**IN THE UNITED STATES DISTRICT COURT**
**FOR THE SOUTHERN DISTRICT OF FLORIDA**
**(MIAMI DIVISION)**

Civil Action No. 1:11-cv-24438-GAYLES

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

STIEFEL LABORATORIES, INC. and CHARLES W. STIEFEL,

Defendants.
_____/

## OBJECTIONS TO DISTRIBUTION PLAN

Michael Martinolich ("Martinolich"), Wayne Hazelton ("Hazelton"), James Bacon ("Bacon"), and Denise Hulbert, as executor of the Estate of Glendon Hulbert ("Hulbert") (collectively "Objectors"), through their undersigned counsel, object to the SEC's proposed Distribution Plan [DE 240-1] and state:

## BACKGROUND

### Stiefel Laboratories and the Employee Stock Bonus Plan

1. Stiefel Laboratories, Inc. ("SLI") was, when this litigation commenced in 2009, a 162-year old company that prided itself on its family-owned independence. *Finnerty v. Stiefel Laboratories*, 756 F.3d 1310, 314 (11th Cir. 2014), *cert den.* 575 U.S. 912, 135 S.Ct. 1549, 191 L.Ed.2d 637 (2015).

2. In 1975, SLI established the Employee Stock Bonus Plan (ESBP) as a benefit for its U.S. employees. The ESBP was a tax-qualified, defined contribution pension plan governed by the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue

Code. Under the terms of the ESBP, shares of SLI common stock and/or cash were contributed annually to the ESBP by SLI and allocated to participants' ESBP accounts. At all relevant times, including at the time of the merger with. GSK, SLI had over 100 shareholders, including the ESBP, and the ESBP had over 500 participants. *Martinolich v. Stiefel Laboratories, Inc.*, 2015 WL 11201167 *2 (S.D. Fla. 2015); *Wagner v. Stiefel Laboratories, Inc.*, 2015 WL 4557686 *1 (N.D. Ga. 2015); *Beede v. Stiefel Laboratories*, 2016 WL 916418 (N.D.N.Y. 2016).

Prior to 2008, the terms of the ESBP only permitted a participant to take a distribution of his or her shares and then sell (or "put") the shares back to SLI upon certain triggering events, including termination of employment, retirement, and death. SLI would purchase the distributed stock from the ESBP participant at a price set annually by the Plan Trustee. Because SLI's stock was not publicly traded, the Trustee would have to determine the fair market value of the Company's common stock at least once a year. At all material times, Charles Stiefel served as Trustee. During that time, he annually engaged Terence Bogush, CPA ("Bogush") to perform valuations of the SLI common stock held by the ESBP as of the end of the Plan year, March 31. *Id.* Bogush initially was retained in 1987 to conduct the annual appraisals of SLI's stock. In March 2006, Bogush valued SLI's common stock at $13,012 per share, in March 2007—at $14,517 per share, and in March 2008—at $16,469 per share. *Wagner* at *1.

3. On September 26, 2008, the ESBP was amended to give eligible participants employed by SLI for over five years the right to request a distribution of stock and to put that distributed stock to SLI. These "optional diversification" rights were announced to eligible ESBP participants on November 21, 2008. *Finnerty* at 1315; *Martinolich* at *3.

4. On July 6, 2009, Objector James Bacon ("Bacon") and two others sued Stiefel Laboratories, Inc., ("SLI"), Charles Stiefel ("Stiefel") (the "Stiefel Defendants") and others in a

class action complaint in Case No. 09-21871 in the Southern District of Florida (the "Original Action"). Objectors Martinolich, Hazelton and Hulbert were putative class members. The Original Action, later repeated in the SEC's Complaint in this case, alleged:

a. a scheme whereby the annual valuation of the Employee Stock Bonus Plan ("ESBP") was consistently undervalued by Bogush, the person annually retained by the Stiefel in his capacity as Trustee of the ESBP to perform the annual valuations required by law.

b. a second scheme by the Stiefel Defendants beginning November 21, 2008 to induce participants in the ESBP to sell their shares to SLI at Bogush's March 31, 2008 valuation with the knowledge that Stiefel was in the process of selling the company for many times that value. The program was euphemistically called "Optional Diversification." Employees were given a window to "put" their shares to the company at the March 31, 2008 valuation of $16,469 per share. Most of them sold their shares on February 13, 2019.

5. The events of November 2008-April 2009 are detailed in the SEC's Complaint at ¶¶32-41 and in *Finnerty, Martinolich, Wagner* and *Beede.* See FN 1, *infra.*

6. For reasons not relevant here, Bacon dropped out as a named putative class plaintiff and Timothy Finnerty was substituted. Mr. Bacon subsequently filed a separate action on similar grounds on February 11, 2011: *Bacon v. Stiefel Laboratories, et al.,* Case No. 11-cv-20489-King.

7. Class action status was denied in the Original Action. Mr. Finnerty continued as an individual plaintiff.

8. On October 4, 2012, the District Court entered Final Judgment for Timothy Finnerty against SLI and Stiefel in the Original Action. The judgment awarded Mr. Finnerty $1,502,484.90 in compensatory damages plus pre-judgment interest and costs. *Original Action* DE 533.

9. The Finnerty judgment was appealed to the 11th Circuit Court of Appeals. That court affirmed. *Finnerty, supra.* The Eleventh Circuit specifically affirmed Mr. Finnerty's damages. *Id.* at 1315, FN 8.

10. On December 12, 2011, the Securities and Exchange Commission sued SLI and Stiefel in this cause (the "SEC Complaint"). The allegations were similar to those in the Original Action. A copy of the SEC Complaint is attached as **Exhibit A**. The SEC alleged ill-gotten gains of $110 million.

11. On November 27, 2012, Objectors Martinolich, Hazelton and Hulbert filed an action on similar grounds as to the securities fraud that took place in late 2008-early 2009. *Martinolich, et al v. Stiefel Laboratories, et al.*, Case No. 12-cv-24212-King. The Martinolich and Hazelton claims are still pending.

12. On April 23, 2020, SLI settled the SEC's action against it, agreeing to disgorge $23,000,000 plus prejudgment interest on disgorgement of $2,210,000 and a civil penalty of $1,300,000. (DE 232-1). On the same date, Charles Stiefel settled the SEC's action against him, agreeing to disgorge $9,300,000 plus prejudgment interest on disgorgement of $930,000 and a civil penalty of $260,000. (DE 232-2).

13. On June 4, 2020, the Court entered judgment against SLI for disgorgement of $23,000,00000 plus interest of $$2,210,000 and a civil penalty of $1,300,000 for a total of $26,510,000. (DE 235). On the same day, the Court entered judgment against Mr. Stiefel for disgorgement of $9,300,000 plus interest of $930,000 and a civil penalty of $260,000 for a total of $10,490,000 (DE 234). The total disgorgement, including interest and penalties, was therefore $37,000,000.

14. Including the Original Action involving three plaintiffs, filed on July 6, 2009, and this case involving the SEC, at least six federal cases[1] involving 17 plaintiffs, containing the same or

[1] *Bacon v. Stiefel Laboratories, Inc.,* Case No. 11-cv-20489 (S.D. Fla. 2011 (one plaintiff); *Wagner v. Stiefel Laboratories, Inc.,* Case No. 1:12-CV-3234 (N.D. Ga 2012) (four plaintiffs); *Martinolich v. Stiefel Laboratories, Inc.,* Case No. 12-2412-cv-Altonaga (S.D. Fla. 2012) (three

similar claims were filed against the Stiefel Defendants across the country. Except for the Original Action, the other complaints all related to the "optional diversification" fraud.

**The Distribution Plan**

15. On September 24, 2020, the Securities and Exchange Commission (SEC) filed herein a *Motion to Approve Distribution Plan* with a proposed Distribution Plan and list of "Eligible Shareholders" with identities concealed (DE 240). The proposed Distribution Plan is at DE-240-1 and is attached hereto as **Exhibit B.**

16. The Distribution Plan seeks to distribute $36,999,940 to 258 Eligible Shareholders divided into four tranches: those who sold their ESBP shares to SLI with values as of March 31, 2006 (the "2006 Tranche"), as of March 2007 (the "2007 Tranche"), as of March 31, 2008 (the "2008 Tranche") and those who sold Non-Plan shares to SLI during the period March 27, 2007-June 23, 2008 (the "Non-Plan Tranche").

17. In both the *Motion to Approve Distribution Plan* and the Distribution Plan the SEC recognized that "each group of shareholders suffered a different amount of harm based on the number of shares they sold and the amount by which [SLI] shares were undervalued as of March 31, 2006, 2007 and 2008." *Id.* at 4. They retained expert Marc Brown of AlixPartners[2] to "determine the true value of the Company's stock on each of these respective dates." According to the SEC, Mr. Brown determined the true value of the ESBP shares – "**the price the Company should have paid Stock Plan shareholders** – during the various periods the Company

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plaintiffs); *Beede v. Stiefel Laboratories, Inc.,* Case No. 1:13-cv-120 (N.D. NY 2013) (four plaintiffs); *Fried v. Stiefel Laboratories, Inc.,* Case No. 11-cv-20853 (S.D. Fla. 2011) (one plaintiff); *10097 Canada, Inc. v. Stiefel Laboratories, Inc.,* 11-cv-22389 (S.D. Fla. 2011 (one plaintiff).

[2] The valuations are actually those of R. Bruce Den Uyl, Managing Partner of AlixPartners, whose reports are of record at ECF 50-24 and 145-15. Mr. Den Uyl has since died, and counsel is informed that the SEC has a non-public report by Marc Brown that adopts the valuations of Mr. Den Uyl. For purposes of this Objection, we will refer to the Den Uyl reports of record.

purchased shares from employees… **The differences in price between what Stiefel Labs paid shareholders and what the shares were actually worth**, and the corresponding amounts of the Distribution Payments, are explained in the Distribution Plan." *Id.* (emphasis added); Distribution Plan (DE 240-1, p.8).

18. There are 258 identified Eligible Shareholders in the Distribution Plan.[3] They break down as follows, with the amount of the Fair Fund allocated to each Tranche, the net loss and percentage of total losses for each:

| Tranche | Investors | Shares sold | Expert Proceeds | Net Loss | Pro Rata Distributions | Pro Rata % |
|---|---|---|---|---|---|---|
| 2006 | 15 | 257.64 | 8,838,312 | 5,484,640 | 4,969,224 | 13.43% |
| 2007 | 56 | 360.00 | 18,923,865 | 15.221,880 | 13,791,440 | 37.27% |
| 2008 | 181 | 650.50 | 28,366,139 | 15,697,216 | 14,222,107 | 38.44% |
| Non-Plan | 17 | 123.04 | 4,625,518 | 4,625,518 | 4,017,159 | 10.86% |

19. It can therefore be seen that the 2008 Tranche, with over three times the number of Investors and nearly twice the number of shares – and who suffered a second and greater fraud, is allocated approximately the same amount of the losses as the 2007 Tranche.

## VALUATION OBJECTION

All Objectors join in objecting to the valuation placed on the 2008 Tranche. As stated in the Distribution Plan, the value used for distributing the Fair Fund should be **"the difference in price between what Stiefel Labs paid shareholders and what the shares were actually worth when they were sold**," not an arbitrary date nearly a year before. The correct amount, determined in the *Finnerty* judgment and affirmed by the 11th Circuit, is $69,705 per share. The

[3] There are 258 total enumerated Eligible Shareholders. Seven of them have claims in both the 2008 Tranche and either the 2006 or 2007 Tranches and thus were not assigned a separate number. The total number of listed transactions is 265.

Distribution Plan wrongly sets the amount per share at $40,500 per share at March 31, 2008 instead of the date the 2008 Tranche claimants sold their shares to SLI. An appropriate date would be February 13, 2009, which is the date that 146 of the 181 investors in the 2008 Tranche sold their shares to SLI.[4] All of them are short-changed in the Distribution Plan.

**Standard of Review**

"The standard of review for a proposed Fair Fund distribution plan is whether the fund distribution plan 'fairly and reasonably distribute[s] the limited Fair Fund proceeds among the possible claimants." *SEC v. CR Intrinsic Investors,* 164 F.Supp.3d 433, 434 (S.D.N.Y. 2016), quoting *Official Comm. of Unsecured Creditors of WorldCom, Inc. v. S.E.C,* 467 F.3d 73, 85 (2d Cir. 2006). [A]ny SEC plan to distribute disgorged profits is reviewed under the court's general equitable powers to ensure that [the plan] is fair and reasonable. *Worldcom* at 82-83, *quoting SEC v. Wang,* 944 F.2d 80, 81 (2d Cir. 1991). The Court reviews the SEC plan under its general equitable powers to ensure that the plan is fair and reasonable. *Worldcom* at 82-83.

**Disgorgement of Ill-gotten Gains and the Fair Fund**

The SEC Complaint alleged that the SLI defrauded shareholders out of $110 million at the direction of Mr. Stiefel, its then chairman and CEO. The SEC asked, among other things, that the Stiefel Defendants "disgorge all ill-gotten profits or proceeds resulting from the violations alleged in this complaint, with prejudgment interest… and [civil penalties]." It further asked for relief under the Sarbanes-Oxley Act of 2002 and Section 21(d) of the Exchange Act. (DE 1, p. 22). The SEC settled its $110 million disgorgement claim for $37 million, or approximately 33.6%.

[4] Seven sold their shares on April 1, 2009. The rest sold their shares in December 2008-January 2009.

"Disgorgement is an equitable remedy and that unlike damages, 'it is a method of forcing a defendant to give up the amount by which he was unjustly enriched.'" *Wang, supra at 85; CR Intrinsic Investors, supra* at 435. Although disgorged profits may be distributed to defrauded investors, "[t]he primary purpose of disgorgement orders is to deter [future] violations of the securities laws by depriving violators of their ill-gotten gains." *Worldcom, supra* at 81. "[U]nlike a private action seeking compensatory damages, the SEC enforcement action 'involve[s] penalties, which go beyond compensation, are intended to punish, and label defendants wrongdoers. *Securities and Exchange Commission v. Graham,* 823 F.3d 1357, 1361 (11th Cir. 2016), *quoting Gabelli v. SEC,* -- U.S.--, 133 S.Ct 1216, 1223, 185 L.Ed.2d 297 (2013).

On the other hand, "the goal of a Fair Fund distribution plan is the **compensation of victims rather than the deterrence of future wrongdoing**." *Worldcom* at 82 (Emphasis added).

**The SEC Valuation**

The SEC's use of the March 31, 2008 date for valuation for the 2008 Tranche is neither fair nor reasonable. It is not supported by anything the SEC has alleged in this case or, importantly, in the *amicus curia* brief it filed in *Finnerty.* There is simply no basis to use that date to the detriment of 181 out of the 258 affected shareholders.

Objectors do not take issue with Mr. Den Uyl's valuations as of March 31 of each year. They take issue with use of the March 31, 2008 valuation to determine "**the price that the shares were actually worth"** and the price that SLI should have paid when the 2008 Tranche shareholders sold their shares to SLI in early 2009. Mr. Den Uyl said that in his Report filed January 23, 2013 (DE 50-24). That report criticizes the values and reasoning of Bogush and SLI's then-expert, Chester Gougis, concluding:

> Given that in late 2008 and 2009 Stiefel Labs was actively shopping the Company (having hired an investment banker and actively seeking bidders) rather than

> conduct a valuation exercise, the Trustee should have deferred purchases of the Plan stock until the outcome was known. **With current indications of value so dramatically different than the current appraisal value the participants in the Plan would be significantly harmed by not receiving the value offered and ultimately received by the common stockholders in Stiefel Labs.**

DE 50-24, p 19 (emphasis added).

Hence, the value assigned by the SEC's expert for March 31, 2008 is not his determination of the "**price that the shares were actually worth**" when the 2008 Tranche shares were purchased from the investors in late 2008-early 2009. The SEC's Complaint in this case says as much. *See*, Complaint (DE 1) at ¶¶ 36-41 ("from December 2008-April 2009, SLI bought more than 800 shares from current and former employee shareholders for $16,469 per share. This fraudulent scheme deprived shareholders of their interest in their shares at artificially low prices." *Id*, ¶ 37) ("At the time, senior management knew that the Company's enterprise value was at least $3 billion and the Stiefel family would not accept a sale for less.") ¶ 39 ("GSK paid SLI $2.9 billion and most then-existing shareholders got $68,131 per share.")[5] *Id.* ¶ 41.

**Distribution Plan is Contrary to SEC's Brief and Numerous Filings**

The SEC has recognized that the valuations should have been updated for significant events occurring after the dates of the valuations. SEC Complaint ¶ 44. Those events are described in ¶¶32-47, particularly where it is alleged that the 2008 valuation from December 2008-April 1, 2009 was misleading because it failed to take into consideration, among other things, "that Stiefel Labs had become actively engaged in material discussions, including receiving offers, to sell the Company.."

[5] The difference between $68,131 per share and the $69,705 per share awarded Mr. Finnerty is that the remaining shareholders were entitled to an additional amount based on certain conditions regarding the sale.

The SEC filed an *amicus curiae* brief on the subject in the *Finnerty* appeal (the "Amicus Brief).[6] Among other things, the SEC argued that, "Defendants had a *duty to correct* any valuation that was incorrect when made because, for example, the valuation failed to reflect contemporaneous, material merger negotiations or other offers to purchase Stiefel Lab's shares at materially higher prices… Even if the valuation was correct when made, defendants had a *duty to update* their prior statements regarding the valuation, if there was an event after the valuation was announced-during the year the valuation was in effect- that made that valuation materially inaccurate, such as material merger discussions… Here, defendants' duty to update the valuation is especially clear because they represented that the 'fair market value of Stiefel Labs' shares would be redetermined 'from time to time as may be necessary.'" *Amicus Brief*, p.8 (emphasis in brief).

In addition to the Complaint in this case, the SEC similarly argued that the March 31, 2008 valuation date should not be used in other filings. In its *Motion for Summary Judgment* (DE 27, pp. 4-11) the SEC focuses on the identical facts of the SEC Complaint and Finnerty. At p. 6, the SEC asserted that SLI failed to provide their employee shareholders with a correct valuation of their stock. In doing so, "they also instituted a diversification plan, which allowed them to buy back company stock at far undervalued values." This allowed [the Stiefel Defendants] to sell these shares to the Company's acquirer, GSK, for a vastly inflated value compared to previous valuations of the Company's stock.

On pp. 7-8 of the *Motion for Summary Judgment*, the SEC reiterated the allegations of the SEC Complaint regarding the ill-gotten gains of $110 million and the identity of this case to

[6] Brief of the Securities and Exchange Commission as *Amicus Curiae* in Support of Plaintiff-Appellee, Urging Affirmance, *Finnerty v. Stiefel Laboratories, Inc. and Charles W. Stiefel*, Eleventh Circuit Case Nos. 12-13947-DD, 12-15060-DD and 12-15642-DD.

*Finnerty*, asserting entitlement to relief for collateral estoppel regarding the facts of the 2008-09 optional diversification fraud. In its Statement of Undisputed Facts (DE 27-1), the SEC again asserted all of the facts related to the "diversification" program from Nov 21, 2008 to the merger agreement with GSK on April 24, 2009.

The SEC filed another *Motion for Summary Judgment* at DE 144. On pp. 4-8 the SEC again described the plan to sell SLI beginning in November 2008 and the resulting undervaluation at that time.

Clearly, the valuation date used in the Distribution Plan for the 2008 Tranche is not only unreasonable- it is wrong, leading to a false value for the shares sold by 2008 Tranche claimants to SLI. None of the numerous filings in this case and the *Finnerty* appeal are relevant if the date to be used is March 31, 2008.

**The Actual Value of the 2008 Tranche**

The actual value of the shares in the 2008 Tranche was determined by the trial court and affirmed by the Eleventh Circuit in *Finnerty*. That value is $69,705 per share.[7]

## ARGUMENT

**The Distribution Plan is Not Fair and Reasonable.**

While the SEC's Fair Fund Distribution Plan is entitled to deference by the Court, it must be fair and reasonable. *Worldcom* at 82-83; *Wang* at 81. It cannot be said in this case that the Distribution Plan is fair and reasonable. Rather, it can be said that it is arbitrary because the valuation is made as of a date that is irrelevant to the circumstances under which the 2008 Tranche claimants sold their shares.

[7] Mr. Finnerty received a judgment for $1,502,484 plus interest and costs. *Case No.* 09-21871-cv-King (S.D. Fla. 2009) ECF 533. He had 28.223 shares and had gotten $$464,804.58 from SLI at $16,469 per share for his ESBP shares on February 12, 2009. This amount was affirmed. *Finnerty* at 1321, FN 8.

There were two different frauds perpetrated against the ESBP participants. The first was the systematic under-valuation of the shares by Mr. Bogush. His methodology was attacked by the SEC's expert here and experts in the other cases. Most notable was his incorrect application of a 35% discount for lack of marketability (versus a correct 5% or less) that he applied on March 31 for over 20 years.

The more sinister of the frauds was perpetrated on the 2008 Tranche claimants**.** In addition to the undervaluation as of March 31, 2008, these 181 victims were subjected to a second and more deceptive fraud. They were enticed by the Stiefel Defendants to sell their shares back to the company as part of a first-time ever "optional diversification" program. Under that program, SLI harvested shares from unsuspecting shareholders while knowing that the shares were worth over four times the value.

The fair and reasonable standard requires similarly situated investors to be treated alike. On the other hand, investors who suffered different types and amounts losses should be treated differently. It is appropriate to approve a plan where "the most grievously injured claimants should receive the greatest share of the fund." *SEC v. Certain Unknown Purchasers of the Common Stock of and Call Options for the Common Stock of Santa Fe Int'l Corp.*, 817 F.2d 1018, 1021 (2d Cir. 1987); *Securities and Exchange Commission vl JP Morgan Securities, LLC,* 266 F.Supp.3d 225, 233 (D. DC 2017), *citing Worldcom* at 84 (SEC is allowed to focus on the most grievously injured claimants at the expense of the other investors). Here, the SEC did the opposite- it focused on the other investors at the expense of those most grievously injured.

According to the Distribution Plan, the SEC's expert identified the "differences in price between what the Defendants paid Stock Plan shareholders and what the shares were actually worth." Distribution Plan, p.8. The SEC's expert did not do that for the 2008 Tranche. He simply

did a valuation at the same date as Bogush to disprove those valuation. By selecting the March 31, 2008 valuation date for the 2008 Tranche, the SEC arbitrarily selected a date that had nothing to do with a calculation of the difference in price between what the Stiefel Defendants paid Stock Plan shareholders and what the shares were actually worth. That is not the expert's fault- in his report at DE 50-24, p.19, quoted above, Mr. Den Uyl specifically opined that the valuation date should have been deferred the outcome of the sale process was known, failing which the participants would be significantly harmed.

The SEC's selection of March 31, 2008 valuation date did not accomplish the stated purpose of identifying the difference in price between what was paid to the shareholders on or after November 21, 2008 and the amount they should have received if the shares were evaluated after that date – the amount set forth in the *Finnerty* judgment. The SEC selected an arbitrary and debunked date that was contrary to their own expert's opinion of the proper date and contrary to its own numerous filings in this case and *Finnerty*.

**Fair and Reasonable Standard – Court's Discretion**

It is within the court's discretion to determine how and to whom the money will be distributed. *Worldcom* at 81; *JP Morgan Securities* at 229. In doing so, the court must ensure that the Distribution Plan is fair and reasonable. *Worldcom* at 82-83; *Wang* at 81; *JP Morgan Securities* at 229.

The Distribution Plan cannot be fair and reasonable where 181 investors who bore the brunt of the Stiefel Defendants' fraudulent activities are short-changed to the benefit of 151[8] who did not. Arguably the investors who are not in the 2008 Tranche will see a windfall under the Distribution Plan. After all, they were not wrongfully enticed to put their shares to SLI- they took

[8] There are 71 Plan Participants in the 2006 Tranche (15) and the 2007 Tranche (56).

advantage of the ESBP's usual and statutory provisions to convert their shares on happening of an approved event.

We recognize that the SEC may engage in line-drawing to make allocations that may leave out some potential claimants. *Wang* at 88. That line-drawing ability is subject to the determination that the overall plain is fair and reasonable. *Id.* For the reasons stated, this Distribution Plan is not.

**JAMES BACON AND DENISE HULBERT OBJECTIONS[9]**

Objectors James Bacon and Denise Hulbert are excluded from the Distribution Plan because they settled their claims with the Stiefel Defendants for amounts the SEC incorrectly deems to be in excess of the amount they would otherwise receive from the Fair Fund. They object to their classification as "Excluded Shareholder(s)" due to 1) the under-valuation of the 2008 Tranche discussed above, and 2) the SEC's refusal to subtract their attorney's fees and costs from the gross amounts of their settlements in calculating their net loss for the purposes of determining their participation in the Distribution Plan.

The Distribution Plan defines "Investment Recovery" as:

> [A]ny amount recovered by an Eligible Shareholder on the sale of Stiefel Labs stock to the Company in excess of the sales proceeds the Eligible Shareholder received from the Company, including but not limited to **any payment the Eligible Shareholder obtained** from prevailing in or settlement of any lawsuit against the Defendants arising from the same or similar facts as alleged in the Commission's Complaint.

The Distribution Plan defines "Net Loss" as:

> "Net Loss" means the calculated amount an Eligible Shareholder should have received from his or her sale of Company shares to Stiefel Labs based on the valuations performed by Commission expert witness … ("Expert Valuation"),

[9] Although these Objectors believe that their objections should properly be raised and determined after the valuation objection is resolved, the SEC has requested, and Objector's counsel has agreed, to raise this objection at this time in order to accelerate the overall process.

> **minus the amount the Eligible Shareholder actually received from the Company,** and minus any Investment Recovery. Each Eligible Shareholder will receive a pro rata share of their Net Loss through this Distribution Plan**… If the total amount a Potentially Eligible Shareholder actually received** plus any Investment Recovery is equal to or greater than the Expert Valuation, then the Net Loss for that Potentially Eligible Shareholder shall be zero and that shareholder shall be an Excluded Shareholder.

Distribution Plan pp. 3-4.

**Mr. Bacon's Wrongful Exclusion from the Distribution Plan.**

Mr. Bacon had 25.386449 shares in the ESBP that were sold to SLI as part of the "optional diversification" plan on February 13, 2009 for $16,469 per share. On February 3, 2015, Mr. Bacon settled his claim with the Stiefel Defendants for $1,050,000. After attorney's fees of $350,000 and costs of $85,045.99 he received $614,954.01. But for his exclusion, Mr. Bacon would be a member of the 2008 Tranche.

According to the SEC, Mr. Bacon would be excluded because his gross recovery of $1,050,000 exceeds the amount he would get under the Distribution Plan plus the money received from SLI in 2009. Using the methodology in the Distribution Plan, Mr. Bacon would have "Expert Proceeds" of $1,030,689.87 (25.386449 x $40,600) and a net loss of zero because he received a $1,050,000 settlement. If one uses the amount Mr. Bacon **received** from his settlement with the Stiefel Defendants, Mr. Bacon has a net loss of $2,353.58 and he should be included in the Distribution Plan for that amount prorated accordingly.

Using the correct valuation of $69,705 per share for his shares, Mr. Bacon's Net Loss is $301,473.05 before application of attorney's fees and costs. His net loss is $736,519.05 after attorney's fees and costs. He should be included in the Distribution Plan for that amount, prorated accordingly.

**Ms. Hulbert's Wrongful Exclusion from the Distribution Plan**

Ms. Hulbert's deceased husband, Glendon Hulbert, had 13.395242 shares in the ESBP that were sold to SLI as part of the "optional diversification" plan on February 13, 2009 for $16,469 per share. On May 30, 2015, Ms. Hulbert settled her claim with the Stiefel Defendants for $450,000. After attorney's fees ($150,000.00) and costs ($5,102.11), Ms. Hulbert received $294,897.89. But for her exclusion, Ms. Hulbert would be a member of the 2008 Tranche.

According to the SEC, Ms. Hulbert is excluded because her gross settlement recovery of $450,000 plus $220,606 received from SLI is greater than the net loss of calculated using the $40,600 per share valuation. Using the SEC's methodology and the March 31, 2008 valuation of $40,600 per share, Ms. Hulbert's Expert Proceeds are $543,846.74. After reduction for $220,606 per share paid by SLI at $16,469 per share and the $450,000 settlement, Ms. Hulbert received a total of $670,606 which would disqualify her from the Distribution Plan if one does not use the correct valuation **or** deduct for her attorney's fees and costs. On the other hand, considering attorney's fees and costs, Ms. Hulbert's "net loss" using the SEC's valuation is $515,504.21. In that case she would be included in the Distribution Plan with a net loss of $38,342.54 ($543,846.74-515,504.21) even without correcting the SEC's valuation. Using the correct valuation, Ms. Hulbert should be included with a loss of $263,109 (Revised valuation of $933,715- funds received from SLI $220,606- gross settlement $450,000). If one uses the "funds received" after considering attorney's fees and costs, Ms. Hulbert's "net loss" is $418,211.11 and she should be included in the Distribution Plan for that amount, prorated accordingly.

**Exclusion of Attorney's Fees and Costs Violates the Distribution Plan and is Unfair and Unreasonable.**

The exclusion of attorney's fees and costs incurred in the private actions by Mr. Bacon and Ms. Hulbert violates the terms of the Distribution Plan and is unfair and unreasonable. They are "Eligible Shareholders" as defined in the Distribution Plan.

As quoted above, an "Investment Recovery" is "**any payment the Eligible Shareholder obtained** from prevailing in or settlement of any lawsuit against the Defendants…" Whether the funds received in settlement should be calculated before or after the application of attorney's fees and costs depends on what is meant by "obtained" in a settlement. That question is answered in the definition of "Net Loss" that is also quoted above. There, the shareholder's Net Loss is defined to mean the "Expert Valuation" minus the amount the Eligible Shareholder **"actually received."** It goes on to use that measure again: "if the total amount a Potentially Eligible Shareholder **actually received** plus any Investment Recovery is equal to or greater than the Expert Valuation then the Net Loss… shall be zero…"

Whether it is the "payment obtained" or "actually received," the Distribution Plan must be interpreted as the money the shareholder actually got from his or her efforts. After all, these people could not plan on receiving anything from the SEC's efforts which, at the time of their settlements, had languished for four years and would languish for another five years. Nor is it equitable to not consider their expenses in getting a recovery. Their litigation expenses are not in their pockets. They have lost that money as a result of the Stiefel Defendants' scheme as surely as if someone took some of their shares. In Mr. Bacon's case, his Original Action was the basis for the SEC Complaint and all others brought around the country. The actual costs he bore are greater than others as a result; all claimants and the SEC owe him a debt of gratitude rather than a reduction of his claim.

There does not appear to be any case law exactly on the point. However, there is strong public policy favoring private actions in securities fraud cases. *See, e.g., Hernandez v. Balakian,* ("[W]e repeatedly have emphasized that implied private actions provide 'a most effective weapon' in the enforcement of the securities laws and are a necessary supplement to

Commission action), *quoting Bateman Eichler, Hill Richards, Inc. v. Berner,* 472 U.S. 299, 319-311, 105 S.Ct. 2622, 86 L.Ed.2d 215 (1985). That public policy is undercut where private parties are discouraged from bringing actions against securities fraudsters because, if successful, they end up getting a reduced amount from any recovery that the SEC may ultimately get from the same defendants. In essence, private actions that are supposed to supplement the SEC action instead compete with it. It is one thing to offset the money **actually obtained or received** by a claimant in determining a proper Distribution Plan; it is quite another to offset funds that never reached the claimants' bank accounts.

WHEREFORE, Objectors request that their Objections be sustained and that:

a. The Court determine that the value for those in the 2008 Tranche who sold their shares at the March 31, 2008 valuation be set at $69,705 per share; and

b. That the Court reject the exclusion of Objectors Bacon and Hulbert, and direct the SEC to include them at their net loss after payment of attorney's fees and costs; and

c. That the Objectors have such other and further relief as deemed just and proper.

**Certificate of Good Faith**

Pursuant to Local Rule 7.1(a)(3)(A), I hereby certify that counsel for the Objectors has conferred with all parties or non-parties who may be affected by the relief sought in this motion in a good faith effort to resolve the issues but has been unable to resolve the issues.

Respectfully submitted this November 9, 2020.

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