UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

SECURITIES AND EXCHANGE COMMISSION	:	
	:	
Plaintiff,	:	Civil Action No.: 1-12-cv-00033
	:	
v.	:	
	:	
LIFE PARTNERS HOLDINGS, INC., BRIAN PARDO, R. SCOTT PEDEN, AND DAVID M. MARTIN	:	
	:	
Defendants.	:	
	:	

DEFENDANTS' RESPONSE TO PLAINTIFF'S MOTION TO ENTER JUDGMENT AND REPLY IN SUPPORT OF DEFENDANTS' MOTION FOR ENTRY OF JUDGMENT

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TABLE OF CONTENTS

4850-2857-8076.4.

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

DEFENDANTS' RESPONSE TO PLAINTIFF'S MOTION TO ENTER JUDGMENT AND REPLY IN SUPPORT OF DEFENDANTS' MOTION FOR ENTRY OF JUDGMENT

Come now, Defendants LIFE PARTNERS HOLDINGS, INC. ("LPHI"), R. SCOTT PEDEN ("Peden"), and BRIAN PARDO ("Pardo) (collectively "Defendants") and file this consolidated Response to Plaintiff's Motion to Enter Judgment [Dkt. 293] and Reply in Support of Defendants' Motion for Entry of Judgment [Dkt. 292] and respectfully show the Court as follows:

I. PRELIMINARY STATEMENT

In a remarkable filing, Plaintiff is urging the Court to enter a Judgment in its favor—ordering disgorgement, assessing penalties and interest, and ordering "reimbursement" under SOX Section 304—in an amount exceeding **$2,050,000,000**. This comes in a case where Plaintiff obtained no finding of fraud against Defendants, no finding that Defendants acted with *scienter*, no finding of insider trading, and Plaintiff failed to prevail on nine (9) of the twelve (12) claims against Defendants. Such a massive judgment would destroy the Defendants (an objective Plaintiff has been trying to accomplish for many years) and would devastate LPHI shareholders. Perhaps the Motion was drafted before the trial of the case? Perhaps the Motion relates to some other case entirely? It bears no resemblance to what happened in this jury trial and its aftermath.

Plaintiff's Motion is littered with misstatements, half-truths, hyperbole, and inconsistencies.[1] Similarly, if there was any credence to Plaintiff's fanciful assertions that Defendants "knowingly misled shareholders, customers, and the public" in a "vast…scheme" of "prolonged" and "rampant and systemic wrongdoing," one might believe that Plaintiff would

[1] *See* an example of which is found in Plaintiff's conclusory prayer for an officer and director bar against Pardo and Peden [*see* Dkt. 293, p. 30], despite Plaintiff's earlier concession that such a bar is not appropriate [*see id.*, p. 2 n.1].

have prevailed on all of its claims at trial. But Plaintiff didn't. More importantly, the jury and the Court rejected Plaintiff's primary claims for securities fraud.

The Motion to Enter Judgment also represents a disturbing trend in SEC enforcement actions. From the *Wyly* case in New York—where the Commission sought over **$480 million** in disgorgement, which was rejected out-of-hand by Judge Shira Scheindlin—to the most recent example in the Southern District of Texas—where Judge Lynn Hughes described as "abusive" the Commission's request for an officer and director bar against two executives of a failed mortgage company[2]—this case is another example of increasingly common government overreaching.

In light of these issues and the importance of this case, Defendants respectfully request an opportunity for oral argument on the parties' pending motions, which may assist the Court in determining an appropriate Judgment to be entered.

II. ARGUMENT AND AUTHORITIES

For the three claims on which Plaintiff prevailed in this case, Plaintiff seeks a Judgment containing: (1) a permanent injunction against Defendants prohibiting them from violating the securities laws; (2) disgorgement in the amount of $500 million, plus prejudgment interest in the amount of $37,366,578; (3) civil penalties ranging from $67,930,000 to $1.5 billion; and (4) "reimbursement" from Pardo under SOX Section 304 in the amount of $13,340,371. The Court should deny Plaintiff's Motion to Enter Judgment in its entirety.

A. A Permanent Injunction Against Defendants is Unnecessary.

Plaintiff first argues that permanent injunctive relief is appropriate because Defendants' actions were egregious and accompanied by *scienter*, and there is a risk of future violations of

[2] For the Court's convenience, Defendants have attached the opinions of Judge Scheindlin and Judge Hughes as Exhibits 1 and 2, respectively.

the securities laws. This argument focuses entirely on one topic: "Life Partners' systematic use of materially underestimated LE calculations." Dkt. 293, p. 3. According to Plaintiff, Defendants allegedly knew about longer LEs for the policies they sold but concealed the longer LEs and, consequently, their "retail investors" paid a lot more than they otherwise would have. *Id.*, pp. 3-4.

None of these assertions, however, is supported by the evidence, the jury's verdict, or the Court's post-trial rulings. No injunctive relief should be entered for several reasons: (1) there was no evidence Defendants fraudulently concealed longer LEs; (2) **the SEC totally ignores the stipulated fact that viatical patients' lives were extended by unforeseeable medical advances (*see* Dkt. 248, ¶ 45)**; (3) there was no evidence that LPHI's shareholders, or its "retail investors," were harmed; (4) there was no finding or probative evidence that Defendants acted with *scienter*; and (5) there is no risk of future violations of the securities laws.

No Evidence of Concealing Longer LEs

Plaintiff has cited no evidence and, in fact, there was no evidence admitted at trial showing that Defendants systematically concealed longer LEs from investors when the sale of life settlement contracts were facilitated. Plaintiff's assertion that Pardo and Peden knew about "longer-than-Cassidy LEs" and that Peden compared longer LEs to Cassidy's LEs is misleading. At trial, Peden was questioned about an analysis he performed for a July 2010 presentation to LPHI's auditors, which was made in response to a complaint the auditors received about the company's LEs. *See* 1/28/14 a.m. Trial Transcript, pp. 59-61, 65. Peden confirmed that, in connection with the July 2010 letter to the auditors, he analyzed the company's files and compared Cassidy's LEs to those of 21st Services. *Id.*, p. 65. Peden never testified, nor can it be inferred, that he (or Pardo) had possession of longer LEs, considered or compared them, but knowingly sold the same policies to retail investors using Cassidy's shorter LEs. Plaintiff's suggestion to the contrary is demonstrably false.[3] In any event, Plaintiff failed to submit evidence that this alleged conduct harmed LPHI shareholders.

No Other Evidence of Harm to Shareholders

Plaintiff also relies on testimony from two of Life Partners, Inc.'s ("LPI") master licensees (Jim Sundeluis and Tim Harper) who claimed that having information about longer LEs would have been important to them and would have affected their decisions to buy policies facilitated by LPI. Dkt. 293, pp. 3-4. But retail investors who bought life settlement policies facilitated by LPI were not in the same position and did not share the same interests as LPHI's shareholders. In other words, their status as retail investors, and the impact of the company's business practices on them, is not probative of harm to LPHI's shareholders.

No Finding or Probative Evidence of Scienter

Contrary to Plaintiff's bald assertions, there has been no finding in this case, either by the jury or the Court, that Defendants acted with *scienter*. Simply put, Plaintiff failed to prevail on any of its *scienter*-based fraud claims against Defendants. And Plaintiff's reliance on Rubin's testimony to illustrate the "egregiousness" of or *scienter* associated with Defendants' conduct is unavailing.

Using an "actual-to-expected ratio" analysis, Rubin criticized LPI's use of Cassidy's LEs.[4] Rubin conceded, however, that his actual-to-expected analysis is actually very complicated. *See* 1/29/14 a.m. Trial Transcript, p. 18. Indeed, only persons with statistical

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[3] Peden also testified that, even if they had received LEs from third parties, they usually came from another broker. Thus, LPI would not and could not consider and use them because, among other things, they did not pay for the estimates, the LEs may be calculated using a different methodology, and there may be other questions about the reliability of the estimates and the source of the information. *See* 1/28/14 p.m. transcript, pp. 41-44.

[4] LPHI did not facilitate the sale of life settlements, only LPI did. (*See* Dkt. 248, ¶¶ 23-24)

training, coupled with some actuarial training, could perform such an analysis to determine the accuracy of Cassidy's LEs. *Id.*, p. 19. In addition, Rubin admitted that, as late as May of 2013, a mere eight months before this trial commenced, there were (1) no specific guidelines or practices for calculating an actual-to-expected ratio in the life settlement industry; and (2) no specific regulatory standards defining life settlement assumptions. *Id.*, pp. 19-20.

Rubin also acknowledged that a shorter LE is not necessarily inaccurate. *Id.*, p. 24. Yet, Rubin did not, and the SEC did not ask him to, perform an analysis to determine <u>why</u> LPI's LEs were short. *Id.*, p. 18. He took a simple "lumped together" approach in calculating his ratio, without differentiating between the types of policies or the medical condition of the insureds. *Id.*, p. 24. The failure of the SEC to even attempt to differentiate between AIDS insureds and senior insureds was intentionally geared toward confusing the jury and obtaining an undeserved verdict. Moreover, in terms of comparing Dr. Cassidy's LEs to others in the industry (e.g., AVS, 21st Services, Fasano), Rubin admitted he is not familiar with their methodologies to calculate LEs (*Id.*, p. 26), and he could not say whether their LEs were based on the same medical information as Cassidy's LEs. *Id.*, p. 46. Hence, Rubin's opinions about the use of Cassidy's LEs did not withstand scrutiny. Most importantly, nothing in Rubin's testimony demonstrates *scienter* or egregious conduct justifying a permanent injunction. Indeed, because Rubin's actual-to-expected ratio analysis was so complicated, Pardo and Peden, both of whom lack actuarial and statistical training, could not reasonably be expected to replicate the analysis on their own. And nothing required them to pay someone like Rubin—at $1,000/hour—to conduct such an analysis which, by Rubin's own admission, is not even standard in the industry.

Plaintiff's reliance on other evidence in the case also falls short of establishing *scienter*. For example, Plaintiff refers to Pardo's alleged threat of legal action against LPHI's auditors (*see*

Dkt. 293, p. 5), but the jury found in favor of Defendants on this claim. In addition, evidence of Peden's reminder to himself to "call Cassidy on accuracy" which he failed to do, and providing Cassidy an LE calculator which he (Peden) did not know how to work (*see id.*, pp. 5-6), have no bearing on *scienter*, much less prove an intent to deceive or defraud. These typify the efforts of the Plaintiff to confuse the real issues.

We suggest the Court need look no further than Plaintiff's admission that an officer and director bar against Pardo and Peden is precluded because Plaintiff failed to obtain a predicate finding of fraud.[5] Thus, Plaintiff's repeated accusations that Defendants acted with *scienter*, contrary to the jury's verdict and the Court's post-trial ruling, is unsupported and inaccurate.

No Risk of Future Violations

There is no evidence establishing a reasonable likelihood that Defendants will violate the relevant securities laws in the future; thus this potential basis for an injunction does not apply. Plaintiff ignores the fact that, since March of 2011, LPI has been using two sets of LEs (from both Cassidy and 21st Services) to market life settlements and have been providing those estimates to investors. *See* 1/27/14 p.m. Trial Transcript, pp. 184-85. In addition, Defendants began using a cash-basis accounting method for revenue recognition as of November 2011, about which Plaintiff did not, and has not, complained. *See* Trial Ex. G-31, pp. 26, 36. Hence, for over three years now, Defendants have operated with a different approach in using two LEs and a different method of accounting; yet, there have been no complaints from Plaintiff about either of these practices. Not only does this refute the notion that Defendants are "recidivists," as alleged by Plaintiff, common sense suggests that if Plaintiff were concerned about Defendants' future

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[5] *See* 15 U.S.C. § 77t(e) and 15 U.S.C. § 78u(d)(2), which authorize the Court to prohibit any person from serving as an officer or director of an issuer, but only when that person has violated the antifraud provisions in the respective Acts – Section 17(a) of the 1933 Act [15 U.S.C. § 77q(a)(1)] and Section 10(b) of the 1934 Act [15 U.S.C. § 78j(b)].

compliance with filing accurate public reports, Plaintiff would have complained about the Defendants' new practices. Moreover, one would think Plaintiff would not have chosen to jettison evidence of revenue recognition practices at trial if it was concerned with alleged LPHI's ongoing accounting irregularities. Importantly, Plaintiff has not even alleged, much less shown, that Defendants are prone to revert to their former business and accounting practices.

Plaintiff argues that Defendants have not acknowledged wrongfully using shorter LEs. Of course, they have not acknowledged this because the evidence showed there was no such wrongful use. The SEC claims that Defendants should have violated U.S. copyright restrictions – that Defendants' reference to that problem is not sufficient. *See* Dkt. 293, p. 6. But, as indicated above, Peden actually testified that, if the company received third-party LEs, they ordinarily came from another broker, "but that's the last person you want to get the information from [because] [t]hey're representing the other party." 1/28/14 p.m. Trial Transcript, p. 44. Thus, in addition to concerns that the company had not paid for proprietary, protected information, LPI did not consider or use the third-party LEs because (1) they may have been calculated using a different methodology (i.e., an "actuarial approach") (*Id*., p. 42-43); and (2) there could be questions about the reliability of LEs received from the other side's brokers.[6]

Finally, the SEC's proposal for an injunction ignores some key facts: Scott Peden has never been the subject of any injunction; nor has LPHI. In fact, the aged injunction against Brian Pardo was a general "obey the law" type mandate which lacks the specificity to be enforceable.

In summary, Plaintiff has failed to carry its burden to demonstrate that permanent injunctive release is warranted against each of the Defendants. *SEC v. Blatt*, 583 F.2d 1325,

[6] As Peden explained: "We're looking out for the buyers, and so – because we're buying, as an agent for them, the policies. So we want to know the source of the information. We want to know what they were provided with. We have no way of knowing how much of that medical file that firm used when they did that estimate." 1/28/14 p.m. Trial Transcript, p. 44.

1334 (5th Cir. 1978); *see also Aaron v. SEC*, 446 U.S. 680, 701 (1980) (Burger, C.J., concurring) (holding that "the Commission must establish a sufficient evidentiary predicate to show that such future violation may occur . . . . Moreover, as the Commission recognizes, a district court may consider *scienter* or lack of it as one of the aggravating or mitigating factors to be taken into account in exercising its equitable discretion in deciding whether or not to grant injunctive relief."); and *see SEC v. Nocella and McCann*, *supra* (opinion of Judge Hughes), and cases cited in our opening brief in support of the Motion for Entry of Judgment. Accordingly, Defendants urge the Court not to impose a permanent injunction in this case.

B. Plaintiff's Request for "Equitable" Disgorgement of $500 Million, Plus Prejudgment Interest, is Unwarranted and Not Supported By the Evidence.

Plaintiff argues that the Court should order Defendants to disgorge $500 million in alleged "ill-gotten gains" and, in addition, award prejudgment interest in the amount of $37,366,578. Dkt. 293, pp. 8-13. The Court should deny this equitable remedy for at least three reasons: (1) there is no proof of a causal connection between the violations and the amount to be disgorged; (2) there is no proof that Defendants received the amount sought to be disgorged; and (3) there is no proof distinguishing between legitimate and allegedly illegitimate gains.

"The court's power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing." *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978). Plaintiff must show a causal relationship between the alleged wrongdoing and the amount to be disgorged and, at least, a "reasonable approximation" of the ill-gotten profits. *Allstate Ins. Co. v. Receivable Fin. Co., L.L.C.,* 501 F.3d 398, 413 (5th Cir. 2007) (citation omitted). Moreover, "the party seeking disgorgement must distinguish between that which has been legally and illegally obtained." *Id.*

Here, Plaintiff argues that disgorgement of $500 million is appropriate because Defendants "were able to extract $500 million more from customers than they otherwise would have" if Defendants had disclosed their use of Cassidy's shorter LEs. Dkt. 293, p. 10.[7] Not only is this assertion inherently speculative, there is no testimony or other evidence establishing a causal link between this fictional figure and the Defendants' non-fraud-based violations. Regardless of how Plaintiff wishes to label Defendants' business practices, there is no changing the fact that Defendants were found liable for only one core violation: failing to disclose information in SEC filings. Thus, Plaintiff is obliged to show that the $500 million figure is, in fact, causally connected to the inaccurate disclosures. Stated differently, Plaintiff must establish that <u>had the missing information appeared in the SEC filings</u>, Defendants would not have received the amount sought to be disgorged. There is no evidence supporting such a conclusion. In fact, the evidence established that Defendants never received $500 million in revenues! *See* Trial Ex. G-31, p. 23. Although disgorgement may be ordered if there is a reasonable approximation of ill-gotten gains, the amount and its causal link to the wrongdoing cannot be speculative. *SEC v. Platforms Wireless Int'l Corp.,* 559 F. Supp. 2d 1091, 1105 (N.D. Cal. 2008) (vacating order of disgorgement because causal connection between profits and violation was too speculative). As Judge Scheindlin wrote in *SEC v. Wyly,* supra, at 21:

> Disgorgement is thus remedial, not punitive . . . . Here, the SEC's proposed disgorgement does not appear to arise from the violations and therefore smacks of punishment, not equity or deterence.

Moreover, despite labeling this unsubstantiated amount as ill-gotten "gains" and "profits," Plaintiff has not met its burden to establish that Defendants ever received $500 million,

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[7] The thrust of the SEC's overreaching in this case mimics its approach in *Wyly*. There, the court held: "While the SEC liberally refers to the trades at issue as unlawful or illegal, this characterization lacks support in law or fact." *See Wyly*, supra, at 18. The court rejected the SEC's approach in its entirety <u>despite the fact the jury found the Wylys had committed fraud</u>.

much less that $500 million (or any other figure) represents a disgorgeable sum. Indeed, Plaintiff vaguely refers to this amount as a "premium in acquisition costs" while acknowledging that the payments LPI received from purchasers of life settlements are subject to "escrowed premiums, payments to salesmen, **the price paid to the seller of the policy**, and medical and escrow fees." Dkt. 293, p. 11. Thus, Plaintiff cannot demonstrate—and has made no effort to do so—what amount the Defendants supposedly received from customers, or what amount constitutes an illegitimate "gain," versus legitimate expense for each life settlement transaction. Simply put, Defendants cannot disgorge funds they never received. Instead of showing a "reasonable approximation" of ill-gotten gains, Plaintiff's absurd request for $500 million is nothing more than rank speculation and is completely out of line with the jury's and Court's findings.[8]

Finally, Plaintiff's request for prejudgment interest should also be denied. Prejudgment interest has to be based on a net number attributed to Defendants as ill-gotten funds. As discussed above, Plaintiff has not demonstrated what amount, if any, Defendants actually received or used in the form of ill-gotten gains. Accordingly, prejudgment interest on this unknown sum is not appropriate.

C. Plaintiff's Request for Civil Penalties Should Be Denied

Plaintiff advocates for a third-tier penalty under the statute and requests the Court to impose penalties on the Defendants ranging from a low of $67,930,000 to a high of $1.5 billion. Dkt. 293, pp.16-19. Plaintiff claims such astounding amounts are appropriate, even though it did

[8] At footnote 6 in the Motion to Enter Judgment, Plaintiff includes a chart purporting to show the salaries and bonuses received by Pardo and Peden for the years 2007-2011. Dkt. 293, p.12 n.6. Plaintiff cites to no evidence supporting this data, nor does Plaintiff explain how this data is relevant to disgorgement or any other issue. Plaintiff cannot recover these sums as part of the Judgment. Thus, Defendants can only conclude that Plaintiff included this information in an effort to inflame or prejudice the Court, or someone else, against Pardo and Peden.

not prevail on any of its fraud claims, because of the nature of Defendants' conduct, their alleged *scienter*, and the alleged risk of substantial losses to shareholders. *Id.*

As discussed above, there is no finding in this case—either by the jury or the Court—that any of the Defendants' actions were undertaken with *scienter*. The jury rejected Plaintiff's fraud claim under Section 10(b), and the Court concluded there was no evidence supporting the jury's finding that Defendants violated Section 17(a). In upholding the remainder of the jury's verdict, the Court was not required to, and the Court in fact made no finding that Defendants' acted with *scienter*.

Moreover, there is no evidence supporting Plaintiff's bald assertion that investors were put at risk for substantial losses based on a gradual drop in price of LPHI stock from December 2010 through November 2011. *See* Dkt. 293, p. 18, n.12. Plaintiff speculates that the drop was caused by the release of information about Cassidy's methodology for estimating LEs and Defendants' use of his LEs. *Id.* However, there is nothing that correlates these events to each other. Nor is there any statistical or other analytical data probative of a cause and effect relationship between the stock price and news articles over the 11-month period.

There was also no evidence that LPI lost investors during the relevant time because they were not getting returns they were seeking. In addition, Plaintiff presented no evidence that, as a result of any alleged loss of investors by LPI, LPHI's business, financial condition, or results of operations were adversely affected in any material amounts. To the contrary, the evidence showed that revenues were increasing throughout the relevant period. *See* Trial Ex. G-31, p. 23.

Alternatively, in the event the Court is inclined to assess penalties (which Defendants contend are unnecessary), Defendants urge the Court to consider a low amount in the first tier for three reasons. First, under the first tier, the statute permits the Court to impose a capped penalty per violation, or alternatively, based on "the gross amount of pecuniary gain" to the defendant "*as a result of* the violation." *See* 15 U.S.C. § 77t(d)(2); 15 U.S.C. § 78u(d)(2) (emphasis added). For a penalty tied to the pecuniary gain, Congress's use of the phrase "as a result of" plainly indicates that a causal connection between the gain and the violation must be shown. *See SEC v. Huff*, 758 F. Supp. 2d 1288, 1364-66 (S.D. Fla. 2010) ("In other words, under the plain language of the statute, a court must tie the potential maximum penalty to financial gain that the defendant enjoyed because of the violation that the penalizing court found him to have committed."). As discussed above, there is no causal connection. Therefore, the amount of any penalties can only be based on the number of violations.

Second, Plaintiff's suggested range of potential penalties based on the number of violations is artificially inflated. Plaintiff asserts there are "discrete" violations of multiple provisions of the Exchange Act related to seventeen public filings—68 violations for Peden, 85 for Pardo, and 68 for LPHI. Dkt. 293, p. 18-19 nn. 13-15. In essence, however, there is only one primary violation: the failure to disclose specific information in SEC reports. At most, then, Defendants could be charged with no more than 17 violations.

Third, a penalty in the second or third tier is completely inappropriate because it overstates the culpability of Defendants' misconduct. Penalties in either the second or third tier ***require*** a showing that the violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement." *See* 15 U.S.C. § 77t(d)(2)(B); 15 U.S.C. § 78u(d)(3)(B)(ii). With no actual finding of fraud, no finding of *scienter*, and no evidence of manipulation, the only criteria supporting a second or third tier penalty is deliberate or reckless disregard of a regulatory requirement. But when coupled with the fact that, over three years ago, Defendants modified their use of LEs and their accounting practices, and there have been no complaints from the Plaintiff related thereto, a penalty in the first tier (to the extent any penalty should issue) adequately achieves the goals of punishment and deterrence.

We include the above discussion for the benefit of the Court without waiving our argument that no penalties are appropriate. The question presented is really: What did the Defendants fail to disclose? Their revenue recognition practices? This is what the SEC contended it its Complaint. But the lack of importance – indeed irrelevance – of the "rev rec" issue was manifested by the SEC's decision to introduce no evidence of the subject. The Court will obviously recall this dramatic pre-trial announcement.

D. Plaintiff Failed to Prove That Reimbursement Under SOX Section 304 is Required.

Plaintiff also argues that Pardo should be required to reimburse the company for $13,340,371 in alleged bonuses and other incentive or equity-based compensation under Section 304 of the Sarbanes-Oxley Act. Dkt. 293, pp. 28-30. As a preliminary evidentiary matter, Plaintiff asserts that any deficiencies in the evidence supporting its Section 304 claim can be cured "[b]ecause the Commission's Section 304 claim is one for equitable relief, [therefore] it was not tried to the jury and the Court may receive evidence, and find facts, pertaining to it." Dkt. 293, p. 19. The authority cited by Plaintiff, curiously, is *SEC v. Jasper*,[9] a Ninth Circuit case, which Plaintiff cites for this proposition: "reimbursement provision of SOX 304 is an ***equitable disgorgement remedy*** and not a legal penalty, so defendant not entitled to have jury find all facts necessary to support reimbursement." *Id.* (emphasis added).[10]

Plaintiff's reliance on *Jasper* is odd because, when the merits of Plaintiff's Section 304 claim were previously argued in this Court, Plaintiff maintained that *Jasper* did not apply to this

[9] 678 F.3d 1116 (9th Cir. 2012).

[10] Notably, the District Court's decision in *Jasper* granting Section 304 relief was based on the evidence submitted by the SEC at trial. *See Jasper*, 883 F. Supp.2d 915, 932-33 (N.D. Cal. 2010).

case. *See* Dkt. 132 at 18-19 (SEC's Response to Defendants Pardo and Martin's Motion for Partial Summary Judgment). More specifically, the SEC relied on Judge Sparks' decision in *U.S. v. Baker*,[11] noting that Judge Sparks rejected *Jasper* and "agreed with the Commission" that Section 304 does not provide for an equitable disgorgement remedy. *Id.* at 19. At the time, Plaintiff also argued that Section 304's remedy is "reimbursement"—not "disgorgement"—and had Congress intended Section 304 to require disgorgement, it would have said so. *Id.* n.13.

This about-face illustrates Plaintiff's desperate post-trial efforts to salvage whatever it can from the case. The Section 304 claim, which courts have construed as a penalty,[12] should rise or fall on the evidence Plaintiff introduced at trial. No evidence was presented and this issue was not supposed to be the subject of a bifurcated proceeding. Thus, since the evidence fails to support a claim for reimbursement under Section 304 in the amount of $13,340,371, this SEC request must be rejected.

Plaintiff's calculation of the reimbursement under Section 304 includes bonuses and "other reimburseable SOX Compensation" allegedly paid to Pardo totaling $1,811,532. Dkt. 293, p. 28. The trial evidence, however, does not support this calculation. Plaintiff relies on an appendix with additional evidence, not admitted at trial, purportedly showing bonuses paid to Pardo in FYs 2009 – 2011. *Id.*, p. 7 n.4 and p. 28 (referring to Ex. G-75, App. 062). The Court should disregard this evidence.

In addition, Plaintiff's request for "other reimburseable SOX Compensation" includes such things as country club dues, personal cell phone expenses, a home PC, and a family member's tuition and books. *Id.* But Plaintiff cites no evidence that such expenses are, or were

[11] 2012 U.S. Dist. LEXIS 161784 (W.D. Tex. Nov. 13, 2012).

[12] *See SEC v. Microtune, Inc.*, 783 F. Supp.2d 867, 887 (N.D. Tex. 2011) (holding that Section 304 remedy is, in fact, a penalty).

intended to be, "incentive-based or equity-based compensation" required to be reimbursed under Section 304. Nor has Plaintiff cited any authority supporting the argument that these expenses are the kinds of reimburseable compensation captured by the statute.

Likewise, Plaintiff's request that Pardo reimburse the company for $11,528,839 in alleged profit from sales of LPHI stock must be rejected. Not only is this amount unsupported by the evidence at trial (*see* Dkt. 293, pp. 29-30, referring to evidence in appendix), Plaintiff has offered no proof that Pardo (1) personally received those proceeds, or (2) personally profited from any sales of LPHI stock. Plaintiff argues that Pardo controls his family trust which owns the LPHI stock that was sold. Dkt. 293, p. 29. Again, however, there is no evidence that Pardo controlled the family trust, the family trust was not a party in this case, nor was the family trust named as a relief Defendant. Moreover, there is no evidence that the proceeds from any stock sales by the family trust, even if authorized and approved by Pardo, were received by Pardo himself. Once again, the remedy sought by the SEC is excessive and not supported by the pleadings, much less the evidence.

Finally, even if there is some evidentiary support for reimbursement from sales of LPHI stock, at least two of the transactions on which Plaintiff relies fall <u>outside</u> of the relevant time period under the statute. *Compare* Dkt. 293, p. 29 *with* Dkt. 293, p. 27. The Form 10-QSB, filed on January 16, 2007, was not restated. Thus, the sale of stock on February 12, 2007, allegedly resulting in $961,550 in proceeds (*see id.*), is irrelevant. Similarly, the sale on May 18, 2007, allegedly resulting in $2,685,000 in proceeds (*see id.*), occurred <u>before</u> the restated 10-KSB was filed on May 29, 2007. Accordingly, there is no basis to order reimbursement by Pardo under Section 304 in the amount requested by Plaintiff.

E. Defendants Are Unable to Pay the Amounts Requested By Plaintiff

The Defendants' inability to pay is a relevant factor for the Court's consideration in entering a Judgment in this case. *See SEC v. Huffman*, 996 F.2d 800, 803 (5th Cir. 1993) (discussing inability to pay in context of disgorgement order); *SEC v. Harris*, 2012 U.S. Dist. LEXIS 31394, at *16 (N.D. Tex. March 7, 2012) (inability to pay is one factor to be considered in imposing a penalty). Defendants do not have the capability of paying the enormous and extraordinary amounts sought by Plaintiff.

III. CONCLUSION

For the reasons set forth herein, Defendants respectfully request the Court to set the pending motions for hearing and, following a hearing, to enter a Judgment in this matter that is consistent with the foregoing and Defendants' Motion for Entry of Judgment, and for such other and further relief to which they may show themselves justly entitled.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on August 20, 2014, I electronically filed the foregoing document with the Clerk of the Court using the CM/ECF system, which will send notification of such filing to all counsel who have registered with the Court. All others were served a copy via U.S. mail.

/s/ *S. Cass Weiland*
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