pgs. 6-7.

Receivership assets belonging to Par – as well as those belonging to McElhone, LaForte and their companies – must be applied against the disgorgement award the SEC seeks from McElhone and LaForte. Since the SEC is seeking to hold them liable for all of Par's gains based on their control of that entity (rather than seeking disgorgement of the profits they personally received from Par's operations), Par's assets must be applied against any disgorgement award entered against them. Notably, the Receiver has also acknowledged that the Receivership assets should be used to satisfy the disgorgement awards. *See* D.E. 1223, p. 18 (anticipating a phased distribution in which "the Receiver would request permission to make an initial distribution from amounts already collected, after the disgorgement and penalty amounts have been determined") (Emphasis supplied).

The Defendants do not object to engaging in supplementary proceedings to determine the source and value of the assets under Receivership. However, the Court cannot ignore the fact that the Receivership estate has been valued at nearly $600 Million. Additionally, the Court should note that the value of the Receivership estate has been steadily increasing. The Receiver's cash on hand has increased every quarter, growing from $35,939,842 in the third quarter of 2020 to $103,533,364 in the first quarter of 2022.[7] Assets under Receivership have also grown from $463,040,000 to $593,517,364 during this period.[8] These gains primarily come from the Receiver's continued nominal operation of Par's business (and/or the liquidation of Par's receivables), and have been realized even though the Receiver is not generating new MCA

[7] *See* D.E. 358-1, p. 6 and D.E. 1223-1 p. 6 for cash balances in the third quarter of 2020 and the first quarter of 2022. The cash balances during each intervening quarter are shown at D.E. 482-1, p.3, D.E. 577-1, p. 6, D.E. 666-1, p. 6, D.E. 902-1, p. 6 and D.E. 1140-1, p. 6. Furthermore, although the most recent quarterly report runs through March 31, 2022, the Receiver notes that the cash balance as of April 29, 2022 was $105,672,519 – an increase of more than $2 Million in a month's time. (*See* D.E. 1223, p. 2).

[8] *See* D.E. 358-1. P. 7 and D.E. 1223-1, p. 6-7.

business and has been incurring approximately $1 Million a month in operating expenses.[9]

It is not surprising that the SEC turns a blind eye to the value of the assets under receivership in its motion, as an examination of these assets thoroughly debunks the SEC's contention that Par was not a profitable company and was using money raised from new noteholders to pay the old. If this were true, the Receiver would not be sitting on a mountain of assets worth more than double the amount needed to disgorge all sums raised from Par's promissory notes. Likewise, had Par truly been a failed company, the Receiver would have placed Par in bankruptcy rather than continuing to operate it as a going-concern. Indeed, the Receiver has been able to generate a profit from the operation of Par's business notwithstanding the fact that: 1) the rate of MCA collections has been significantly reduced under the Receivership; 2) the Receiver is not generating any new MCA business, which dramatically reduces Par's factoring rate; and 3) the Receiver's operating costs have been approximately $1 Million a month. These facts are telling and must be considered in the context of both disgorgement and penalties.

For all of these reasons, the Receivership assets must be applied to the disgorgement judgements against McElhone and LaForte. For the Court's convenience, the Defendants have attached as Exhibit 1 a document identifying the various Receivership assets and the approximate values of those assets.[10]

III. <u>THE REQUEST FOR AN ADVERSE INFERENCE SHOULD BE DENIED</u>

The SEC argues that Defendants should be barred from presenting evidence and that an adverse inference should be drawn against them because of their assertions of their Fifth

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[9] *See* D.E. 1123-1, p. 11, Line 10 (showing total disbursements for receivership operations from July, 28 2020 through March 31, 2022 – a 20 month period – were $19,973,169).

[10] The figures presented in Exhibit 1 are subject to adjustment, and the Defendants specifically reserve their rights to supplement and revise their calculations in any subsequent briefings to the Court, or in any supplementary proceedings.

Amendment right against self-incrimination. However, the invocation of the Fifth Amendment does not give rise to a conclusive presumption, but rather a rebuttable adverse inference at most. Furthermore, it is not a universal adverse inference that prevents Defendants from presenting any evidence in their defense, but rather only prohibits them from using the Fifth Amendment as a sword and a shield to withhold unfavorable evidence while putting forth favorable evidence. However, given that the SEC raided Defendants' homes and offices and seized their computers and papers at the outset of this case, there is a very limited universe of evidence that could potentially be excluded, and the Defendants are not barred from introducing evidence that the SEC has in its possession and has had the opportunity to discover.

Here, by asking both for an adverse inference and to prevent the Defendants from introducing evidence, the SEC is attempting an end-run around a rebuttable adverse inference and is asking this Court to punish Defendants for asserting their Constitutional rights with a conclusive presumption. Therefore, this Court should reject the SEC's argument that Defendants should be barred from presenting evidence and not permit an adverse inference where the documentary evidence that the SEC has had in its possession clearly rebuts any inference.

"Because courts must take care not to punish valid invocations of the privilege against self-incrimination and must try to accommodate those who would properly seek to claim the privilege, a prior assertion of the Fifth Amendment does not preclude a litigant's later attempt to submit evidence." *United States v. Certain Real Prop. & Premises Known as 4003-4005 5th Ave., Brooklyn, N.Y.*, 55 F.3d 78, 80 (2d Cir. 1995). However, to prevent abuses of the privilege, trial courts have broad discretion to fashion remedies in the discovery process. *Id*.

> Where adverse inferences are drawn from invocation of the privilege, such inferences must not result in automatic summary judgment against the person invoking the privilege. *See Pervis*, 901 F.2d at 944; *Incendy*, 936 F.Supp. at 956 n. 4. In addition, "[a] trial court must carefully balance the interests of the party

> claiming protection against self-incrimination and the adversary's entitlement to equitable treatment. ***Because the privilege is constitutionally based, the detriment to the party asserting it should be no more than is necessary to prevent unfair and unnecessary prejudice to the other side.***" *Id.* at 192; *Suman*, 684 F.Supp.2d at 386–87 (court must balance the equities). "Courts should 'give due consideration to the nature of the proceeding, how and when the privilege was invoked, and the potential for harm or prejudice to opposing parties.'" *S.E.C. v. Cavanagh*, 2004 WL 1594818 at *13 (S.D.N.Y.2004) (quoting *United States v. Certain Real Property and Premises Known As: 4003–4005 5th Ave., Brooklyn, N.Y.*, 55 F.3d 78, 83 (2d Cir.1995)).

S.E.C. v. Monterosso, 746 F. Supp. 2d 1253, 1262 (S.D. Fla. 2010) (emphasis added).

Courts in this district have long held that an adverse inference is just that – an inference, that may be rebutted with other evidence. *See Martinez v. Majestic Farms, LLC*, 05-60833-CIV, 2006 WL 8431632, at *2 (S.D. Fla. Sept. 20, 2006). The inference can be rebutted with other fact evidence or through the presentation of expert testimony, even where it is the result of sanctionable bad faith for spoliation, which is not the case here. *Penick v. Harbor Freight Tools, USA, Inc.*, 19-CV-23134, 2020 WL 6581606, at *1 (S.D. Fla. Nov. 10, 2020) ("Because Plaintiff's actions amounted to sanctionable bad faith, the Court imposed an adverse inference jury instruction in which the '"jury is to presume that the destroyed generator was relevant and favorable to Defendant and unfavorable to Plaintiff, but Plaintiff can rebut this presumption through his presentation of evidence, including expert testimony.'").

The SEC cites *S.E.C. v. Zimmerman*, 854 F. Supp. 896, 899 (N.D. Ga. 1993) for the proposition that "[b]ecause LaForte and McElhone refused to produce sworn accountings, the Court should preclude them from now presenting evidence of the amounts they received in connection with Par Funding." D.E. 1252 at 24-25. However, *Zimmerman* does not stand for this proposition, and the SEC has selectively omited a crucial portion of the *Zimmerman* opinion. The Court's actual holding was that "Zimmerman may not use, therefore, any evidence which he has withheld by his invocation of his testimonial privilege in this matter. ***He is free, of course, to use***

any other outside discovered evidence." *Zimmerman*, 854 F. Supp. At 899 (emphasis added). Analogizing *Zimmerman* to the facts of this case, if LaForte and McElhone decided to present a sworn accounting to prove the amounts they received at this stage of the proceedings, it would be appropriate for this Court to preclude its admission from evidence. However, nothing prohibits LaForte and McElhone from presenting documentary evidence that the SEC and the Receiver have had from the outset of this case or the testimony of other witnesses who did not assert their Fifth Amendment rights, including their expert witness Joel Glick who produced a compelling GAAP compliant report and whom the SEC deposed on this report. To hold otherwise would turn an adverse inference into a conclusive fact, and would be tantamount to granting summary judgment on an adverse inference as a penalty for Defendants asserting their constitutional rights, which is not permitted. *Monterosso*, 746 F. Supp. 2d at 1262.

Moreover, an adverse inference is not warranted insofar as it would extend the conclusive presumption—for the purposes of this motion only—that the facts alleged in the Amended Complaint are true as the Parties agreed in the bifurcated settlement. The SEC has the tremendous advantage (by virtue of the Defendants' Consents) of not having to prove the facts alleged in the Addended Complaint. Any further adverse inference or prohibition on the submission of evidence would substantially outweigh any prejudice to the SEC by the Parties' innovation of the Fifth Amendment, especially since they are not attempting to submit affidavits on the topics that they previously refused to testify. Combined with the fact that the books and records of Par that the Defendants are attempting to introduce as evidence at this time have been in the SEC's possession since the outset of this case, there is no justification to exclude this evidence or allow an adverse inference on top of the conclusive presumption of the truth of the allegations of the Amended

Complaint for the purposes of this motion.[11]

IV. DISGORGEMENT ANALYSIS

A. Disgorgement Standard

Disgorgement is an equitable remedy which must be limited to the "the gain made upon any investment, when both the receipts and payment are taken into account. *See Liu*, 140 S. Ct. at 1946 (citing *Rubber Co. v. Goodyear*, 76 U.S. 788, 804 (1870))., 19 L. Ed. 566 (1869) *See S.E.C. v. Blackburn*, 15 F. 4th 676, 682 (5th Cir. 2021) (to keep an award from becoming punitive, disgorgement "cannot exceed the defendants' net profits and must be awarded for victims") (citing *Liu*); *S.E.C. v. Blatt*, 583 F. 2d 1325, 1335 (5th Cir. 1978) ("Disgorgement is remedial and not punitive. The Court's power to order disgorgement extends only to the amount with interest by which the defendants profited from his wrongdoing. Any further sum would constitute a penalty assessment"). *Liu* recognizes that, absent a limited exception, "courts must deduct legitimate expenses before ordering disgorgement under § 78u(d)(5)." *See Liu*, 140 S. Ct. at 1950. The *Liu*

[11] Furthermore, if an adverse inference is proper based on Defendants' claim of privilege, an adverse inference should also be assessed against the SEC for refusing to answer questions at deposition as well as withholding other evidence based on various claimed privileges. Adverse inferences are not limited to defendants who assert their right against self-incrimination – they may also apply to government entities. *U.S. v. $3,000,000 Obligation of Qatar Nat. Bank to Nomikos*, 90 CIV. 6427 (PNL), 1993 WL 267364, at *1 (S.D.N.Y. July 12, 1993) ("[I]t may be that the privilege is appropriately claimed but that its invocation by the Government may expose the Government to adverse inferences at trial"). At the SEC's 30(b)(6) deposition, the SEC's Lead-Counsel repeatedly proclaimed, the SEC would only "testify about what we have already provided publicly in connection with our TRO and preliminary injunction exhibits." [D.E. 776-4 at 96:13-18]. This assertion was based on various privileges, including the law enforcement privilege and deliberative process privilege. What is sauce for the goose is sauce for the gander. If an adverse inference is proper as to the Defendants, the same hold true for the SEC and it should be limited to presenting only that evidence that it provided publicly as exhibits in connection with the TRO and preliminary injunction. *See* generally D.E. 776. If anything, the adverse inference against SEC for asserting privilege and not answering deposition questions should be harsher than any inference against the Defendants because the SEC is the plaintiff who chose to bring this case – rather than the Defendants who were asserting a constitutional right for which they cannot be punished.

Court also noted that "[a] rule to the contrary that makes no allowance for the cost and expense of conducting a business would be inconsistent with the ordinary principles and practice of courts of chancery." *Id.* (citing *Tilghman v. Proctor*, 125 U.S. 136, 145, 8 S. Ct. 894, 899, 31 L. Ed. 664 (1888)) (internal quotations omitted).

"The district court has broad discretion in fashioning the equitable remedy of a disgorgement order." *Sec. & Exch. Comm'n v. Huffman*, 996 F.2d 800, 803 (5th Cir. 1993). However, "[b]ecause disgorgement is meant to be remedial and not punitive, it is limited to property causally related to the wrongdoing at issue." *Allstate Ins. Co. v. Receivable Fin. Co.*, 501 F.3d 398, 413 (5th Cir. 2007). "Accordingly, the party seeking disgorgement must distinguish between that which has been legally and illegally obtained." *Id.* "In actions brought by the SEC involving a securities violation, 'disgorgement need only be a reasonable approximation of profits causally connected to the violation.'" *Id.* (quoting *Sec. & Exch. Comm'n v. First City Fin. Corp.,* 890 F.2d 1215, 1231 (D.C. Cir. 1989)). The SEC "bears the ultimate burden of persuasion that its disgorgement figure reasonably approximates the amount of unjust enrichment." *First City Fin*., 890 F.2d at 1232; *see also Zacharias v. S.E.C.*, 569 F.3d 458, 473 (D.C. Cir. 2009) (Judge Williams dissenting) (finding SEC had not met its burden to show its disgorgement figure was a reasonable approximation because it "did not attempt even a superficial showing of petitioner's profits; instead it pointed simply to their proceeds from sales, after an arbitrary deduction of some costs but not others"). Once the SEC meets its burden of reasonably approximating the defendant's ill-gotten gains, the burden shifts to the defendant to "demonstrate that the disgorgement figure was not a reasonable approximation." *First City Fin*., 890 F.2d at 1232.

B. <u>Disgorgement Analysis: LaForte and McElhone</u>

The SEC contends that LaForte and McElhone should be held jointly and severally liable, and should be ordered to disgorge the amount received from noteholders minus the total principal and interest repaid to noteholders, less the disgorgement amounts sought or obtained from Cole and Abbonizio. Using this methodology, the SEC calculates the disgorgement amount to be $226,471,877.

As discussed herein, the SEC's calculation fails to account for Par's legitimate business expenses, other avenues of recovery that will be used to make noteholders whole, and other equitable deductions which should be accepted by the Court. Accordingly, the SEC fails to provide a reasonable approximation of either McElhone and LaForte's alleged "profits" or "ill-gotten gains." Additionally, the SEC's disgorgement calculation relies on inaccurate figures regarding the amount raised from, and repaid, to noteholders. The SEC appears to have cherry picked these figures – knowing that a more accurate calculation was available – in order to inflate its disgorgement model by $3.8 Million.

If the Court determines to excuse the SEC's failure to even offer a profit calculation and accepts the SEC's methodology of comparing the amount raised from noteholders and the amounts repaid to them, then to do so fairly and equitably, the Court must start with the real amounts raised from and repaid to noteholders (rather than the SEC's numbers, which over-count the raise and undercount repayment), and must then deduct Par's legitimate business expenses and other equitable deductions. As discussed below, when these factors are considered, and the calculations are properly performed, the actual disgorgement amount for McElhone and LaForte comes out to approximately **$48,755,537.**28. As discussed above, **these funds are readily available from the assets held by the Receiver.**

1. The Unpaid Balance on Par's Promissory Notes

The starting point for SEC's disgorgement calculation is the amount Par raised from noteholders, less the total principal and interest that was repaid. The SEC's Motion attaches and relies on a Declaration from the Receiver stating that the amount raised from noteholders was $550,325,596 and total principal and interest repayment was $300,108,117. This yields a delta of $250,217,479. By contrast, the Receiver's most recent Quarterly Report states that $548.8 Million was raised from investors and $302.4 Million in principal and interest was repaid – which yields a delta of $246.4 Million.[12]

Although the SEC asks the Court to accept the numbers from the Receiver's Declaration, the evidence shows that the numbers reported in the Receiver's Quarterly report are more reliable for several reasons. First, the figures presented in the Quarterly report are supported by a summary of cash sources for each year from Par's inception through the date of the Receivership, whereas the Receiver's Declaration presents conclusory numbers without any explanation or support. Second, the Quarterly report (and the figures reported therein) reflects the Receiver's fulfillment of its court appointed duties under the Receivership – whereas the Declaration was prepared for the SEC's use in an adversarial proceeding and is a surrogate for an expert opinion. Because the Quarterly report reflects the Receiver's work in its quasi-judicial capacity, whereas the Declaration is an advocacy piece, the Report is inherently more reliable. Finally – and most importantly – counsel for the Receiver has explained (on the record in open-court) that the number presented in Quarterly report for the amount raised ($548.8 Million) comes from a more "in-depth" analysis performed by DSI, which included a "reconciliation from bank account statements" – and is therefore inherently more accurate than the figures presented in the Declaration. (*See* Hearing

[12] *See* DE 1223-3 pg. 2, line items for "Receipts from Investors" and for "Disbursements to Investors."

Transcript, attached as Ex. 2, p. 11, l. 2-11; *see also id.* at p. 10 l. 10-15, acknowledging discrepancy in the Declaration's disgorgement figures).[13] Accordingly, the Court should use the numbers presented in the Quarterly report – which come form a more "in-depth" analysis – as the starting point for the SEC's disgorgement analysis. These numbers show that Par raised $548,800,000 from investors and repaid $302,400,000, yielding a delta of **$246,400,000**.

2. Deductions for Other Disgorgement Awards

The SEC acknowledges that the disgorgement award obtained from Abbonizio ($10,498,581, *see* D.E. 1169, p. 5) and the disgorgement amount it seeks from Cole ($13,247,011) must be deducted from the disgorgement it seeks from McElhone and LaForte.[14] But for reasons that are not entirely clear, the SEC contends that the Defendants are not entitled to an offset for the disgorgement sought or obtained from Furman, Gissas and Vagnozzi – which totals approximately $7,405,248.[15] The disgorgement awards obtained from these three Defendants will be used to repay noteholders and will therefore reduce the balance of the amount raised from noteholders versus the amount repaid. Accordingly, this amount should be deducted from the

[13] McElhone sought to take the deposition of the Receiver in order to get to the bottom of these discrepancies, but the Receiver filed a Motion to Quash, and Magistrate Reinhart granted the motion – notwithstanding the fact that the Receiver's counsel acknowledged that the Declaration presented less accurate numbers to the detriment of McElhone. The stated basis for Judge Reinhart's ruling was that the discovery sought was not proportional to the needs of the case.

[14] McElhone and LaForte agree that Cole and Abbonizio's disgorgement should be deducted from the SEC's disgorgement calculation for them, but acknowledge Cole's disgorgement has not yet been determined. As discussed herein, Cole asserts his disgorgement should be $5,909,543. McElhone and LaForte should receive an offset for whatever Cole's disgorgement amount may ultimately be.

[15] The SEC has obtained a $4,531,248 disgorgement judgment against Vagnozzi. *See* D.E. 1165, p. 5. The SEC obtained a $1,075,000 judgment against Gissas for disgorgement and prejudgment interest. *See* D.E. 1133, p. 5. For purposes of this motion, we reduce the judgment against Gissas to $1,040,000 to back out the estimated pre-judgement interest. The SEC seeks $1,834,000 in disgorgement from Furman. Whatever Furman's disgorgement ends up being, that amount should be deducted from the disgorgement the SEC seeks from McElhone and LaForte on a dollar-for-dollar basis.

disgorgement the SEC seeks from McElhone and LaForte (which will be applied against this same balance). To hold otherwise would result in a double recovery. For these reasons, the SEC's disgorgement calculation should be reduced by the total disgorgement obtained from other parties in this case – which will be approximately $31,000,000.00.

For the same reason, the amounts the SEC is seeking from A.G. Morgan Financial Advisors, LLC, Vincent J. Camarda and James McArthur in a separate action which was filed in the U.S. District Court for the Eastern District of New York (the "AGM Lawsuit") should also be deducted. In the AGM Lawsuit, the SEC alleges that the defendants violated securities laws by raising at least $75 Million from investors as part of the Par investment offering.[16] The Complaint specifically alleges that Par paid over $5,550,000 Million in compensation to one fund controlled by the defendants in that case (¶ 97-98), and at least $1,400,000 in compensation to another fund (¶ 110-111), and the SEC is seeking disgorgement of this compensation (which totals $6,950,000). Accordingly, the Court should deduct an additional $6,950,000 from McElhone's and LaForte's disgorgement based on the monies the SEC is seeking to recover in the AGM Lawsuit.

3. Deductions For Balance of Notes to Other Profit Participants

As discussed in section I. a., above, the total delta between the amount raised from noteholders and the amount repaid is $246,400,000. The SEC maintains that this delta represents that amount that must be returned to noteholders (through Defendants' and Abbonizio's disgorgement) in order to make them whole. For the reasons discussed below, this number should be adjusted downward by $56.6 Million – which represents the outstanding balance on notes Par issued to a family of investors as part of a business arrangement which included consulting agreements with Par (for certain family members), together with profit participation. Accordingly,

[16] *See* Case No. 2:22-cv-03421-DG-ST, Complaint ¶ 50, attached hereto as Ex. 3.

those in this small group were investors receiving profit participation, as distinct from noteholders with no equity participation who may be entitled to share in the disgorgement from the Receivership.

Par had consulting agreements with Isaac Shehebar, GEMJ Chehebar Grat, LLC (executed by its Manager, Josef Chehebar), and Lindsay Blake Inc. (executed by its President, Robert Frei).[17] Pursuant to the terms of these consulting agreements, Par issued certain promissory notes to Chehebars and their family members and affiliated entities.[18] The outstanding balance on these notes is $56.6 Million[19], and the Chehebars received a profit percentage on all of these transactions pursuant to their consulting agreements.[20] Furthermore, the Chehebars are wealthy, sophisticated business people who dealt directly with Par principals and conducted extensive due diligence on Par prior to executing their consulting agreements and entering the promissory note transactions at issue. For all of these reasons, the outstanding balance on the promissory notes issued to the Chehebars (as well as the notes issued to their family members and affiliated entities), should not be treated like the obligations to noteholders who came to Par through the agency funds and had

[17] The consulting agreements are attached hereto as Ex. 4. They are materially similar to the consulting agreement that Cole and Abbonizio had with Par. The consulting agreements provide that the consultants shall assist Par in making contact with potential investors (see Section 2.(a)(1)), and shall receive a profit percentage from investment transactions.

[18] In addition to issuing notes to the persons and entities who entered and executed the consulting agreements (referred to as the "Chehebars"), Par issued notes to the following members of their family and affiliated entities: Albert E. Chehebar, Cherie Chehebar, Danielle Halabai, Ezra Chehebar, Ezra Shehebar, LLC, Gamed LLC, Isaac Bennet Sales, Jack Terzi, Joyce Chehebar, Michael Berkowitz, Michael Chehebar, Richard Chera, She'erit Ezra and Steven Chehebar. All of these investments were generated through the Chehebar consulting agreements. Copies of the promissory notes, and a spreadsheet summarizing the balance on the notes, are attached as Ex. 5.

[19] Of this, approximately $23,025,000 is for notes issued to the Chehebars, and approximately $33,575,000 is for notes issued to the Chehebars' family and affiliated entities.

[20] In total, the Chehebars received $6,468,260.77 in consulting fees. This sum is reflected in Par's summary of historic consulting payments, which was prepared using Par's QuickBooks records, and is attached hereto as Ex. 6. Total payments are $4,062,075.46 to Lindsay Blake, Inc., $325,000 to Robert Frei, #1,233760.79 to GEMJ Chehebar GRAT, and $847,424.52 to Isaac Shehebar.

no profit or equity participation. It is these noteholders who should be compensated from the Receivership estate. The Chehebars were Par consultants who were entitled to a percentage of the company's profits, and they entered into their promissory notes with open-eyes after conducting their own extensive due diligence. Accordingly, the $56.6 Million balance of their notes does not need to be repaid from the Receivership estate and should therefore be deducted from the SEC's disgorgement calculation (which seeks repayment of all sums raised from noteholders that have not been repaid) since those amounts are not causally related to any violations of Securities Laws.

4. Deductions for Consulting Fees Paid to Outsiders

Part of Par's business practice was to retain consultants to help generate investment from potential noteholders. These consultants were profit participants who received a percentage on the transactions they generated. Several persons and entities who had consulting agreements with Par are Defendants in this case. For example, Cole and Abbonizio had consulting agreements, and the SEC has sought disgorgement of the consulting fees they received (and has acknowledged that the disgorgement sought from McElhone and LaForte should be offset by the amounts disgorged by Cole and Abbonizio). Likewise, McElhone and LaForte are entitled to an offset for the consulting fees paid to other consultants who were not included in this lawsuit – which total $8,620,102.26. (*See* Ex. 6, Consulting Summary).[21] *See, e.g., Sec. & Exch. Comm'n v. Almagarby*, No. 17-62255-CIV, 2021 WL 4461831, at *2 (S.D. Fla. Aug. 16, 2021), report and recommendation adopted, No. 17-62255-CIV, 2021 WL 4459439 (S.D. Fla. Sept. 29, 2021), and report and recommendation

[21] The consulting fees included in this sum were paid to following persons and entities: Lindsay Blake, Inc., Robert Frei, GEMJ Chehebar GRAT, Isaac Shehebar, AG Morgan, Alan Candell, Caetrina Talbot, Christian J Tamburro, Daniel A. Cistone, Daniel O'Neill, Fran Cassidy, Goldner & Associates, Howard Greenberg, Jacalyn Kerbeck, Keli M Falco, Mac Mrkting, Matthew Milstead, Mid Atlantic Brokers Inc., PTK Financial, Richard K. Armon, Robert Half, Robert Hughes, Tzvi Ozder and Vincent Ricciardi.

adopted, No. 17-62255-CIV, 2022 WL 832279 (S.D. Fla. Feb. 15, 2022) (deducting fees paid to finders from disgorgement award based on gross proceeds).

5. Deductions for Legitimate Business Expenses of Par

Importantly, the SEC's disgorgement calculation denies the Defendants any offset for Par's legitimate business expenses, asserting that it is "well-established" that such expenses should not be deducted from the disgorgement amount under the circumstances of this case. As support, the SEC cites to *Liu*, and its discussion of certain trademark infringement cases. This argument is not well taken for several reasons.

First, the portion of *Liu* the SEC cites is, at most, *dicta*, as the Court specifically declined to address the Petitioner's argument that the disgorgement judgment was improper because it did not deduct business expenses. *Id*. at 1950. Second, the case law the SEC relies on addresses the exception, not the rule. *See Liu* at p. 1945 ("The Court has carved out an exception when the entire profit of a business or undertaking results from the wrongful activity") (citations omitted) (emphasis supplied). The *Liu* opinion made clear that – where this limited exception does not apply – "courts consistently restrict[] awards to net profits from wrongdoing after deducting legitimate business expenses." *Id.* at 1946 (emphasis supplied). The Court went on to state that "declining to deduct even legitimate expenses from the receipts of fraud" is one of three main ways in which courts "test the bounds of equity practice." *Id*. The *Liu* opinion also noted that some of the petitioner's expenses, such as lease payments and certain physical equipment, presented potential deductions from the disgorgement – but remanded this issue to the lower court. *Id.* at 1950.[22]

[22] The SEC also cites *Rubber Co. v. Goodyear*, 76 U.S. 788, 803-4 (1870), for the proposition that a deduction for claimed expenses is not appropriate where the manner in which the defendants books and records were kept renders such an accounting impossible. But this holding has no application here, where Par kept detailed and accurate books and records which have been examined and relied upon by both the SEC's and the Defendants' experts, and where the Receiver

As discussed *supra*, the Defendants in this case ran a profitable business that generated significant returns for noteholders. In doing so, they incurred legitimate expenses that must be accounted for in any equitable disgorgement award based on Par's revenues. Though the Defendants have admitted the allegation of the SEC's Amended Complaint *for purposes of these disgorgement proceedings only*, those allegations merely state that the promissory notes they issued were unregistered securities and that they made certain misrepresentations and/or omissions in connection with the promotion and sale of the notes. Defendants categorically reject – and have thoroughly debunked – the SEC's unsupported and unpled allegations that Par used money raised from new investors to pay prior investors.[23] Indeed, prior to the Receivership, Par was a thriving company with 75 or more employees and had paid hundreds of millions of dollars in principal and interest to noteholders without ever missing a payment, except for a brief Covid related moratorium in April of 2020. As Defendants have stated, the reason that the Receiver has so many assets on hand is twofold. First, very substantial profits were generated from the MCA operations. Second, the Defendants did not squander their earned Consulting Fees; rather, they prudently invested in local commercial real estate and other hard assets and valuable investments. On these facts, Par clearly does not fit into the limited exception discussed in *Liu*, wherein expenses will not be deducted from profits because the entire profit of a business results from wrongdoing.

The central holding of *Liu* is that a disgorgement award "that does not exceed a wrongdoer's <u>net profits</u> and is awarded for victims is equitable relief permissible under § 78u(d)(5)." *Id*. at 1940 (emphasis supplied) (cited by *Sec. & Exch. Comm'n v. Faulkner*, No. 3:16-CV-1735-D, 2021 WL 75551, at *1 (N.D. Tex. Jan. 8, 2021)). "Courts may not enter disgorgement

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himself has validated Par's records and record keeping practices. *See* D.E. 1214-1, ¶ 4, 8-10.

[23] A fulsome discussion of the evidence refuting these allegations is found in the penalties section of this brief, Section V.

awards that exceed the gains made upon any business or investment, when both the receipts and payments are taken into the account." *Liu* at 1949-1950 (citing *Providence Rubber Co. v. Goodyear*, 76 U.S. 788, 804, 19 L. Ed. 566 (1869) (internal citations omitted)); *see also* Restatement (Third) § 51, Comment *h*, at 216 (reciting the general rule that a defendant is entitled to a deduction for all marginal costs incurred in producing the revenues that are subject to disgorgement); *See Almagarby*, No. 17-62255-CIV, 2021 WL 4461831, at *2 (in scheme involving unregistered dealers purchasing aged debt which they then converted into common stock and sold, disgorgement of *net profits* was proper, and was calculated by taking the total amount realized from defendants' sale of the stock less the face amount of the aged debt, brokerage commissions, fees paid to finders, fees paid for legal opinions and fees paid to transfer agents). These cases make clear that the disgorgement the SEC seeks from McElhone and LaForte – which is based on Par's net profits – must account for and deduct Par's legitimate business expenses.

As detailed below, a conservative estimate of Par's legitimate business expenses is $54.4 Million. The Defendants have attached as Exhibit 7, a profit and loss statement (the "P&L") showing Par's annual expenses by category, as well as Par's QuickBooks files and other books and records that backup these expenses.[24] The figures presented in the P&L are also confirmed by the expert report of Joel D. Glick of the accounting firm of Berkowitz Pollack and Brant. (*See* D.E. 535-1, p. 32).[25] As noted in the P&L, the Defendants have eliminated certain operational costs

[24] The SEC and the Receiver are also in possession Par's QuickBooks files and records and have the ability to verify these figures. Importantly, the Receiver's Declaration validated these records, stating that they were made "at or near the time of the occurrence of the matters set forth", that they were "kept in the course of regularly-conducted business activities of the Receivership Entities" and that it was the regular practice of the Receivership Entities to make and maintain such records. *See* D.E. 1214-1, ¶ 4, 8-10.

[25] Glick's analysis runs from 2012 through 2019, whereas the P&L prepared by the Defendants also includes expenses incurred in 2020 prior to the receivership. Glick's figures and the P&L are identical for 2012 through 2019.

which they acknowledge should not be deducted as legitimate business expenses. These include payroll to Mclhone and Cole,[26] processing expenses,[27] commissions paid to RMR,[28] consulting fees,[29] a fine paid to the Pennsylvania Department of Banking and Securities, factoring losses, and interest expenses.[30]

The remaining business expenses that should be deducted from McElhone's and LaForte's disgorgement equals $54,441,665.65.[31] As shown in the P&L, these legitimate business expenses include items such as banking fees, computer and internet expenses, insurance costs, janitorial services, legal fees, other professional fees (such as accountant and tax preparation costs), payroll to non-insiders[32] and utilities costs. All of these represent legitimate business expenses which the Receiver also incurred after taking over Par's operations.

6. Deductions for the Legitimate Business Expenses of FSP

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[26] *See* Ex. 7, Payroll Adjustments, p. 3-9.

[27] *See* Ex. 7, Processing Fee Adjustments, p. 10-12. Processing Expenses reflect payment from Par to FSP. As discussed in Section I. f., below, FSP was a Florida company formed to handle all of Par's processing functions, including payroll to employees, bookkeeping and internal accounting.

[28] *Id. at* p. 13-15.

[29] *Id.* Par has $92,921,152.43 in consulting fees on its books and records, however, a significant portion of these were paid to the Defendants and their entities, or to other defendants in this case. Because such payments are part of the profits the SEC seeks disgorgement of, they are removed from the Defendants' calculation of Par's legitimate business expenses. The consulting fees paid to outsiders (which McElhone and LaForte do seek credit for) are identified in Section I. d., above. These total approximately $8.6 Million – less than 10% of the total consulting fees paid.

[30] McElhone and LaForte do not address Par's tax costs in this section. Tax expenses *should* be deducted from their disgorgement, and are addressed separately in the Section 7, below.

[31] The Court should note that the Receiver's Quarterly Report reflects that Par's "Operating Expenses" from 2012 through the date of the receivership are $42.6 Million – and this category excludes all consulting fees and commissions, which are identified separately in the Receiver's spreadsheet.(*See* D.E. 1223-3, p. 2). McElhone and LaForte assert that their presentation of Par's legitimate business expenses is more accurate and complete and should be utilized by the Court. However, if the Court disputes these calculations, then – at a minimum – the $42.6 Million in operating costs identified by the Receiver should be deducted from disgorgement award.

[32] Par had up to 75 employees at its peak – at least 15 of which were rehired by the Receiver and are currently being paid a salary out of receivership funds to continue Par's operations.

In addition to deducting Par's expenses from the disgorgement calculation (as outlined above), the Court should deduct the legitimate business expenses of Par's affiliate entity, FSP, which played an integral role in Par's operations. In 2017, on the advice and recommendations of Par's tax accountants, Par moved its legal domicile to Florida, and McElhone formed FSP as a new Pennsylvania corporation charged with performing Par's essential back office functions, including employing and paying all employees who provided services to Par, handling processing and underwriting for Par's MCA, maintaining an office space for these operations, and performing all bookkeeping, in-house accounting functions, payroll, IT and HR services. The formation of FSP was done on the advice of Par's accounting professionals for tax management purposes and was a legitimate exercise of business judgment. Moreover, had FSP not been formed, these functions would have been performed by Par and the associated expenses would have been paid by Par.

FSP's expenses are reflected in a Profit and Loss spreadsheet obtained from Par's QuickBooks records, and total $12,769,171.47. (Attached as Exhibit 8). From this amount, McElhone and LaForte deduct $175,646 for consulting expenses which were paid to ESC – since this reflects payment to McElhone through her consulting entity.[33] They also deduct $336,230.34 in salary payments to Cole from the total Payroll Expenses,[34] and $40,546 in depreciation expense

[33] This adjustment was made by examining the QuickBooks records for FSP's consulting payments and deducting all payments to ESC. The remainder of ESC's consulting payments were made to outsiders and constitute legitimate business expenses.
[34] The remaining portion of Payroll Expenses is for salary payments to non-insiders who performed valuable work which contributed to Par's success and profitability. These are legitimate expenses – as evidenced by the fact that the Receiver rehired at least 15 of these employees to continue Par's operations and is paying them a salary out of the proceeds of the Receivership.

(since this is not a cash expenditure). After performing these adjustments, the total deductions for FSP's legitimate business expenses equals approximately **$12,216,749.13**.[35]

7. Deductions for Taxes

In addition to the expenses discussed above, Par's tax payments constitute a legitimate business expense that should be deducted in the disgorgement calculation. McElhone and LaForte were unable to obtain Par's tax returns from their prior accounting firm, Rod Ermel Associates, Inc.,[36] and have therefore reconstructed Par's tax payments by analyzing the checks Par paid to the Federal, State and Municipal tax authorities. These documented payments total $11,854,776.23[37] – though this amount appears to be incomplete and is subject to upward adjustment.[38]

The taxes that McElhone and her entities incurred on income she earned from Par's operations and/or distributions received from Par also constitute legitimate business expenses or equitable deductions. The tax liability for McElhone equals at least $13,049,072.45. (*See* Exhibit 10, spreadsheet of tax payments and supporting documents). Likewise, ESC paid $1,961,260 in taxes in connection with ESC's 2018 tax return and made $800,000 in pre-payments for ESC's

[35] As discussed above, the payments Par made to FSP for services have been deducted from the business expenses McElhone and LaForte claim against the SEC's disgorgement calculation. Accordingly, it is fair and equitable for the Court to deduct the operational expenses FSP incurred for the work it performed on behalf of Par from the disgorgement amount.
[36] Magistrate Judge Reinhart quashed their subpoenas to Ermel. *See* D.E. 1280.
[37] *See* Ex. 9, spreadsheet of tax payments and supporting documents.
[38] Additionally, McElhone and LaForte note that Par's 2019 taxes were not filed prior to the appointment of the Receiver and – to their knowledge – the Receiver has not yet filed Par's tax return for 2019 or 2020. Par's tax assessment for these years is also a legitimate business expense that should be deducted from the disgorgement calculation based on Par's net revenues. Accordingly, McElhone and LaForte reserve all of their rights to claim these sums as an offset to their disgorgement, to seek satisfaction of these tax liabilities out of the Receivership estate, or for other relief that may be appropriate.

2019 taxes. (*See* ESC Account Transcripts, attached as Exhibit 11).[39]

All of these sums should be accounted for in the Court's disgorgement analysis and represent an offset of at least $27,665,108.68.

8. Total Disgorgement for McElhone and LaForte

In summary, the starting-point for the SEC's disgorgement demand for McElhone and LaForte is the amount Par raised from noteholders minus the amount repaid. This equals **$246,400,000**. Starting with this number (which represents total net-proceeds from the issuance of Par's promissory notes), the Court must make several deductions to reach an equitable disgorgement figure.

First, the disgorgement judgments that have been or will be entered against the other defendants in this case, as well as the disgorgement judgments that will be entered against the defendants in the related AGM Lawsuit, should be deducted. The total sum of these disgorgement judgments will be up **to $38,100,840**.

Second, the balance owed on promissory notes issued to the Chehebars – who are insiders that had consulting agreements with Par and were profit participants in Par's business – should be deducted. That amount equals **$56,600,000**.

Third, **$8,620,102.26** in consulting fees paid to persons and entities who were not parties to this action should be deducted.

Fourth, the legitimate business expenses of Par and FSP should be deducted. Par's expenses are $54,441,665.65 and FSP's expenses are $12,216,749.13. Accordingly, the total deductions for

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[39] The $1,9621,260 ESC paid for 2018 excludes penalties and interest. Defendants lack information and records regarding ESC's total tax liability for 2019 and 2020, and likewise lack such information regarding taxes paid by FSP and HBC. McElhone and LaForte reserve all of their rights to claim additional tax sums as an offset to their disgorgement for these entities.

the legitimate business expenses of Par and its affiliate entity, FSP, are **$66,658,414.78**.

Finally, the documented tax expenses for Par, McElhone and ESC – which total at least **$27,665,108.68** – must also be deducted.

Under the calculation described above, the maximum amount of McElhone's and LaForte's disgorgement – even under the SEC's methodology – is **$48,755,537.28**.

9. Deduction for, or Satisfaction from, Receivership Assets

While the Court may request additional briefing and proceedings to address the value of the Receivership assets and how they will be applied against the disgorgement judgements, a fair examination of the Receivership estate reveals that there are more than enough assets to cover an equitable disgorgement judgment against McElhone and LaForte. Indeed, the Receiver's most recent report shows a cash balance of $103,527,145 as of March 31, 2022, and notes that the cash balance was $105,672,519 as of April 29, 2022 (an increase of more than $2 Million in a month's time). Assuming the current cash balance remains approximately $105.6 Million, and that the disgorgement award against McElhone and LaForte should be approximately $48.7 Million, the Receiver's cash holdings alone are more than double the amount needed for a complete disgorgement.

Even if the Receiver's available cash was not sufficient to cover disgorgement, Par's corporate assets are more than adequate to cover an equitable disgorgement.[40] The Receiver's report acknowledges that he is in possession of $354 Million in MCA receivables, $38 Million in other receivables (for ESC and HBC, which are solely owned by McElhone), and over $60 Million in real estate, amongst other significant assets. The bottom line is that the Receivership estate is worth more (far more) than will be needed to satisfy any fair and equitable judgment for

[40] In fact, these assets are more than sufficient to cover the $226 Million the SEC seeks in its inflated and inequitable disgorgement calculation.

disgorgement and penalties against McElhone and LaForte – and once any such judgement is satisfied, the remainder of the assets under Receivership will need to be returned to their rightful owners, (primarily) McElhone and LaForte.

C. Disgorgement Analysis: Cole

The SEC seeks disgorgement of $13,247,011 from Cole, asserting that this sum reflects the "funds we have identified as his ill-gotten gains." Significantly, the SEC does not explain the basis for its calculation, provide a declaration supporting its contention, or cite to any other record evidence as support.[41]

Although the SEC's analysis is opaque, it appears that its disgorgement figure is based on its mistaken belief that Cole received distributions from Par through New Field Ventures, LLC ("New Field"). This allegation was not pled in the Amended Complaint and is not deemed admitted for purposes of these proceedings.[42] Furthermore, the record evidence refutes this unpled allegation,[43] and the SEC has presented no evidence whatsoever to support its claim that Cole received distributions through New Field. The entities Cole has an ownership interest in, and received distributions through, are ALB Management and Beta Abigail. The Receiver calculates the total distributions from those companies to be $8.1 Million. (*See* D.E. 1223-3. Pg. 2). In addition, Cole received approximately $751,000 in salary and bonus payments over the course of

[41] The SEC states that because the Amended Complaint alleged that Cole received more than $14 Million from Par, he is handcuffed by his Consent and cannot contest this "fact." We do not address the $14 Million figure in this Response, we address the SEC's unpled allegation that it has identified $13,247,011 as Cole's gains.

[42] The Amended Complaint alleges that New Field was "Abbonizio's company with Cole" and that Cole had an "ownership or other beneficial interest" in New Field. (*See* D.E. 119, ¶ 19-20). However, these allegations do not assert what specific ownership interest or beneficial interest in New Field Cole supposedly had, or any specific sums that he would have allegedly received through New Field.

[43] *See* Cole Depo Transcript, p. 81, l. 17 to p. 82, l. 4 (attached Ex. 12); *see also* New Field Consulting Agreement, showing Perry Abbonizio was Manager (attached Ex. 13).

his association with Par,[44] as reflected in Par's books and records (*See* spreadsheet showing Cole W2 wages, Exhibit 14). Accordingly, the record evidence shows that the total income received by Cole was approximately $8,851,000 – rather than the $13,247,011 the SEC is seeking.

Of course, $8,851,000 represents Cole's gross income from his work for Par and should be the starting point for the Court's disgorgement analysis – not the ending point. Cole's tax liability – which totals $2,941,457[45] – should also be deducted from this amount, which would reduce the disgorgement amount to **$5,909,543**.

Finally, Cole has a 60% ownership interest in CS 2000 – which is currently under Receivership. Accordingly, the assets of CS 2000 (which Cole believes includes millions of dollars in MCA accounts receivable), should be applied against any disgorgement award entered against Cole in proportion to his ownership interest.

V. CIVIL PENALTIES

a. *Legal Standard*

Civil penalties serve both a punitive and deterrent purpose. *SEC v. Monterosso*, 756 F.3d 1326, 1338 (11th Cir. 2014); *SEC v. Sargent,* 329 F.3d 34, 41 n. 2 (1st Cir. 2003). Section 20(d) of the Securities Act and section 21(d)(3) of the Exchange Act authorize three tiers of monetary penalties for statutory violations:

> The first-tier penalty may be imposed for any violation; a second-tier penalty may be imposed if the violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement"; and a third-tier penalty may be imposed when the second-tier requirements are met and the "violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons[.]" *See Monterosso*, 756 F.3d at 1338 (*quoting* 15 U.S.C. §§ 77t(d)(2), 78u(d)(3)(B)).

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[44] This sum includes money received from Par as well as from FSP. In 2017, FSP was created to serve as the employer and paymaster for various employees who provided services to PAR. This was done on advice of accountants and attorneys, primarily for tax management reasons.

[45] *See* Ex 15, spreadsheet of Cole's tax obligations and supporting documents.

Civil penalties, if imposed, are within the sound discretion of the district court. *Id., citing SEC v. Warren,* 534 F.3d 1368, 1369 (11th Cir. 2008) (*per curiam*). The amount of a civil penalty is determined "in light of the facts and circumstances" of the case and subject to statutorily prescribed maximums. *See SEC v. BIH Corp.*, No. 2:10-CV-577-FTM-29, 2014 WL 7057748, at *3 (M.D. Fla. Dec. 12, 2014) (*quoting* 15 U.S.C. § 77t(d); 15 U.S.C. § 78u(d)).

> In evaluating the facts and circumstances of the case, the Court looks to factors such as: (1) the egregiousness of the violations at issue, (2) defendants' scienter, (3) the repeated nature of the violations, (4) defendants' failure to admit to their wrongdoing, (5) whether defendants' conduct created substantial losses or the risk of substantial losses to other persons, (6) defendants' lack of cooperation and honesty with authorities, if any, and (7) whether the penalty that would otherwise be appropriate should be reduced due to defendants' demonstrated current and future financial condition.

Id. (*quoting SEC v. Aerokinetic Energy Corp.,* No. 08–CV–1409, 2010 WL 5174509, at *5 (M.D. Fla. Dec. 15, 2010) (quotation omitted), *aff'd,* 444 F. App'x 382 (11th Cir. 2011)).

For the reasons set forth below, an analysis of these seven (7) factors makes clear that no penalty or – at most – a second tier penalty should be imposed.

b. <u>Analysis of the Seven Factors</u>

i. Scienter

Scienter is a factor for the Court to consider in determining penalty. Here, penalties should be crafted in recognition that this is, at worst, a disclosure case; not a theft case. The specific misrepresentation in the Amended Complaint are not causally related to any loss. Moreover, the SEC's allegations that the Defendants conducted a sham business – and did so intentionally – has been proven false.

The evidence shows that the Defendants built a powerful business with 75 employees and engaged teams of lawyers and accountants to ensure compliance. Those are the facts. The Defendants did not misappropriate noteholder funds, nor did they need to. The revenues created

by the financial model and its implementation were more than sufficient to pay consulting fees, and interest and principal to noteholders, without resort to using incoming noteholder funds. Indeed, there was a cash surplus.

Defendants did not use noteholder funds to pay other noteholders, nor to pay themselves. *See* D.E. 727-2, Expert Report of Joel D. Glick at p. 4 ("As a result of investor funds having been used entirely to fund merchant advances, an analysis of the cash transactions reflects, on a FIFO basis, consulting fees were not paid with Investor Funds");[46] *see also* Report of David Dunkelberger at 10[47] ("Glick presents a rational analysis of monthly inflows and outflows to illustrate that CBSG's cash flow was not relying on additional capital to make payments to noteholders. Additionally, merchant receivables collected were adequate to cover commissions paid to merchant brokers and consulting fees to management. Consulting payments could not have come from noteholder funds due to logistics of cash flows received, and payments for consulting fees were determined by prior quarter funding. Noteholder funds were already exhausted in merchant cash advance funding before quarterly consulting payments were made.")

ii. The Defendants Created a Powerful, Lawful Business[48]

From its inception in or about 2012, the business of Par and its affiliates grew to include up to 75 or more employees including 15 accountants. Par routinely turned to outside auditors and counsel as well as in-house counsel to guide its affairs and ensure compliance. The company attracted large, sophisticated investors[49] who engaged in substantial due diligence before investing

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[46] Attached hereto as Exhibit 16.
[47] Attached hereto as Exhibit 17.
[48] *See*, generally, D.E. 84.
[49] As per the deposition testimony of CBSG/Par Controller and CPA James Klenk, large investors who received equity participation are identified as "investors"; individuals who received promissory notes at a stated rate of interest and no equity participation (usually coming to Par through an agency fund), are identified herein as "noteholders." Noteholders are not investors in

tens of millions of dollars. Some of those investors provided Declarations to the Court at the beginning of the SEC case attesting to their relationship and understanding of the business. *See* Declaration of Norman M. Valz (D.E. 132-1); Declaration David L. Alperstein (D.E.148-10); and Declaration of Vincent J. Camarda (D.E. 148-11).

The MCA business model is easy enough to describe, but its operations rely on extremely complex math and require teams of people expert in the financial calculations to effectively run the business. It also requires highly sophisticated accounting to track performance and revenue, which is why Par came to hire up to 15 in-house accountants in addition to utilizing an external accounting firm – Rod Ermel and Associates – who had a direct access portal into the books and records, daily revenues and cash flow of Par. Par's performance was largely dependent on the quality of the merchants it funded, which is why Par utilized an impressive 750 gigabyte, custom built underwriting platform to collect and analyze merchant financial data, [50] and ended up funding only 17% of merchant applicants.[51] Merchants received funding from Par on future receivables with a promise to repay that funding by paying a contracted amount per day to Par. Often, merchants requested additional funding before the initial funding was repaid. Payments received from the merchants were often reinvested in other MCA funding deals. All of this complex math

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the company and received no shares or equity interest.

[50] *See* D.E. 535-1 at ¶ 39, Declaration of Joel Glick, attached as Ex. 18.

[51] The SEC claims that "LaForte oversaw the day-to-day operations of the underwriting department at Par Funding and decided which Loans to fund. Accordingly, he knew or was reckless in not knowing that statements that Par Funding conducted rigorous underwriting and conducted an on-site inspection of the small businesses were false." (*See* D.E. 1252 at p. 38). However, Glick confirmed Par's robust underwriting procedures and17% funding rate. The SEC was not even aware of Par's underwriting platform when they brought the case. (*See* DE 649 at 6 n. 8). Nor was the SEC aware that the company used merchant verification services which took photos of the merchants, accumulated financial data on the merchants and provided it to CBSG. All of that data was entered into Par's underwriting data base. Defendants concede that some reloaded companies were not viewed again prior to the MCA reload.

was multiplied by thousands of funding deals. Indeed, Par funded 7,600 merchants across the country and executed over 17,000 funding deals. Calculating performance and revenue was a hugely sophisticated task, which is why CPA Joel Glick had to painstakingly analyze over 4.2 Million transactions to verify the financial performance of Par in his four reports. *See* Ex. 17 and Ex. 18; Glick Declaration dated July 13, 2021, D.E. 649-8;[52] and Expert Rebuttal Report of Joel D. Glick, D.E. 803-2.[53] No other expert even attempted to analyze Par's 4.2 million transactions, and no other expert analyzed Par's cash flows in accordance with GAAP standards. Furthermore, Mr. Glick's reports have been examined and verified by CPA David Dunkleberger. (*See* Ex. 17).

The core of Par's business was collections from merchants. Inevitably, some merchants at times fall into arrears or do not pay all that is contractually due – which is why Par hired lawyers to bring actions or reach settlements with delinquent merchants. However, as we have reported to this Court before, the number of lawsuits bears no relationship to profitability or to the cash over cash default rate. (*See* D.E. 663 at p. 18). This is because a lawsuit or the filing of a Confession of Judgment ("COJ") is occasioned by the merchant's failure to pay as per the terms of the contract. Thus, a merchant can receive $100 in funding under a contract that provides for the payment of $130 in 100 days. If the merchant pays $120 by day 80 but fails to make any additional payments, the funding is still profitable even though the merchant did not comply with the contract and could be sued. In that scenario (referred to as 'cash-over-cash'), Par is up 20% on the original funding in just 80 days. The merchant's signed COJ could be filed, or not, depending on the financial viability of the merchant and the efforts the merchant has made to continue payments. The power of this financial model – borne out and proven by teams of accountants, tax returns filed with the IRS,

[52] Attached hereto as Exhibit 19

[53] Attached hereto as Exhibit 20.

and by the Glick Reports – is self-evident.

Since Par began receiving noteholder or investor funds in 2012, it had never missed a payment (except) for a short Covid-related moratorium in April 2020) and it paid interest averaging 15-20% per annum to noteholders and investors. Because of the powerful financial models used to run the business, Par attracted large, sophisticated investors. For example, two brothers conducted a thorough due diligence investigation using their own accountants and experts and invested $40 million. Similarly, another sophisticated investor conducted a separate comprehensive due diligence investigation and invested $60 million. And an attorney for a fund invested approximately $10 million. Likewise, James Klenk (a CPA and the Controller of Par since 2018, who is still working under the Receiver) testified that Par was having meetings with a large financial institution and a large investor who was interested in purchasing a substantial percentage of Par. (*See* Klenk Depo. at 131-132, attached as Exhibit 21). In fact, in 2020, Par was valued for potential purchase by these sophisticated potential investors at around $800,000,000.

And, contrary to the suggestion in the SEC's Amended Complaint, there is no question that the MCA business is perfectly legal – it has been affirmed by courts throughout the country. *See* Chart of MCA Approved Cases, DE 663-1; *see also* Transcript of Berman Deposition at 105:16-23, attached as Ex. 22 ("…we filed a lot of briefs in court addressing the legality of the merchant cash advance business and the fact that they were not usurious or loans or anything of the sort."); 236:18-237:15 (… Did we take the position these are not usurious or illegal loans? Yes. Do I believe that sitting here today? Yes. And the reason I believe that are the court opinions around the country that have upheld the legality of this type of business."); and 237:24-238:4 ("Q. Is it your understanding that [Mr. Cole] had an opinion with respect to whether these advances were usurious based on the pleadings that you provided to him? A. I think that Mr. Cole had an

understanding that this was not illegal."). Indeed, after a period of examination. the Receiver began ending litigation holds and re-opening litigations against merchant debtors. The Receiver has thus far filed forty-three motions to lift litigations holds and – through its actions, as well as its statements of the Court – has ratified Par's MCA Factoring Agreements as legal and binding contracts. *See* Receiver's Feb. 21, 2021 Quarterly Report, p. 8 ("Certain investors have also suggested that the Receiver aggressively collect merchant cash advance ("MCA") balances from all merchants… The Receiver is utilizing practices that are lawful and consistent with the characterization of the Par Funding receivables as merchant cash advances").

1. Experienced Certified Public Accountants were Advising Par

In or about 2014, Par Funding employed Joseph Cole Barleta as its Chief Financial Officer. Pursuant to tax advice, Par restructured its business operations in 2017. Thereafter, an affiliated company, FSP, handled Par's day-to-day operations. *See* Exhibit 12, Cole Deposition Tr. at 19:16-20. In 2018, James Klenk was hired as its Controller and Ariel Benjamin Mannes, as its Chief Compliance Officer. *See* Exhibit 21, Klenk Depo. at 8:19-22. Mr. Klenk quickly grew the in-house accounting staff to 15.

In his deposition testimony, James Klenk, the current Financial Controller at CBSG/Par since 2018, made clear that Par did not use noteholder funds to pay noteholders. Further, he dispelled any notion that Par's financial condition was precarious. Mr. Klenk's first duties at Par "were to get CBSG and some of the other MCA companies GAAP compliant…" (Ex. 21 at T. 9, 31). This process was part and parcel of the audits of CBSG and other entities already commissioned by the company. (*Id.* at T. 10, 31-32). In 2018, Par hired Friedman LLP to conduct a full audit of the 2017 tax year. Mr. Klenk was the primary contact with the Friedman audit team. (*Id.* at 11, 32-36). The purpose of the audit was to have audited financials for potential purchasers

or joint venturers of Par. (*Id.* at 32) Over the course of 2018 and 2019, Par's books and records were analyzed and reviewed by at least the following CPA's and CPA firms: James Klenk; Rod Ermel, Ken Bacon and Dan Kinney; Friedman, LLP and its CPAs Anthony Barone (Senior Auditor), Svetlana Tsiaptseyeva, and Willem Vanderburgh; and the firm of Clifton Larson Allen (CLA) and its CPAs June Park and Rick Huff. (*Id.* at 32-36, 50-53, 142).

Mr. Klenk made clear that in no manner did he agree that note holder monies were being used to pay other note holders. To the contrary, he testified that the company (and its tax returns), reflected significant profitability. (*Id*. at 86: Q: Did you think this was a Ponzi scheme?; A: No, I did not think it was Ponzi scheme"; (*Id.* at T. 93: So, going back to these three meetings that you were present at in, was in any of those three meetings was there any discussion about the profitability of CBSG?; A: Again, on a high level, yes, it was a profitability company. (Transcription error)).

Indeed, Par's "factoring revenue" in 2018 was about $124,000,000 (*id*. at T. 128) and Par's 2018 tax return, prepared by the Ermel firm, showed income of $123,238,999.[54] (*id.* at T. 156). As Mr. Klenk stated, "You're looking at revenue. This is the revenue of last year cost of sales is what you are looking at up top." (*Id.* at T. 156-57) This data, including the filed tax returns of Par, is squarely consistent with the four Glick Reports which were authored by the firm Berlowitz Pollack Brant Advisors and filed with this Court. The Berkowitz firm – the leading forensic accounting firm in Miami – analyzed 4.2 million transactions and engaged in extensive analysis to reach its conclusions. For 2019, we understand that the Ermel firm-prepared estimated tax returns reported Par revenues of $179,000,000. (*See* Ex. 23, p. 140). It is unknown whether the Receiver filed this

[54] *See* Ex. 23, Par's 2018 Form 1120 Return Summary and tax return, and Par's 2019 Form 1120 Return Summary, attached as Ex. 23.

return or what the Receiver ultimately reported as Par income for 2019.

2. Par Sought and Obtained Qualified Legal Advice

From the start, Par obtained and relied upon the advice of counsel. In 2014, the law firm Offit Kurman produced Par's initial promissory note/security agreement for use in raising capital through third party creditors in the form of debt. The instrument typically provided for monthly interest and principal payments over 12 to 24 months. The notes ranged between $50K - $500K in principal, with some creditors purchasing multiple concurrent notes. Importantly, Offit Kurman issued an opinion letter, dated April 25, 2014, on the legality of the funding business under Pennsylvania law and the purchase and sale of future receivables agreement. *See* Opinion Letter of Jason C. Berger of Offit Kurman dated April 25, 2014.[55] In July 2016, a securities lawyer and Partner at DLA Piper reviewed and edited the Notes. DLA Piper added language that said, "This note has not been registered under the Securities Act of 1933 . . ."[56] DLA Piper, and other attorneys, were certain that the notes were debt instruments and not securities and made this clear to the principals of Par and creditors. Their advice to the principals of Par included: Opinion Letter of Jason C. Berger of Offit Kurman dated April 25, 2014; Opinion Letter of Norman Valz dated

[55] *See* Ex. 24, various opinion letters provided by Par's counsel.

[56] *See* Sample Note drafted by DLA Piper (DLA0000397), attached hereto as Exhibit 25. SEC claims that "[McElhone and LaForte] engaged in hundreds of separate violations in connection with their investor solicitations, and they orchestrated this multi-year massive fraud, operated Par Funding with Cole in a fraudulent scheme, controlled Par Funding and its unregistered and fraudulent offerings, and profited handsomely to the tune of at least $100 million." (*See* D.E. 1252 at p. 36). The SEC argues further that "[McElhone and LaForte] operated a multi-year unregistered securities offering fraud that raised about half a billion dollars from investors," and "Par Funding executed numerous securities in the form of promissory notes during the course of the fraudulent scheme, some of which McElhone signed." *Id.* However, the Defendants clearly relied on the advice of reputable counsel in concluding that the Promissory Notes were not securities. Had they understood the Notes were securities, they would have registered them as such. The Promissory Notes themselves were drafted by counsel.

March 31, 2016; Email from Martin Hewitt to Cynthia Clark dated March 1, 2019.[57] To be clear, none of the Defendants ever drafted a legal document in connection with the business or had the requisite legal expertise to do so. All of the agreements, contracts, consulting agreements, promissory notes, and other legal documentation were drafted by counsel.

In December 2017, CBSG/Par retained noted securities regulation expert, Philip Rutledge. Three states had made regulatory claims against CBSG arising from the payments between CBSG and the agency funds. Mr. Rutledge was empowered to make any changes in the business structure necessary to address these regulatory issues. For example, to improve Par's compliance, Mr. Rutledge introduced a note purchase agreement and changed the business structure so that the company would not be involved with soliciting and raising capital from noteholders. He also registered Par in Pennsylvania under SEC section 503b for its non-principal debt instruments. In January 2019, Par's counsel reviewed and filed all state registrations needed for its current creditors.[58] Similarly, in early March 2020, when payment issues were raised by the Texas Securities Commission, attorneys from the law firm Haynes Boone and lawyers from that firm with substantial SEC and regulatory experience, were engaged to address the issues.

All along, Par also employed full time in-house counsel. These lawyers included Norman Valz, Cynthia Clark, Peter Mulcahy, John Hartley, Brian Smith, and David Alperstein. In late 2019, Par engaged Fox Rothschild LLP to serve as primary counsel for litigation over collections

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[57] *See* Ex. 24.

[58] The SEC argues that "[McElhone and LaForte] designed and orchestrated the offering through Agent Funds in order to circumvent securities registration laws[.]" (D.E. 1252 at 36). If hiring expert securities counsel to revise the agreements and draft new legal documents to ensure compliance is "circumventing" the securities laws, then every financial institution does so. When the Defendants, acting on the advice of counsel, restructured Par's business to use Agent Funds after settling with PADOBS, they were not circumventing the securities laws - they were complying with them.

and defaults by merchants, which included handling existing and new litigation in Philadelphia (all of the Par's agreements have Philadelphia venue provisions). Fox Rothschild also was engaged to defend against litigation (albeit meritless), brought by a select group of merchants through one Philadelphia law firm trying to void the MCA agreements. Fox Rothchild's collections work generated substantial revenue for Par. *See* Ex. 22, Berman Depo. at T 91:18-92:4 ("Q. And how much were you able to collect? A. Significant amounts of money because not -- I don't know the exact number. I'm sorry. But there were a lot of deals made based on confessions that were filed to do modification agreements, and that led to collection of money.)

In March 2020, at the outset of the COVID-19 pandemic, merchant defaults increased due to government shut-down orders, and Par – like nearly every business in America – experienced setbacks as a result. Par engaged both Phil Ruttledge and Fox Rothschild to again review the notes outstanding with investors and noteholders and create a comprehensive Exchange Offer that sought to recapitalize the existing debt. *Id*. Mr. Rutledge also provided advice regarding required disclosures. (*Id.* at T. 54-58, 61, 66-67). Thereafter, a formal Exchange Offer was sent to all existing investors and noteholders which provided substantial disclosures regarding the three state regulatory actions (Pennsylvania, New Jersey, and Texas), along with disclosures concerning litigation, UCC liens, potential new note offerings, risks associated with the MCA business and other key points. Moreover, as part of the Exchange Offer, Mr. Ruttledge filed public disclosure documents with the SEC and various state law blue sky filings. As we have previously reported, fully 95% of the noteholders and investors signed on to the Exchange Notes. (*See* D.E. 148 at 6). As the SEC has acknowledged, Par spent over $6 million on legal compliance. (*See* Declaration of Melissa Davis, D.E. 290-8 at ¶ 18) ("The Par Funding Accounts reflect that from July 2015 to June 2020 Par Funding paid $5,909,322 to law firms.").

3. ***Par Made Money for its Noteholders***

Since its founding in 2012, and until the SEC's action here and the involvement of the Receiver, Par had never missed a payment to noteholders – except for the brief payment moratorium during the heart of the Covid lockdowns – and noteholders and investors enjoyed a premium return. Except for the brief Covid-related moratorium, there was zero default on principle and interest payments to noteholders and investors. Likewise, there is no evidence that Par ever missed a redemption requested by a noteholder or investor.

Par's actual merchant default rates were also excellent. Prior to the Receivership, the merchant cash over cash default exposure was 1.2%. This means that of all merchants receiving $100 in cash from Par, only $1.20 (1.2%) was defaulted on.[59] This cash over cash default rate was verified through painstaking analysis by CPA Joel Glick. (*See* Ex. 16, at *passim*). GAAP compliant outside audits were performed by Clifton Larson Allen (CLA), Friedman LLP and others in 2017, 2018 and 2019, and the most recent audit by CLA was in final review in July 2020. These expensive and time-consuming audits were commissioned by Par. The numerous CPAs assisting Par filed tax returns reflecting $134 million in revenue for 2018 and a CPA-prepared tax return for 2019 shows revenue of $179 million. All IRS tax returns must be GAAP compliant.

As of July 28, 2020, the balance sheet for Par reflects that the company had just over $26 Million in cash,[60] and just over $421 Million in fixed receivables from merchants. (*See* CBSG Cash Position Summary, attached as Exhibit 26). The company's monthly cash flow from merchant deposits was approximately $30 million. The company's monthly operating costs were

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[59] Again, the number of lawsuits brought against merchants was irrelevant to this analysis as collection lawsuits were routinely brought on MCA deals which, while profitable, nonetheless failed to fulfill the contract terms.

[60] The cash holding is comprised of the balance of cash on hand, cash pending, available ACH funding, pending ACH funding and ACH payment processing.

about $5 million which included salaries, office rent and other monthly business expenses. At the time, two million ($2 million) was scheduled to be released to noteholders/creditors. The strength of the Par's portfolio in July of 2020 (the height of Covid lock-down) and its growth over the prior year is detailed in the KPI report.

Importantly, in February 2020, Par decided not to raise any new capital. Par renegotiated with its noteholders, reducing interest rates to 5% across the board to account for reduced receipt of merchant payments due to the onset of the Covid pandemic. Notwithstanding the decision not to raise any new capital, Par's profitability was such that it could still pay – and did pay – $18M in interest to noteholders and creditors from March 2020 through May 2020. David Dunkelberger, CPA, has attested to the significance of this fact:

> The fact that cash flows generated by CBSG (primarily, collection of merchant accounts receivable) during the period April 2020 through July 2020 were sufficient to cover the interest and principal payments to noteholders, without any additional capital from noteholders, is significant. This proves that the fees generated from the funding portfolio were sufficient to cover interest and principal payments with no outside funding from noteholders. *See* Ex. 17 at p. 5.

But for the SEC's action, Par was anticipating paying approximately $46 Million in interest to noteholders under the restructured notes in 2020 alone. Prior to the SEC's action in July 2020, Par had historically collected about $3,788,689.40 per week from its merchant MCA portfolio.[61] The merchant MCA portfolio was obviously profitable, generating significant revenues that were reported on Par's tax returns. This profitability was confirmed by all of the CPA's engaged by Par, by Par's tax returns (which were prepared and filed by CPAs), and by Joel Glick (a CPA) who after analyzing all of the transactions according to GAAP methodology, found a rate of return on Par's MCA portfolio of 34-39%. (*See* Ex. 18 at p. 5 and 9; *see also* Ex. 17, confirming analysis).

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[61] The average weekly collections were: $639,424 in 2015; $1,231,839 in 2016; $3,266,997 in 2017; 6,343,946 in 2018; and $7,461,241 in 2019. *See* Ex. 16 at 32-36.

ii. Substantial Loss or Risk of Loss

The above analysis confirms that Defendants did not put Noteholder funds at risk. The SEC claims that the Defendants utilized noteholder funds to pay interest and principal to Noteholders and to pay themselves Consulting Fees. (*See* D.E, 1252 at p. 36-37). Similarly, the SEC claims that "McElhone authorized the filing of Par Funding's filings with the SEC, falsely reporting that she and Cole would not receive any of the gross proceeds of the offering and that there were no finders' fees." (*Id.* at p. 38). The SEC claims that these alleged circumstances created a substantial risk of investor losses. (*Id*. at 39 and 41).[62]

These assertions are false. As has been exhaustively proven, Consulting Fees were generated from MCA deal profits – they were not taken from noteholder funds. Par did not need to use, and did not use, Noteholder funds to pay Noteholders interest or principal and did not use noteholder funds to pay the Consulting Fees. Indeed, the only reason that the SEC makes these unfounded claims is because the allegations in the Amended Complaint do not warrant tier three penalties. Defendants have now produced two experts – and GAAP compliant reports – explaining that Par was a highly profitable business that did not need to use, and did not use, noteholder funds to pay noteholders of Consulting Fees. *See* Ex. 16 at p. 4 ("As a result of investor funds having been used entirely to fund merchant advances, an analysis of the cash transactions reflects, on a

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[62] The SEC also claims that "when McElhone and LaForte were caught, they lied to the Court about it. Specifically, while an asset freeze was in effect against them, they advised the Court that they were maintaining the status quo with the respect to the properties purchased with investor funds – when in truth, they had transferred at least one property to a third party while that asset freeze was in effect." (D.E. 1252 at p. 37) (footnote omitted). We believe that this reference is to the so-called Liberty Eight transfer that is currently being litigated in civil court in Texas. When the SEC raised this issue, among others, in an Order to Show Cause directed against Fox Rothschild and McElhone (*see* D.E. 757), the Court cautioned against such "scorched earth" tactics, suggested that the SEC withdraw the filing, and directed a substantial meet and confer prior to such allegations. *See* Response to Order to Show Cause filed by Lisa McElhone dated September 19, 2021 (D.E. 780); Court Conference dated September 20, 2021 at T. 21-25, 36, 51-53.

FIFO basis, consulting fees were not paid with Investor Funds.") *See* Ex. 17 at p. 10 ("Glick presents a rational analysis of monthly inflows and outflows to illustrate that CBSG's cash flow was not relying on additional capital to make payments to noteholders. Additionally, merchant receivables collected were adequate to cover commissions paid to merchant brokers and consulting fees to management. Consulting payments could not have come from noteholder funds due to logistics of cash flows received, and payments for consulting fees were determined by prior quarter funding. Noteholder funds were already exhausted in merchant cash advance funding before quarterly consulting payments were made.")

These reports are fully corroborated by CBSG's filed, GAAP compliant tax returns reporting very significant revenue, by the testimony of James Klenk, and by the work of teams of CPAs who have examined the books and records of Par over the years.

iii. Egregiousness

In this category, the SEC claims that "LaForte utilized a trail of aliases to conceal his identity as a convicted felon from investors[.]" (D.E. 1252 at 36). Defendant LaForte acknowledges that he could have made more disclosure in this regard. As indicated in previous filings, Mr. LaForte used a pseudonym to protect his family because he was involved in that portion of the business which may have incited threats from merchants (not investors) when Par's lawyers used lawful and available collection techniques, including the filing of COJs. However, the evidence is clear that everyone at Par, including every lawyer who advised Par – both in-house counsel and external counsel – were aware of Mr. LaForte's criminal history. As Mr. Berman testified, "everybody knew he had a criminal conviction…..He didn't hide it from anybody." (*See* Ex. 22, Berman, Depo at T. 78-86). Mr. Berman testified that Mr. LaForte's convictions were public and easily obtainable and were regularly used by opposing counsel in litigation. *Id.* Indeed,

it is "100 percent" certain that Phil Rutledge was aware of Mr. LaForte's criminal history and, importantly, the attorneys discussed whether it needed to be disclosed. (*Id*. at T. 207-09). Had Mr. LaForte been advised to make additional disclosures, he would have.

The SEC rests some of its penalty arguments on disclosure claims. For example, the SEC claims that "LaForte helped draft the marketing materials[.]" (D.E. 1252 at p. 37). The SEC also claims that "as CFO Cole knew Par Funding's true financial status and yet created the false marketing materials touting Par Funding's success for Abbonizio, Vagnozzi, and others to distribute to potential investors." (*id.* at p. 40). And the SEC argues that "[Cole] prepared new false marketing materials touting the 1% default rate every month for years." SEC's Revised Omnibus Motion (*id.* at 41).

The Defendants acknowledge that the marketing materials could have contained more extensive and explicit disclosures as to the different types of default rates and their precise definition. But as indicated herein and confirmed by: Mr. Glick's three reports; by the tax returns filed by CBSG; by the testimony of James Klenk; and by the new report prepared by CPA David Dunkelberger, which confirms the work of Mr. Glick; and by all of the CPAs engaged by CBSG, Par Funding's true financial status was a healthy, indeed, very powerful financial company. There is simply no way around that fact. Mr. Cole's KPI analysis was correct and confirmed by Mr. Glick. (*See* Ex. 19 at *passim*).

The SEC claims that "McElhone authorized the false marketing materials for distribution to investors[.]" (D.E. 1252 at p. 36). This is simply not true. Ms. McElhone did not authorize any marketing material. Nor did Ms. McElhone distribute the marketing materials or approve them for distribution to investors or noteholders. Alexis Abbonizio (Perry Abbonizio's daughter) distributed it, at Mr. Abbonizio's direction – a fact that came out during the Furman trial and is

acknowledged in the SEC's recent Complaint filed in the AGM Lawsuit. (*See* Ex. 3). The SEC also claims that "[LaForte] helped draft the false offering documents." (D.E. 1252 at p. 37). This too is false. All legal documents, including the offering documents, were drafted by qualified legal counsel. There is no evidence to the contrary. There is no evidence showing that Mr. LaForte drafted legal documents. Par paid lawyers over $6 million to do so.

The SEC claims that "As the Court found when granting the SEC's TRO in July 2020, their conduct was egregious, and the evidence since then has only strengthened that finding." SEC's Revised Omnibus Motion (D.E. 1252 at 37). However, had the Court been provided accurate information in the TRO regarding the company and not been provided with false claims, i.e., "funds to Georgia," the Court may not have granted the TRO. *See* Motion to Dismiss the Complaint pursuant to Rule 41, D.E. 663; Court conference of August 25, 2021. And the discovery ultimately provided shows that Par was a strong thriving business.

The SEC claims that "Cole's conduct was also more egregious because he prepared the false document distributed to investors claiming that Par Funding's default rate was only 1% when in fact it was at least 10 times that amount[.]" (D.E. 1252 at p. 40). This is simply inaccurate. *See* Ex. 19 at *passim*). The SEC also claims that "as CFO Cole knew Par Funding's true financial status and yet created the false marketing materials touting Par Funding's success for Abbonizio, Vagnozzi, and others to distribute to potential investors." (*id*. at p. 40). But, as addressed throughout this memorandum, the "true" financial status was a powerful, profitable company.

In July 2020, the SEC, using inaccurate allegations and based on a woefully insufficient, indeed, a grossly negligent investigation,[63] brought a bad case and obtained a TRO against a

[63] *See* Motion to Dismiss the Complaint pursuant to Rule 41 filed July 28, 2021 (D.E. 663); August 25, 2021 Conference.

profitable, thriving company where no investor or noteholder had been harmed and no noteholder or investor complained. This case did not originate from Par investors – it originated from Par's MCA merchant clients who received and owed millions of dollars. The Defendants cannot be blamed for the SEC's *ex parte* actions here, and the SEC's failure to communicate with Par counsel about their allegations, or properly investigate them, prior to filing this action. And the Defense cannot retroactively change the facts on the ground to conveniently fit the SEC's unfounded factual theories. The Defendants should not be sanctioned for their refusal to agree with unfounded and inaccurate allegations.

iv. Repeated Nature of Violations

With respect to McElhone and LaForte, the SEC asserts that the violations set forth in the Complaint "occurred for at least 5 years, and involved the solicitation of hundreds of investors through deceit." (D.E. 1252 at 38). The same argument is made concerning Mr. Cole. *Id.* The Defendants have acknowledged the registration and disclosure issues. The foregoing notwithstanding, hundreds of investors do not equal hundreds of violations. There is no discernable analysis in the Omnibus Motion of which marketing materials were created by Cole and which were created by consultants (*e.g.*, Abbonizio and his lawyer, Vagnozzi, *inter alia*) or which noteholders purchased because of oral representations at seminars or statements made over the internet – over which these Defendants had no control. The fact is that the SEC has utterly failed to show how many separate violations occurred – let alone how many of those violations can fairly be attributed to these Defendants.

v. Admission of Wrongdoing

The SEC claims that the defendants have not admitted any wrongdoing. (D.E. 1252 at p. 38, 41). It is true that Defendants deny that they used noteholder money to make interest or

principal payments or misappropriated funds from noteholders. Nonetheless Defendants have acknowledged the registration and disclosure issues. Moreover, the Defendants entered into consent orders, thus accepting responsibility for their actions and avoiding a lengthy and complex trial and the attendant drain on SEC and Court resources such trial would occasion.

vi. Cooperation

The SEC argues that the Defendants "have litigated against the Receiver from the outset of this case, complicated collections efforts by the Receiver, and utterly failed to cooperate." (D.E. 1252 at p. 38, 41). Defendants disagree. Joe Cole endeavored to assist the Receiver early on. An examination of the filings in this case shows that the overwhelming efforts of the Defense in this case were, initially, to keep the company alive and healthy, create a plan for the company's future, and to avoid a liquidation; and then to rebut inaccurate factual claims made about the company, its finances, its operations, and the principals. Such litigation was both appropriate and necessary.

Further, the SEC previously complained to the Court about the Defendants' actions in defending themselves and filing motions, which the Court flatly rejected. Specifically, at the hearing on Laforte's Rule 41 Motion to Dismiss [D.E. 663] on August 25, 2021, the Court stated:

> Listen, everyone here is doing the very best they can on behalf of their clients, and I will say this, and I understand the SEC's view of the evidence, but at the same time, this is an adversarial process, Ms. Berlin. You know that. You know that I agree with you that we need to make sure we have all due respect paid to all parties. I don't think it's fair to malign defense counsel for attempting to mount a vigorous defense on behalf of their clients. It's what they are here to do, and I wanted to give them today's audience to do that. I think it's only fair. (*See* Rule 41 MTD Hearing Transcript at 241:1- 242:23).

c. Civil Penalties

As demonstrated herein, Defendants' conduct did not lead to substantial investor losses or the risk thereof. For these and the many reasons set forth above, Tier-2 Civil Penalties should apply and consideration of the factors weigh strongly against severe penalties.

Defendants have surveyed civil penalties imposed in the district courts within the Eleventh Circuit since May 1999 – 91 cases covering a period of 23 years. Defendants' analysis can be found in the Chart attached as Exhibit 27.[64] This chart shows that the average court ordered penalty in the last 23 years has been $1,390,867.45. It further shows that courts in this circuit imposing Tier 2 penalties apply penalties between 3% and 30% of disgorgement, with an average of 15%. Further, when the most egregious cases in which a court-imposed penalties at sums greater than disgorgement are removed, courts in this circuit imposing Tier 3 penalties apply penalties between 3% and 100% of disgorgement, with an average of 43%.

Here, for the reasons set forth above, McElhone's and LaForte's Disgorgement should be $48,755,537.28. Therefore, Defendants suggest that penalties of $5,000,000, or approximately 10% are appropriate. In no event should penalties be greater than 15% or $7,313,330.59.

The SEC cites to *SEC v. Shapiro*, 2018 WL 7140669 and 2018 WL 7140359, 17-cv-24624 (S.D. Fla.) (Dec. 27, 2018), for support that $100 million dollars in penalties is appropriate for Mr. LaForte and Ms. McElhone. That case is inapposite. First, and most glaringly, Shapiro operated a $1.2 billion dollar Ponzi scheme. Defendants here did not. Second, in Shapiro, the Court did not have an opportunity to opine on the penalties, which were not litigated. The SEC included in its Motion for Final Judgement a Consent Order signed by Mr. Shapiro in which he consented to just over $20 million disgorgement and prejudgment interest and a $100 million dollar penalty. The SEC did not have to argue for penalties, the Defendant Shapiro did not dispute the penalties,

[64] This chart was created, first, by performing a search for cases in the Eleventh Circuit (and district courts within the Eleventh Circuit) with the terms "SEC", "Civil Penalties" and "tier". That search yielded 91 results. Cases from May 1999 through the present have been reviewed. The results were imported as a spreadsheet from Westlaw. Most of data was inputted manually. The pivot chart was created using the "Pivot Chart" function in Microsoft Excel. The Chart is divided into defendants where the penalty as a percentage of disgorgement is "calculable" or "incalculable."

and the Court did not have to opine on the penalties. Third, Woodbridge went into Chapter 11 Bankruptcy (Case No. 17-12560-KJC (Bankr. D. DE)). *Sec. & Exch. Comm'n v. Shapiro*, No. 17-24624-CIV, 2018 WL 7140359, at *1 (S.D. Fla. Dec. 27, 2018). That has not happened here. Par was a thriving, successful company.

As discussed *supra,* Defendant Cole's Disgorgement should be $5,909,543. Therefore, Defendants suggest that penalties of $600,000, or approximately 10% are appropriate. Certainly, penalties should be no greater than 15% or $886,431.45.

As demonstrated by the Defendants' Penalties Chart (Ex. 27), the SEC's proposed penalties are grossly disproportionate both to the facts of this case and to the history of court imposed sanctions. To truly understand the egregiousness of the SEC's overreaching one has only to consider the Investor Log produced by the SEC in discovery. (Attached as Ex. 28). That Log shows that at the commencement of this action there were only 115 notes outstanding (all the prior notes had been fully paid and retired). Even if each and every one of these notes could somehow be viewed as a separate violation (and there has been no such showing) which could possibly justify a Tier 3 penalty imposed in the maximum amount for each and every violation, the resulting penalty would amount to approximately $22M – an enormous amount of money to be sure – but a far cry from the $100M the SEC now seeks." We respectfully submit that the SEC's proposed $100M penalty is so irrational, arbitrary and capricious in this case that to impose such penalties would be unconstitutional.[65]

For these reasons, the Court in the exercise of its discretion should not impose any penalties. Alternatively, it should impose Tier-2 civil penalties in the amount of $5,000,000.

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[65] It would violate, among other sections, the Due Process Clause of the Fifth Amendment, the Takings Clause of the Fifth Amendment, and the Cruel and Unusual Punishment Clause of the Eighth Amendment.

DEMAND FOR AN EVIDENTIARY HEARING AND ORAL ARGUMENT

The Defendants respectfully request an evidentiary hearing on the SEC's Amended Omnibus Motion. As addressed in Defendants' Motion to Strike (D.E. 1224) and subsequent Reply (D.E. 1248), after the Defendants agreed to a bifurcated settlement, the SEC inserted unpled and unproven liability allegations into a motion designed to address disgorgement and penalties only. These unpled and unproven allegations form the basis for the SEC's demand for disgorgement and penalties. Therefore, at a minimum, the Defendants should be granted an evidentiary hearing so they have the opportunity to address and rebut these unpled and unproven allegations. At a minimum, Defendants request the opportunity to present oral argument.

CONCLUSION

For all of the foregoing reasons, the Defendants respectfully request that the Court deny the Omnibus Motion or, in the alternative, enter an order of disgorgement and penalties as discussed immediately above.

Respectfully submitted,

Dated: July 8, 2022

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 8th day of July 2022, I electronically filed the foregoing 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