UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO.: 1:11-cv-24438-GAYLES

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

STIEFEL LABORATORIES, INC. and CHARLES W. STIEFEL,

Defendants.
_____/

100079 CANADA, INC. AND RICHARD MACKAY'S
OBJECTIONS TO THE DISTRIBUTION PLAN

100079 Canada, Inc. and its shareholder, Richard MacKay (collectively, the "Excluded Shareholder"), hereby submit these objections to the Security and Exchange Commission's ("SEC") Distribution Plan (DE 240-1) that arbitrarily, unfairly, and unreasonably exclude 100079 Canada, Inc. from any distribution from a Fair Fund consisting of disgorged funds, prejudgment interest on disgorgement, and civil penalties paid by Stiefel Laboratories, Inc. ("Stiefel Labs") and Charles Stiefel. The Excluded Shareholder requests the Court to reject the Distribution Plan and to require that 100079 Canada, Inc. receive a pro rata distribution from the Fair Fund just like every other defrauded shareholder of Stiefel Labs. Any other result would improperly penalize 100079 Canada, Inc. which, as explained herein, did not participate in and had no knowledge regarding Charles Stiefel's fraudulent conduct.

INTRODUCTION

As articulated in the Complaint (DE 1) and Distribution Plan (DE 240-1), the SEC brought this action to recover damages owed to shareholders of Stiefel Labs which had "defrauded

shareholders out of more than $110 million, at the direction of Defendant Charles W. Stiefel, its then chairman and CEO." DE 1 at ¶ 1. As the SEC explained, Stiefel Labs had been a privately held corporation that was controlled by Charles Stiefel and his two sons, Brent and Todd. *Id.* at. ¶ 8. Although owned, operated, and controlled by the Stiefel family since its founding in 1847, the common stock of Stiefel Labs was distributed among members of the Stiefel family as well as employees who over the years had acquired shares.

While shares in publicly traded corporations are assigned ticker symbols and can typically be valued or liquidated at any moment through the public stock exchanges, the same is not true for privately held corporations such as Stiefel Labs. Instead, shareholders had to rely on Stiefel Labs' valuation, and selling shares back to Stiefel Labs was "essentially the exclusive way for current and former shareholders to liquidate their Stiefel Labs stock." DE 1 at ¶ 2. For this reason, any Stiefel Labs shareholder wishing to liquidate their shares faced a take-it or leave-it proposition: sell to Stiefel Labs at its designated price, or do not sell at all and receive nothing.

In order to determine the fair market value of its shares for the purpose of an intended buyback from its shareholders, Stiefel Labs retained an appraiser to value the shares annually. *Id*. at ¶ 3. Charles Stiefel repeatedly confirmed that the company would remain privately owned, so the appraiser calculated Stiefel Labs' stock price by relying on its financial statements rather than calculating the true value for the open-market sale of a going-concern. *Id*. at ¶¶ 12, 20, 43. *See also Finnerty v. Stiefel Laboratories, Inc. and Charles W. Stiefel*, 756 F.3d 1310, 1314-15 (11th Cir. 2014) (noting that in late 2007 Stiefel Labs had issued a press-release confirming the company will remain privately owned, and Charles Stiefel sent a follow-up e-mail to all employees confirming that Stiefel Labs "will continue to be a privately held company operating under my direction as Chairman, Chief Executive Officer, and President.").

Despite the Stiefel family's stated intent to maintain Stiefel Labs as a family-owned business, Charles Stiefel and his two sons were secretly soliciting bids to sell the company to the highest bidder. As a result, neither the appraiser nor shareholders realized that the supposed "fair market value" of Stiefel Labs' shares was misleading and undervalued. DE 1 at ¶ 1. Likewise, none of the shareholders knew that in addition to misrepresenting the intent to sell the company, Charles Stiefel reduced the appraiser's valuation of the company by adjusting it downward by approximately 35-percent before disclosing the misleading valuation to shareholders. *Id.* at ¶ 43. As would later be revealed, this was part of a scheme orchestrated by Charles Stiefel so that the Stiefel family could acquire as many shares as cheaply as possible, and thereafter reap a massive windfall when all outstanding shares were sold to one of the third-party bidders then secretly being courted. *Id.* at ¶ 4. *See also* DE 1 at ¶¶ 36.f and 36.l:

> On February 4, 2009, [Charles] Stiefel sent an email to his sons concerning his compensation "It would look really bad to have my 2 sons award me a whole bunch of additional stock right before a sale of the company at a stock price many times the price used to calculate my stock. This might be a windfall for me, but none of us need to want the potential scrutiny or maybe even lawsuits."

Id. at ¶ 36.f.

> On February 20, 2009, Brent Stiefel emailed his father [Charles Stiefel], stating that because of the share buybacks from employee shareholders, "It is nice to see the $ go up for all of us!" On the same day, Brent emailed [Charles] Stiefel and Todd Stiefel information showing how much more they and their relatives should expect to receive from a sale of the Company because of the buybacks from employee shareholders.

Id. at ¶ 36.l.

Ultimately, hundreds of Stiefel Labs' employees fell prey to this scheme and were defrauded by Charles Stiefel out of millions of dollars. One of these shareholders was 100079 Canada, Inc., which had acquired its shares from Richard MacKay – a lifelong employee of Stiefel Labs' Canadian subsidiary. DE 253-1 at ¶¶ 2-4. As explained in Mr. MacKay's declaration and

publicized by Charles Stiefel in his recent tell-all book,[1] Mr. MacKay had originally been an employee of Stiefel Labs' Canadian distributor. DE 253-2 at pg. 2.[2] In 1976, Stiefel Labs, then run by Charles Stiefel's father Werner and Werner's brother Herbert, sought to establish its own Canadian subsidiary and offered Mr. MacKay 24-percent of the stock of the new company if he would quit his job and take a chance on the startup. DE 253-1 at ¶¶ 2-3; DE 253-2 at pgs. 2-3. Stiefel Labs recognized that this was "a risky career change" for Mr. MacKay, and while "[a]t first blush[] this might sound like an overly generous offer. . . as a start-up company[] Stiefel Canada had zero sales and zero assets; so this large block of stock initially had no value whatsoever." DE 253-2 at pgs. 2-3.

Mr. MacKay accepted the offer, grew Stiefel Canada to one of the company's top subsidiaries, and developed marketing campaigns that Stiefel Labs utilized across the globe. DE 253-1 at ¶¶ 2-3; DE 253-2 at pg. 3. Eventually, Werner and Herbert Stiefel exchanged Mr. MacKay's 24-percent interest in Stiefel Canada for 5-percent of the shares in Stiefel Labs. DE 253-1 at ¶ 4; 253-2 at pg. 3. This was done to alleviate any detriment to Mr. MacKay in the event that Stiefel Labs implemented a change in one part of the world that adversely affected its operations in Canada. *Id.* Mr. MacKay subsequently transferred his shares to 100079 Canada, Inc. DE 253-1 at ¶ 4. Mr. MacKay was invited to join Stiefel Labs' board of directors which he did in 2003, but then Mr. MacKay retired in 2007 after more than 30-years of service to the Stiefel family business. DE 253-1 at ¶¶ 5-6; DE 253-2 at pg. 3. As Charles Stiefel explained in his book, after Mr. MacKay's retirement "[t]o thank and honor my friend and colleague for his years of service,

[1] Charles W. Stiefel, *Skin Saga – How a Tiny Family Soap Business Evolved Over Six Generations into the #1 Dermatology Company in the World* (Smart Business Network, 2018), excerpts of which are attached at DE 253-2.

[2] The page references to DE 253-2 refer to the page number in the CM/ECF header.

I appointed him to a newly-created position – Vice Chairman of the Board of Directors." *Id.*

In 2008, one year into Mr. MacKay's retirement and while Charles Stiefel and his children were secretly soliciting bids to defraud employees out of shares for a fraction of their value, 100079 Canada, Inc. advised Stiefel Labs that it wished to liquidate 100 of its shares every year on a going-forward basis. DE 253-1 at ¶ 9; DE 253-2 at pgs. 4-5. Since Stiefel Labs was not publicly traded, this liquidation could only occur by selling the shares back to Stiefel Labs at the value assigned by Stiefel Labs' third-party appraiser. DE 1 at ¶¶ 2, 18; DE 253-1 at ¶ 10. Charles Stiefel refused 1000079 Canada, Inc.'s request and instead, armed with the secret knowledge that he was about to consummate a sale of the entire company and in furtherance of his ongoing fraud to obtain as many shares as cheaply as possible, responded that Stiefel Labs would only go forward with the buyback if it contemplated a much larger number of shares. DE 253-1 at ¶ 9. Ultimately, 100079 Canada, Inc. agreed to sell 750 of its shares (approximately 25% of its entire holdings) for $11,932.97 per share, which Charles Stiefel misrepresented as a slight discount from the current fair market value of $12,339.45 per share.[3] DE 253-1 at ¶¶ 9-10; DE 253-2 at pg. 5. Shortly thereafter, Charles Stiefel announced the sale of Stiefel Labs to the publicly traded GlaxoSmithKline plc for approximately $68,000 per share which was a 570% premium over the $11,932.97 per share price paid to 100079 Canada, Inc. DE 1 at ¶ 1.

Several employees sued Stiefel Labs and Charles Stiefel individually, alleging fraud and other claims. *See, e.g., Finnerty*, 756 F.3d at 1314-15. Mr. MacKay eventually learned of the suits brought by other employees which led 100079 Canada, Inc. to also file suit, but by that time the statute of limitations had expired and the case was dismissed. *See 100079 Canada, Inc. v. Stiefel*

[3] Individuals who held their shares as part of an Employee Retirement Income Security Act (ERISA) Defined Contribution Plan were paid slightly more per share. *See* DE 240-1 at pg. 8.

Laboratories, Inc., Charles Stiefel, and Brent Stiefel, 596 Fed. App. 744 (11th Cir. 2014). Amidst this flurry of litigation, the SEC sued Stiefel Labs and Charles Stiefel for the benefit of all Stiefel Labs' shareholders, leading to the recovery of $37 million and the establishment of a Fair Fund to be distributed among the victims. DE 234, DE 240. The Distribution Plan proposed by the SEC calculates the difference between the amounts received by the shareholders and the fair market value on the date of sale, and proposes a pro-rata distribution among all affected shareholders. DE 240-1. Importantly, the proposed Distribution Plan bars recovery by any member of the Stiefel family or the Board of Directors which is dominated by the Stiefel family. *Id.* at pg. 4 ¶ 4.

100079 Canada, Inc. objects to the Distribution Plan because it does not appear among the shareholders listed to share in the Fair Fund. DE 240-2. This is presumably because Mr. MacKay, the sole shareholder of 100079 Canada, Inc., was an honorary board member of Stiefel Labs post-retirement at the time 100079 Canada, Inc.'s shares were sold. DE 253-1 at ¶¶ 5-6; DE 253-2 at pg. 3. Because the SEC did not explain its rationale for categorically excluding board members, however, if this was an oversight the Court should reject the currently proposed Distribution Plan and require that it be amended to include 100079 Canada, Inc. in the Fair Fund distribution.

If, however, the SEC intentionally excluded 100079 Canada, Inc., then the Court should reject the Distribution Plan because such exclusion would be unfair and unreasonable. When Mr. MacKay was in his 70s and already retired, Charles Stiefel named him an honorary board member based upon his years of service and Mr. MacKay's friendship with Charles Stiefel's father and uncle. DE 253-1 at ¶¶ 5-6; DE 253-2 at pg. 3. Mr. MacKay was not involved in the fraud perpetrated by Charles Stiefel, but to the contrary, was another victim whose loyalty and trust was betrayed for the Stiefel family's personal gain.

Further, the shares at issue were owned and sold by 100079 Canada, Inc. – not Mr. MacKay

– and it is 100079 Canada, Inc.'s right of recovery that is at issue. Excluding 100079 Canada, Inc., which did not serve on the board, completely disregards the separate identity accorded to corporations under well-established law. For these reasons, the Court should reject the proposed Distribution Plan and order that 100079 Canada, Inc. is entitled to a pro rata distribution of the Fair Fund just like the other victims of Charles Stiefel's fraud.

ARGUMENT

I. STANDARD OF REVIEW

The SEC correctly notes that the "fair and reasonable" standard applies to this Court's review of the Distribution Plan. *See* DE 240 at pgs. 6-7 citing *SEC v. Wang*, 944 F.2d 80, 83-84 (2nd Cir. 1991); *SEC v. Levine*, 881 F.2d 1165, 1182 (2nd Cir. 1989); *SEC v. Fischback Corp*., 133 F.3d 170, 175 (2nd Cir. 1997); *Official Committee of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 81 (2nd Cir. 2006). This differs from the arbitrary and capricious standard which would be more deferential to the SEC, *SEC v. Wang*, 944 F.2d 80, 84 (2d Cir. 1991), and instead requires the Court to utilize its "general equitable powers to ensure that the plan is fair and reasonable." *WorldCom*, 467 F.3d at 82-83.

II. THE CATEGORICAL EXCLUSION OF MEMBERS OF THE BOARD OF DIRECTORS IS UNFAIR AND UNREASONABLE WHEN APPLIED TO 100079 CANADA, INC.

As discussed above, the SEC excluded all members of the Stiefel family from sharing in the Fair Fund and did so for good cause. Charles Stiefel and his children engaged in egregious, fraudulent conduct designed to line their own pockets at the expense of the shareholders, including 100079 Canada, Inc. and Mr. MacKay. Further, because the Stiefel family packed the Board of Directors of Stiefel Labs, it is at first glance understandable why members of the Board of Directors were excluded from the Distribution Plan. But Mr. MacKay is not a member of the Stiefel

family, and although an honorary member of the Board of Directors post-retirement, he is an innocent defrauded shareholder against whom there is absolutely no allegation of impropriety. Given these circumstances, a categorical bar that excludes either Mr. MacKay or 100079 Canada, Inc. from sharing in the Fair Fund is unfair and unreasonable.

The Southern District of New York confronted a similar set of circumstances in *SEC v. CR Intrinsic Investors, LLC*, 164 F. Supp. 3d 433 (S.D.N.Y 2016). In that case, two groups of injured investors had their claims pooled together for distribution from a single Fair Fund. *Id*. at 434. One group objected to inclusion of the other, and the court reviewed the plan to ensure that it was fair and reasonable. *Id.* at 436. The court began its analysis by noting that:

> The SEC explained. . . the purpose of the Fair Fund is to provide an equitable distribution to **all investors** harmed during the period of illegal trading. . . . The SEC's economic expert states that the integrated method 'has the economic benefit of **treating all claimants equally.**' The SEC further explained that it proposed including Elan common stock and Wyeth options holders in the Fair Fund distribution because it would be 'arbitrary and unreasonable' to include investors trading Elan options but exclude investors trading Wyeth options when both were harmed by Defendants' nondisclosure. . . .

Id. at 435 (emphasis added, internal citations omitted).

The court then explained that its review obligation centered on ensuring that "the fund distribution plan 'fairly and reasonably distributes the limited Fair Fund proceeds among the potential claimants.'" *Id*. quoting *WorldCom*, 467 F.3d at 85, *Wang*, 944 F.2d at 85. Concluding that "[t]he Amended Distribution Plan was drafted with the goal of creating a fair distribution to **all investors** harmed during the period of illegal trading. . . attributed to Defendants' undisclosed information," the court overruled the objections and approved the distribution plan. *CR Intrinsic Investors*, 164 F. Supp. 3d at 435 (emphasis added).

While the distribution plan in *CR Intrinsic Investors* was deemed fair and reasonable because it included distributions to **all investors**, the same cannot be said here. The categorical

exclusion of members of the Board of Directors has injured an innocent, defrauded shareholder. As a result, the Distribution Plan does not treat "all investors harmed" equally as did the plan in *CR Intrinsic Investors*, but to the contrary arbitrarily excludes 100079 Canada, Inc. merely because Mr. MacKay was on the Board of Directors. Yet there is not a shred of evidence or even an allegation that Mr. MacKay played any role in Charles Stiefel's fraud and, on the contrary, Mr. MacKay was a victim like others whom the SEC included within the Distribution Plan.

While the SEC may argue that the exclusion is fair and reasonable because Mr. MacKay knew that the Blackstone Group ("Blackstone") had made a $500 million investment in Stiefel Labs in 2007, and thus knew that the shares were being undervalued at the time that 100079 Canada, Inc. sold its shares in 2008, such argument would be incorrect for at least two reasons. First, the details of Blackstone's investment were shared by Charles Stiefel in an all-employee e-mail on August 9, 2007, *see Finnerty*, 756 F.3d at 1314-15 (quoting from that e-mail), yet the Distribution Plan includes employees who received that e-mail and sold through April 20, 2009. DE 240-1 at pg. 1. Since the Distribution Plan does not exclude other employees from sharing in the Fair Fund even though they had knowledge of the Blackstone investment, such knowledge does not mitigate Stiefel Labs' fraud or the damages suffered by 100079 Canada, Inc. and, therefore, is immaterial.

Second, Charles Stiefel's characterization of the Blackstone investment eviscerated any notion that it represented a valuation of Stiefel Labs' shares. This is because that same e-mail that conveyed the Blackstone investment also conveyed to Mr. MacKay and other recipients that Blackstone had not actually purchased part of Stiefel Labs, but rather had made a temporary investment with "a defined exit arrangement. . . at the end of eight years. . . ." *Finnerty*, 756 F.3d at 1314-15.

Certainly, if Mr. MacKay knew the true value of Stiefel Labs' shares he would not have agreed to divest 100079 Canada, Inc. of 25-percent of its holdings for only 17% of the secret value negotiated by Charles Stiefel to sell the company. Instead, 100079 Canada, Inc. and Mr. MacKay fell prey to the same fraud that injured the other shareholders and, therefore, categorically excluding 100079 Canada, Inc.'s claim is unfair and unreasonable. For these reasons, the Court should reject the proposed Distribution Plan and order that 100079 Canada, Inc. is entitled to a pro rata distribution of the Fair Fund just like the other victims of Charles Stiefel's fraud.

III. 100079 CANADA, INC. WAS NOT A MEMBER OF THE BOARD OF DIRECTORS

Even if the court determines that the Distribution Plan is fair and reasonable despite categorically excluding all members of the Board of Directors from the Fair Fund, this is completely improper as to 100079 Canada, Inc. because the corporation did not serve on Stiefel Labs' board. This is a critical distinction that exemplifies the unfairness of excluding 100079 Canada, Inc. from sharing in the Fair Fund.

As set-forth above, the shares owned by 100079 Canada, Inc. were originally acquired by Mr. MacKay in 1976, more than thirty years before he retired and was offered an honorary seat on Stiefel Labs' Board of Directors. This is not a situation, for example, where 100079 Canada, Inc. made a large investment in Stiefel Labs, was entitled to appoint a board member as a result of owning a large number of shares, and appointed Mr. MacKay. *See, e.g., UMG Recordings, Inc. v. Veoh Networks Inc.*, 2009 WL 334022 (C.D. Cal. 2009) (recognizing the existence of such practice). Nor is this a situation where Mr. MacKay was appointed to the board first, and was subsequently granted shares as compensation for his board membership. Instead, the shares at issue were acquired decades earlier and completely independent of Mr. MacKay's board membership. For this reason, 100079 Canada, Inc. truly is an innocent victim of Charles Stiefel's fraud.

It is well-settled that a "corporation is a creature of law, separate and distinct from its owners. . . ." *In re Woolum*, 279 B.R. 865, 870 (Bankr. M.D. Fla. 2002). Excluding 100079 Canada, Inc. from any distribution from the Fair Fund premised solely on the ground that the corporation is owned by Mr. MacKay is unfair and completely disregards clear law that accords respect and individuality to the corporate form. *See Marleau v. Lawmen's & Shooters' Supply, Inc.*, 2009 WL 10668544, at *8 (S.D. Fla. 2009) (noting that "this Court is careful to respect [the] distinct corporate identity and business purpose."). Therefore, even if the Court overrules the objection to the categorical exception for board members, it should nonetheless reject the proposed Distribution Plan and order that 100079 Canada, Inc. is entitled to a pro rata distribution of the Fair Fund.

REQUEST FOR HEARING

The Excluded Shareholder respectfully requests the Court to hold oral argument on this objection. Given the facts and legal nuances involved, the Excluded Shareholder believes that an opportunity to present oral argument and to answer questions posed by the Court will be helpful in resolving this objection and ensuring that the Distribution Plan proposed by the SEC is fair and reasonable as required by law. The Excluded Shareholder believes that 30-minutes, exclusive of any time allocated for objections from other claimants, will be sufficient.

CONCLUSION

For the reasons articulated herein, the Court should reject the proposed Distribution Plan and require that 100079 Canada, Inc. receive a pro rata distribution from the Fair Fund.

Dated: November 9, 2020

Respectfully submitted,

/s/ Jack R. Reiter

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was filed this 9th day of November 2020, through CM/ECF and served on all counsel of record via electronic notification generated by the CM/ECF system.

/s/ Jack R. Reiter