

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
WEST PALM BEACH DIVISION**

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

CASE NO. 14-CV-80468-
MIDDLEBROOKS/BRANNON

vs.

JCS ENTERPRISES, INC. d/b/a JCS
ENTERPRISES SERVICES, INC., T.B.T.I., INC.,
JOSEPH SIGNORE, and PAUL L. SCHUMACK, II,

Defendants.

**CLAIMANT FIRST DATA'S CROSS-MOTION FOR SUMMARY ADJUDICATION
AND OPPOSITION TO RECEIVER'S MOTION FOR SUMMARY ADJUDICATION**

First Data Merchant Services, LLC (“First Data”) moves for summary adjudication of its claim against JCS Enterprises, Inc.’s (“JCS”) receivership estate (“Estate”), and opposes James D. Sallah’s (the “Receiver”) Motion for Summary Adjudication of the Receivership Claim of First Data, dated October 7, 2019 (“Motion”) (ECF 435).

INTRODUCTION

This lawsuit arises from a massive Ponzi scheme in which JCS defrauded hundreds of its customers by selling them nonexistent advertising kiosks and promising them guaranteed and exorbitant returns. Although JCS disclosed the terms of its scheme to its customers—promising returns as high as 500%—JCS concealed the true nature of its “business” from First Data, its credit card processor, even though JCS’s customers routinely bought their “kiosks” with credit cards.

When the Ponzi scheme began to unravel, JCS’s principal, Joseph Signore, compounded JCS’s fraud against First Data by encouraging his customers to seek refunds of their investments by disputing their credit card charges. This direction by JCS to its customers led to a massive abuse of the “chargeback” process. Although JCS’s contract with First Data made JCS responsible to reimburse First Data for all chargebacks, Signore knew that, under banking regulations and bankcard industry rules, First Data had a duty to honor *all* chargebacks, and that customers who disputed their charges—regardless of whether the customer had in fact received a return on their investment—would receive automatic credits while the dispute was being investigated. Thus, Signore—who knew that JCS would never have the funds to reimburse First Data—forced First Data to *fund* those chargebacks. And the Receiver exacerbated what Signore started. As a result of the chargeback scheme, First Data was forced to fund over **\$7 million** in chargebacks to JCS customers—making First Data by far the biggest victim of JCS’s Ponzi scheme. Over \$4 million of those chargebacks were received into the JCS merchant account *after* the Receiver took control of JCS, and the Receiver failed to research and affirmatively contest any of them.

The Receiver acknowledges First Data is JCS’s largest victim, and that its position in this equitable proceeding is unique because it was the only party that “had to pay people back.”

Nevertheless, he proposes to put First Data last in line for recovery, ensuring that First Data will receive nothing. Rather than devote the necessary resources to disputing chargebacks or pursuing those customers who abused the chargeback process, the Receiver—who had literally zero experience with credit card processing issues—decided early on that he would simply subordinate First Data’s claim by dismissing First Data as a “trade creditor.”

However, First Data is not making a claim as a routine “trade creditor”—*i.e.*, for payment for credit card processing services—and it is wholly inequitable for the Receiver to wipe out First Data’s claim without engaging in the appropriate analysis. Indeed, by classifying First Data as a trade creditor from the very beginning, the Receiver ignored the uniqueness of First Data’s claim. Moreover, even if the Court determines First Data was a trade creditor, that does not end the inquiry, because the Court still must determine whether subordinating First Data’s claim is equitable. The Southern District of Florida has recognized that, where applicable banking regulations force a claimant to fund chargebacks made by customers of an entity in receivership, equity requires that claimant be reimbursed first. *See FTC v. IAB Mktg. Assocs., LP*, No. 12-61830-CIV, 2013 U.S. Dist. LEXIS 136502, at *5-6 (S.D. Fla. Sept. 19, 2013).

Here, equity requires that First Data’s claim be given *first priority*, or, at the very least, the same priority as the claims of JCS’s customers. The Receiver ignores that First Data’s funding of investor/customer chargebacks made First Data an *involuntary investor* in JCS, and through its “involuntary investment” in JCS, First Data decreased other claims against the Estate by millions of dollars. The Receiver has no authority to support his dismissal of First Data as a mere trade creditor, and none of the Receiver’s new arguments justify that classification. A receiver’s task is to do equity and, while First Data recognizes JCS’s customers are not to blame for JCS’s fraud, there is no equity in denying any recovery to JCS’s largest victim.

FACTUAL BACKGROUND

First Data processes credit card transactions for merchants who accept Visa and MasterCard as payment for goods or services.¹ Merchants are often directed to First Data by independent sales organizations (“ISOs”), such as Merchant One, who solicit merchants and perform an initial underwriting analysis, for example to verify the merchant’s business model and evaluate its credit.² Under its Marketing Agreement with First Data, Merchant One must complete an Application for each prospective merchant.³ It must “[t]ake all necessary action to verify that each prospective Merchant conducts or intends to conduct a bona fide business operation,”⁴ and must “inspect[] the Merchant’s premises to determine whether [it] has the proper facilities, equipment, inventory and license or permit, if necessary, to conduct the business.”⁵ Merchant One warrants all of the data it submits to First Data, other than the merchant’s financial information, is “to [Merchant One’s] knowledge [] correct, complete and not misleading.”⁶

I. Anatomy of a Credit Card Transaction

A credit card transaction is a multi-step process.⁷ A consumer (the “Cardholder”) obtains a credit card from a bank (the “Issuing Bank”) that is a member of Visa or MasterCard (the “Bankcard Company”).⁸ A merchant (the “Merchant”) who wishes to accept bankcards also contracts with a bank that is a member of a Bankcard Company (the “Acquiring Bank”), so called

¹ Deposition of Michael Aufiero (“Aufiero Depo”) Vol. I at 40:5-13 (**Exh. 1**).

² Aufiero Depo Vol. I at 51:12-52:1 (**Exh. 1**); Deposition of Suzanne DeAngelis (“DeAngelis Depo”) at 40:16-24, 42:24-43:9 (**Exh. 2**).

³ Marketing Agreement § 2(c)(1) (Depo Exh. 2 at FD-JCS-0010174-0010192) (**Exh. 3**)

⁴ *Id.* § 2(c)(ii).

⁵ *Id.*

⁶ *Id.* §§ 2(c), 3 (stating that Merchant One is responsible for Merchant credit research to the extent it is allocated to Merchant One in section 2(c) of the Marketing Agreement).

⁷ Declaration of Michael Aufiero (“Aufiero Decl.”) ¶ 14, Exhibit A (**Exh. 4**). Exhibit A to the Aufiero Decl. illustrates the anatomy of a credit card transaction as described in Section I; the chargeback process as described in Section IV, *infra*; and JCS’s abuse of the chargeback process as described in Section V, *infra*.

⁸ *Id.* ¶ 5(a).

because it “acquires” the Cardholder’s card transactions,⁹ which are processed by a “Processor,” such as First Data, under a separate contract with the Acquiring Bank, here Wells Fargo.¹⁰ A Merchant like JCS designates another bank (the “Settlement Account Bank”), here TD Bank, to receive the proceeds of its sales to Cardholders.¹¹

When a Cardholder makes a purchase, the process is as follows. The Cardholder presents the card to a Merchant, who uses a device or software program to request approval from the Issuing Bank (via the Processor/Acquiring Bank and Bankcard Companies),¹² which either approves the purchase or declines it if the Cardholder has insufficient credit.¹³ At the end of each day, the Merchant electronically sends its transaction data to its Processor, which, on behalf of the Acquiring Bank, “bundles” them with the transaction data of other Merchants with which it has a processing agreement and sends that data electronically to the appropriate Bankcard Company.¹⁴ The Bankcard Company sends the transaction data to the Issuing Bank and funds are distributed as follows: (1) the Issuing Bank wires the total dollar amount for all of the transactions (minus its fees) to the Bankcard Company; (2) the Bankcard Company (minus its fees) distributes the funds among the Merchants’ Acquiring Banks; (3) the Acquiring Banks with the assistance of the Processor’s instructions distribute the settlement funds (minus Acquiring Bank/Processor fees) to the Settlement Accounts of the Merchants that originated the transactions; and (4) the Issuing Bank sends monthly bills to its Cardholders for their purchases.¹⁵

⁹ *Id.* ¶ 5(b).

¹⁰ *Id.* ¶ 5(c).

¹¹ *Id.*

¹² *Id.* ¶ 6(a).

¹³ *Id.* ¶ 6(b).

¹⁴ *Id.* ¶ 6(c).

¹⁵ *Id.* ¶ 6(d)-(e).

II. JCS Retains First Data as its Credit Card Processor.

In November 2010, JCS approached Merchant One looking for a credit card Processor, representing that its business was the manufacture and sale of virtual kiosks,¹⁶ and that kiosk purchasers would solicit local businesses to advertise on the kiosks and keep the revenue that was generated.¹⁷ Under the Marketing Agreement, Merchant One performed the initial due diligence on JCS's Application, including calling the business owner listed on the Application to verify his identity and ensuring that JCS's business was real.¹⁸ In its Application to First Data, JCS acknowledged receipt of First Data's Merchant Services Program Guide (the "Program Guide") and agreed to all terms in the Application and Program Guide.¹⁹ In November 2010, First Data approved JCS's Application, which, with the Program Guide, became the parties' agreement (the "Merchant Agreement").²⁰

There is no evidence JCS was operating a Ponzi scheme when First Data approved JCS's Application.²¹ Notably, the Receiver concedes that nothing in the Application alerted First Data to such a scheme or that JCS's intent was to provide investment services.²² He acknowledges JCS's *customers* knew its business model—that JCS was promising guaranteed returns of as much as 500%—but that JCS “was trying to hide from First Data the true nature of [its] business during the time First Data was [its] credit card processor.”²³

¹⁶ Deposition of Andrew Saka (“Saka Depo”) at 148:22-149:10 (**Exh. 5**).

¹⁷ Merchant Processing Application and Agreement § 1 (“Application”) (Depo. Exh. 4) (**Exh. 6**). Due to its small print, Exhibit 3 is difficult to read. Accordingly, a blank Merchant Processing Application and Agreement (Depo Exh. 85) is attached to the end of Exhibit 6.

¹⁸ Saka Depo at 51:17-19, 53:12-20 (**Exh. 5**).

¹⁹ Application § 10 (Depo. Exh. 4) (**Exh. 6**).

²⁰ *Id.*

²¹ Deposition of James Sallah (“Receiver Depo”) at 107:17-20, 109:6-11 (**Exh. 7**).

²² *Id.* at 56:10-17.

²³ *Id.* at 58:11-18, 74:24-76:4.

III. First Data Suspects Unusual Activity and Cancels the Merchant Agreement.

JCS's initial sales were minimal. But sales picked up in 2012. From June to November 2012, for example, monthly sales ranged from \$35,000 to \$155,000, but were typically under \$100,000.²⁴ From November to December 2012, however, sales jumped from \$72,689 to \$314,387,²⁵ which triggered First Data's internal control procedures and First Data initiated a routine review of JCS's activities in January 2013.²⁶ JCS attributed the increased sales to a "formal roll-out" of the kiosks²⁷ and provided financial statements and sample contracts.²⁸ First Data confirmed JCS had recently placed a kiosk at Foxwoods Resort and Casino and reviewed the sale agreement.²⁹ First Data also required Signore to sign a Merchant Application and Agreement Principal Addendum that included a personal guaranty.³⁰ Based on JCS's "clean" processing history, the Application addendum, Signore's personal guaranty, and the updated financial statements, First Data's analyst recommended First Data maintain JCS's rating and quarterly review cycle—notably, JCS still had not disclosed to First Data the "investment" nature of its business model and continued to represent its business as the manufacture and sale of kiosks.³¹

By October 2013, however, First Data saw a substantial increase in irregular card transactions.³² First Data investigated and found that JCS and a third party were sending monthly payments to Cardholders by check, which was not a part of the business model JCS described to First Data in its Application and reiterated during its recent review.³³ On further investigation,

²⁴ April 2013 Periodic Review at 1 (Depo Exh. 16) (**Exh. 8**).

²⁵ *Id.*

²⁶ Aufiero Depo Vol. II at 20:9-16, 24:7-17 (**Exh. 1**).

²⁷ April 2013 Periodic Review at 2 (Depo Exh. 16) (**Exh. 8**).

²⁸ *Id.* at 1.

²⁹ July 2013 Periodic Review at 2 (Depo Exh. 24) (**Exh. 9**).

³⁰ Merchant Application and Agreement Principal Addendum (Depo Exh. 21) (**Exh. 10**).

³¹ July 2013 Periodic Review at 2 (Depo Exh. 24) (**Exh. 9**).

³² First Data Claim Form at 14 (Depo Exh. 3) (**Exh. 11**); Aufiero Depo Vol. I at 104:3-14 (**Exh. 1**).

³³ Aufiero Depo Vol I at 104:20-106:13 (**Exh. 1**).

First Data learned that JCS had changed its business model, without disclosing the change to First Data, and had started marketing kiosks to businesses and individuals as an “investment opportunity.”³⁴

Thus, First Data gave JCS written notice in October 2013 that its merchant account had been suspended pending a review of the irregular activity.³⁵ JCS did not respond. Because that irregular activity was an event of default under the Merchant Agreement,³⁶ First Data terminated JCS’s Merchant Agreement as of November 1, 2013.³⁷ As allowed by the Merchant Agreement, First Data withheld \$1.4 million otherwise payable to JCS in a reserve account.³⁸

IV. As JCS’s Ponzi Scheme Unravels, JCS Defrauds First Data.

It is undisputed that when First Data terminated JCS’s merchant account, First Data was unaware JCS was running a Ponzi scheme, or that the scheme was beginning to unravel. But JCS’s customers, angry that their guaranteed payments had stopped, began demanding answers.³⁹ First Data was also unaware that JCS had falsely accused First Data in communications to its customer/investors that First Data was “causing” the delayed payments because it had seized JCS’s funds while it investigated a transaction.⁴⁰ In these false communications, JCS instructed its customers to dispute their investment purchases, and further advised them that Signore would not challenge any disputed charges; of course, JCS knew this action would in effect “force” First Data

³⁴ Aufiero Depo Vol. I at 106:5-13 (**Exh. 1**); October 2013 Periodic Review at 2 (Depo Exh. 25) (**Exh. 12**).

³⁵ See October 21, 2013 Letter from Michael Aufiero to JCS (Depo Exh. 31) (**Exh. 13**).

³⁶ See Program Guide § 23.4.4 (Depo Exh. 86) (**Exh. 14**)

³⁷ See October 29, 2013 Letter from Michael Aufiero to JCS (Depo Exh. 32) (**Exh. 15**).

³⁸ Program Guide § 24 (Depo Exh. 86) (**Exh. 14**).

³⁹ See Email from Paul Schumack to Andrew Saka, dated December 12, 2013 (12:28pm) (Depo Exh. 92) (**Exh. 16**).

⁴⁰ See Email Chain between Stephen Johnson and Marlys Armstrong (Depo. Exh. 94) (**Exh. 17**); Composite Exhibit of Emails with JCS Customers (Depo Exh. 95) (**Exh. 18**).

to fund the chargebacks first with the money currently held in reserve, and then when that was depleted, out of First Data's own pocket.⁴¹

The result of that instruction was a massive abuse of the "chargeback" process, which had a catastrophic effect on First Data. A "chargeback," when used legitimately, is the process by which a Cardholder receives a refund for something that Cardholder bought but did not receive.⁴² Such a Cardholder receives an immediate refund from its Issuing Bank, which triggers the following: (i) the Issuing Bank withholds the chargeback amount from the Bankcard Company, such as Visa or MasterCard; (ii) the Bankcard Company withholds the chargeback amount from funds sent to the Acquiring Bank, which would otherwise receive the funds to then fund the Merchant; and (iii) then the Acquiring Bank (with assistance of the Processor) will either withhold the chargeback amount from the funds to be sent to the Merchant's Settlement Account or will debit the Merchant's Settlement Account in the amount of the chargeback.⁴³ Thus, a legitimate chargeback is funded directly by the Merchant, the party that failed to deliver the good or service.⁴⁴

Crucial to the chargeback process is that banking and card brand regulations *mandate* that acquirers/processors like First Data honor all chargeback requests from customers who dispute charges.⁴⁵ Agreements among the parties to the chargeback process ensure that cardholders are protected and that there is compliance with federal regulations.⁴⁶ For example, Visa's "Management Guidelines" provide that, "[i]f there are no funds in the merchant's account to cover

⁴¹ Composite Exhibit of Emails with JCS Customers (Depo Exh. 95) (**Exh. 18**).

⁴² See Aufiero Depo Vol. I at 86:10-15 (**Exh. 1**).

⁴³ See Aufiero Decl. ¶ 9 (**Exh. 4**).

⁴⁴ Aufiero Decl. at ¶ 8 (**Exh. 4**).

⁴⁵ See 15 U.S.C. § 1666; 15 U.S.C. § 1601; 12 C.F.R. § 1005; 12 C.F.R. § 1026.

⁴⁶ See. Chargeback Management Guidelines for Visa Merchants, available at <https://usa.visa.com/dam/VCOM/download/merchants/chargeback-management-guidelines-for-visa-merchants.pdf>; Visa Core Rules at § 5.2.1.3 (Oct. 15, 2016), available at <https://www.nrbcommercialbank.com/downloads/visa-core-rules-and-visa-product-and-service-rules-15-october-2016.pdf>).

the [chargeback] amount, [First Data] must cover the loss.”⁴⁷ Visa’s card brand rules provide that in any litigation involving a merchant, First Data must “[o]ppose to the best of its ability any request for legal relief [*e.g.*, an injunction] that would interfere with the Chargeback process.”⁴⁸

The Merchant Agreement provides that JCS is “responsible for all chargebacks and adjustments associated with the transactions that [JCS] submits for processing” with First Data.⁴⁹ It provides that credits in JCS’s Settlement Account are *provisional*, and that First Data may debit the Settlement Account to cover any chargeback-related loss.⁵⁰ It provides that First Data may establish a reserve account, funded by JCS, to cover chargebacks.⁵¹ It provides that, after “termination of this Agreement for any reason whatsoever, [JCS] shall continue to bear total responsibility for all chargebacks.”⁵² And it provides that First Data may terminate the Agreement after an event of default, including “irregular Card sales by [JCS], excessive Chargebacks . . . or any other circumstances which, in our sole discretion, may increase our exposure for your Chargebacks or otherwise present a financial or security risk to us.”⁵³ Thus, funding chargebacks was clearly not a “service” that First Data provided to JCS under the Merchant Agreement. Rather, JCS—through the funds in its Settlement Account and reserve and the personal guarantees of its principals—was obliged to fund all chargebacks, just as a merchant, like JCS, is obliged to deliver a product or service its customer purchases in the first place. JCS not only ignored that funding obligation, but also engaged in an improper and inequitable scheme (which the Receiver is now asking this Court to approve) that would release JCS from that fundamental obligation.

⁴⁷ Chargeback Management Guidelines for Visa Merchants, at 5.

⁴⁸ Visa Core Rules at § 5.2.1.3.

⁴⁹ Program Guide at 2 (Depo Exh. 86) (**Exh. 14**).

⁵⁰ *Id.* at § 16.3.

⁵¹ *Id.* at § 24.1.

⁵² *Id.* at § 23.9.

⁵³ *Id.* at § 23.4.4.

V. JCS Abuses the Chargeback Process.

When First Data terminated JCS in October 2013, JCS's chargeback ratio was zero.⁵⁴ That quickly changed. With its Ponzi scheme collapsing, JCS took advantage of the chargeback process to cause First Data to reimburse Cardholders. As noted above, JCS—knowing that First Data was compelled to honor chargebacks—encouraged its customers to dispute their credit card charges.⁵⁵ JCS even tried to get customers to use chargebacks to prop up its Ponzi scheme, advising certain Cardholders to reinvest their chargeback refunds by check to JCS.⁵⁶

JCS's fictitious-kiosk customers heeded JCS's advice in droves, and JCS's fraudulent chargeback scheme unfolded as follows. The Cardholder disputed the purchase price it paid to JCS, reporting that it did not receive its kiosk.⁵⁷ The Issuing Bank then sent inquiries to JCS (and, when he took over, the Receiver) to determine whether to fund the chargeback request. When JCS and the Receiver failed to respond, the Issuing Bank refunded the full purchase price to the Cardholder's account and, as part of the next day's credit card transactions, withheld that amount from its transfers to the Bankcard Company, making the Issuing Bank whole.⁵⁸ The Bankcard Company, also as part of the next day's credit card transactions, withheld that amount from its First Data merchant portfolio settlement transfers to Wells Fargo.⁵⁹ The next step would have been for First Data to instruct Wells Fargo to withhold the same amount from its daily transfer to JCS so First Data and Wells Fargo could fulfill its settlement obligations to its portfolio of merchants. *But there was no longer any such daily transfer to JCS*, because First Data had

⁵⁴ October 2013 Periodic Review at 1 (Depo Exh. 25) (**Exh. 12**).

⁵⁵ See Email Chain between Stephen Johnson and Marlys Armstrong (Depo. Exh. 94) (**Exh. 17**). See also Composite Exhibit of Emails with JCS Customers (Depo Exh. 95) (**Exh. 18**).

⁵⁶ See Email Chain between Stephen Johnson and Marlys Armstrong (Depo. Exh. 94) (**Exh. 17**).

⁵⁷ Aufiero Decl. ¶ 10(a) (**Exh. 4**).

⁵⁸ *Id.* at ¶ 10(b)-(c).

⁵⁹ *Id.* at ¶ 10(d).

terminated JCS and it was no longer processing credit card transactions; there were no funds that could be withheld to make that settlement funding whole.⁶⁰

To make matters worse, JCS had closed its Settlement Account and the massive wave of chargebacks its customers quickly depleted the reserves held by First Data.⁶¹ With the Settlement Account and reserve empty, and JCS in Receivership, First Data was forced to fund the chargebacks itself thus ensuring the rest of its merchant customers were funded.⁶² JCS flouted its contractual obligations to fund chargebacks for goods it did not deliver, and the chargeback abuse it created—the above scenario was repeated hundreds of times—compelling First Data to fund more than \$7 million in settlement to offset JCS’ investors’ chargebacks.⁶³ From December 2013 to February 2014, First Data sent repeated notices to JCS that it bore all responsibility for chargebacks even after termination of the Merchant Agreement.⁶⁴ JCS did not respond.

VI. First Data Assistance to the SEC Receivership.

Quickly identifying its unique position with regard to the receivership, First Data met with the Receiver as early as May 2, 2014 to discuss their aligned interests.⁶⁵ Indeed, part of the Receiver’s job was to recover fictitious profits from “profiteers”—JCS investor/customers who had actually been paid some of the outlandish returns JCS had promised.⁶⁶ Notably, First Data had involuntarily given additional cash to many of those profiteers by funding their chargebacks.⁶⁷ After several meetings, First Data and the Receiver determined they had an aligned interest in maximizing recoveries for the Estate.⁶⁸ They cooperated for years, and First Data provided

⁶⁰ *Id.* at ¶ 10(e).

⁶¹ *Id.* ¶ 11.

⁶² *Id.* ¶ 13.

⁶³ See Kaufman Rossin Expert Report at Exh. A.1 (Depo Exh. 112) (**Exh. 19**). The schedules to Kaufman Rossin’s report (Depo Exh. 113) are separately attached hereto as Exhibit 20.

⁶⁴ Letters from Michael Aufiero to JCS (Depo Exh. 96) (**Exh. 21**).

⁶⁵ Receiver Depo at 191:10-20 (**Exh. 7**).

⁶⁶ *Id.* at 36:18-38:14.

⁶⁷ Kaufman Rossin Expert Report at Exh. B.3 (Depo Exh. 112) (**Exh. 19**).

⁶⁸ Receiver Depo at 192:22:194:6 (**Exh. 7**).

substantial and crucial documentation that allowed the Receiver's accountants to match purchasers with their credit card numbers and related chargebacks.⁶⁹

First Data also educated the Receiver that, unlike JCS's customers, First Data was not a willing participant in JCS's Ponzi scheme. Because banking and card brand regulations in effect *compelled* First Data to reimburse hundreds of JCS customer investors who disputed their credit card charges, First Data was an "investor" in the JCS scheme, albeit an *involuntary* one. First Data believed the Receiver understood these circumstances and would seek an equitable outcome.

VII. The Receiver Approved the Cardholders' Use of Chargebacks and Failed to Dispute Any of Them, Resulting in More Than \$4 Million in Additional Chargebacks.

On May 28, 2014, after weeks of First Data trying to engage the Receiver to respond to the chargebacks, the Receiver agreed to sign a letter—initially drafted by First Data, but substantially revised by the Receiver—to Cardholders and their Issuing Banks, stating that, “[w]ith regard to this chargeback specifically, I will not likely object to the [Cardholder] or Issuing Bank receiving reimbursement up to the [Cardholder’s] full transaction amount (or investment) *less* any distribution payments received from the Receivership Entities.”⁷⁰ Thus, the Receiver expressly approved the Cardholders’ use of chargebacks (and First Data’s compelled funding of those chargebacks), even though First Data had requested and told the Receiver of the necessity to quickly develop a comprehensive strategy to fight chargebacks. What the Receiver failed to disclose to First Data was at the time he seemed to work with First Data and show an “appreciation” of its concerns about the funding of the JCS chargebacks, the Receiver intended to subordinate First Data’s claim to recover the funds he allowed and authorized. Discovery confirmed that the Receiver decided “[p]retty early on” to designate First Data a trade creditor, virtually guaranteeing it would receive nothing.⁷¹

⁶⁹ Deposition of Melissa Davis (“Davis Depo”) at 75:23-77:18 (**Exh. 22**).

⁷⁰ May 28, 2014 Letter from James Sallah at 1 (Depo Exh. 102) (**Exh. 23**).

⁷¹ Receiver Depo at 156: 25-157:5 (**Exh. 7**).

The Receiver's decision to designate First Data a trade creditor allowed him to avoid altogether the issue of chargebacks, with which he was unfamiliar. Indeed, the Receiver admits that, before this case, he had never dealt with credit card processing issues or chargebacks.⁷² His forensic accountant, Melissa Davis, also had limited knowledge of chargebacks, and no understanding of common chargeback terms such as "presentment," "second presentment" and "chargeback reversal."⁷³ She did not understand that JCS had an obligation to dispute chargebacks and did nothing to educate herself about the chargeback process as it related to JCS.⁷⁴ Although she and the Receiver "were aware that there were chargeback issues,"⁷⁵ the Receiver did not ask for her help to address them.⁷⁶ As the Receiver admits, "the decision [he] made was not to address the chargebacks at that point[.]"⁷⁷

The Receiver's affirmative decision to not address chargebacks had grave consequences for First Data. When the Receiver was appointed, there had been about \$2.8 million in chargebacks.⁷⁸ During the Receiver's tenure, however, First Data was forced to fund another \$4.3 million.⁷⁹ The Receiver concedes First Data is the only party that "had to pay people back," and that First Data's position in this equitable proceeding is therefore "unique."⁸⁰ The Receiver's own accountant testified it is likely "there were investors who were profiteers that received chargebacks," which she said, "by definition," was inequitable.⁸¹ But to the detriment of First Data and JCS customers who did not chargeback, the Receiver did not pursue the profiteers.

⁷² *Id.* at 30:1-15, 30:25-31:3.

⁷³ Davis Depo at 27:7-28:11 (**Exh. 22**).

⁷⁴ *Id.* at 29:2-13.

⁷⁵ *Id.* at 29:17-25 (**Exh. 22**).

⁷⁶ *Id.* at 29:14-16, 35:11-15, 40:5-13.

⁷⁷ Receiver Depo at 36:11-16 (**Exh. 7**).

⁷⁸ *Id.* at 139:17-140:16.

⁷⁹ *Id.* at 138:3-139:4 .

⁸⁰ *Id.* at 187:4-11.

⁸¹ Davis Depo at 41:5-42:12 (**Exh. 22**).

VIII. First Data Retained an Expert to Calculate Its Claim Amount Under Three Alternative Scenarios.

First Data's expert, Patrick F. Gannon of Kaufman Rossin & Co., examined the Receiver's financial reconstruction of JCS's books and records and calculated the amount First Data is entitled to recover under three sets of assumptions. *First*, assuming First Data is entitled to a first priority claim for chargebacks funded before the Receiver was appointed ("Pre-Receiver Chargebacks") and for chargebacks funded after his appointment that he failed to dispute ("Receiver Non-disputed Chargebacks"), Mr. Gannon calculated First Data's claim to be \$7,190,693.⁸² *Second*, assuming that First Data is entitled to a first priority claim for Receiver Non-disputed Chargebacks, plus the amount by which Pre-Receiver Chargebacks enriched the Estate, Mr. Gannon calculated First Data's claim to be \$6,536,747.⁸³ *Third*, assuming that First Data is entitled to a first priority claim for Receiver Non-disputed Chargebacks, plus a pro rata share of the Estate's assets on par with other investors by way of the "Rising Tide" method, Mr. Gannon calculated First Data's claim to be \$5,621,313.⁸⁴

The Receiver's forensic accountant disputed very little of Mr. Gannon's calculations, testifying that her assessment of First Data's claim differed from his by about only \$400,000.⁸⁵

MEMORANDUM OF LAW

The *Receiver does not dispute* that First Data's claim arises from JCS's activities, that First Data suffered a loss because of those activities, and that First Data's losses are consistent with the books and records gathered by the Receiver. Nevertheless, the Receiver initially sought to deny First Data's claims by labeling it a "trade creditor" whose claims should be subordinated to those of JCS's customers. But the Receiver ignores the fact that, by funding chargebacks, First Data

⁸² Kaufman Rossin Expert Report at 11-12 (Depo Exh. 112) (**Exh. 19**). After reviewing Mr. Gannon's detailed analysis, First Data adjusted its claim downward, from \$7,315,647.62 to \$7,190,693.

⁸³ *Id.* at 12-21.

⁸⁴ *Id.* at 21-24.

⁸⁵ Gannon Chart Response (Depo Exh. 111) (**Exh. 24**); Davis Depo 60:13-61:10 (**Exh. 22**).

decreased those other claims against the Estate by millions of dollars. And the Receiver's authority does not support classifying First Data as a trade creditor. First Data, rather, is an *involuntary investor* in JCS's Ponzi scheme, forced to fund JCS' customers' reimbursement of investment amounts through JCS's equally fraudulent scheme to encourage chargebacks—the majority of which were sought by JCS customers, including profiteers, *on the Receiver's own watch*. The principles of equity mandate the Court place First Data *first in line* for recovery, or at least on par with those JCS customers who actually lost money and have not already been reimbursed by First Data. The Receiver now argues, with little to no legal support, that the Court should subordinate First Data's claim for thirteen additional reasons. As shown below, none of these reasons is supported by the facts or by applicable law. Rather, the Receiver is simply engaging in an after-the-fact attempt to shield himself the consequences stemming from his own negligent and inequitable administration of the Estate that created JCS' largest victim.

Accordingly, the Court should grant First Data's motion for summary adjudication and deny the Receiver's Motion or, in the alternative, enter an order setting a bench trial or evidentiary hearing to adjudicate First Data's claim.

I. FIRST DATA'S CROSS-MOTION FOR SUMMARY ADJUDICATION – EQUITY REQUIRES THE COURT TO GIVE FIRST DATA FIRST PRIORITY

A federal receivership action is governed almost entirely by a court's equitable discretion. *SEC v. Elliot*, 953 F.2d 1560, 1566 (11th Cir. 1992). *See also Liberte Capital Grp., LLC v. Capwill*, 462 F.3d 543, 551 (6th Cir. 2006) (“In this range of cases the federal courts exercise the traditional, common law powers of equity.”). And, “[w]hen it comes to fashioning a claims process and related distribution plan, no specific distribution scheme is mandated so long as the distribution is fair and equitable.” *SEC v. Homeland Commc'ns Corp.*, No. 07-80802, 2010 U.S. Dist. LEXIS 57961, at *4 (S.D. Fla. May 24, 2010) (citations omitted). Even the classification of a party as a “trade creditor” is not dispositive of priority, because courts consider many factors when making priority determinations in an equitable receivership. *See, e.g., SEC v. Byers*, 637 F. Supp. 2d 166, 171, 183 (S.D.N.Y. 2009) (approving receiver's plan in which secured creditors

were only permitted to recover out of their secured collateral and were prioritized over unsecured creditors *and* harmed investors); *Homeland Commc'ns Corp.*, 2010 U.S. Dist. LEXIS 57961, at *23 (holding that a trade creditor's claim had priority over claims of defrauded investors because the trade creditor held a statutory lien).

As the Receiver's own authority acknowledges, "[s]itting in equity, the district court is a 'court of conscience.'" *CFTC v. PrivateFX Global One*, 778 F. Supp. 2d 775, 779 (S.D. Tex. 2011). In exercising its discretion, the Court should not simply defer to the Receiver's proposed distribution plan. *See SEC v. Detroit Mem'l Partners, LLC*, No. 1:13-cv-1817, 2016 U.S. Dist. LEXIS 154474, at *34 (N.D. Ga. Nov. 8, 2016) (granting objection to receiver's classification scheme and noting the court's role is to "do equity"); *In re Real Prop. Located at Jupiter Drive*, No. 2:05-cv-01013, 2007 U.S. Dist. LEXIS 65276, at *7 (D. Utah June 7, 2007) (rejecting receiver's proposed pro rata distribution even though it was "very unlikely that Investors will receive any money"). As we show below, First Data's claim against the Estate is not a "trade creditor" claim and the principles of equity mandate that First Data's claim be given *first priority*, or, at the least, be treated on par with those JCS customers who actually suffered a loss.

A. First Data Is Not a "Trade Creditor" and Its Claims Should Not Be Subordinated to Those of JCS Customers

The definition of "trade creditor" is "commonplace"; it is a party "to whom a debt is owed for the provision of goods (or perhaps goods and services) used in the conduct of one's business." *In re Nutritional Sourcing Corp.*, 398 B.R. 816, 827 (Bankr. D. Del. 2008) (citations omitted); *see also, e.g., In re Stratford of Texas, Inc.*, 635 F.2d 365, 367 (5th Cir. 1981) ("[T]heir indebtedness was to trade creditors, *i.e.*, suppliers of goods and services for these operations."); *In re Chicago M. S. P. & P. R. Co.*, 840 F.2d 1308, 1310 n.1 (7th Cir. 1988) ("A trade creditor company is a company to whom the debtor owes money because of the debtor's purchase of goods and/or services from the trade creditor company."). For example, a trade creditor may be owed for gasoline supplies, grocery products and refrigerator services, or office rental. *See In re Craig Oil Co.*, 785 F.2d 1563, 1564 (11th Cir. 1986); *In re Nutritional Sourcing Corp.*, 398 B.R. at 828-29.

First Data *did* provide a service to JCS—it provided credit card processing services for a fee—and First Data would be a trade creditor of JCS if it were trying to recover those processing fees from the Estate. But First Data’s claim is not for reimbursement of processing fees or any other related fees. First Data’s claim is for a reimbursement of the charged-back JCS sale transactions paid to consumers that federal banking and card brand rules mandated it fund due to JCS’s fraudulent actions. Funding JCS customer chargebacks is not a “service” First Data provides to customers. Stated another way, First Data is not in the business of funding customer chargebacks.⁸⁶ As shown above, the Merchant Agreement provides that *JCS*, not First Data, is responsible to pay chargebacks.⁸⁷ The Court should reject the Receiver’s improper attempt to transform First Data into an insurance company.

The Receiver’s only case in support of labeling First Data a trade creditor is *In re Nutritional Sourcing Corp.*, but in that case—unlike here—the court addressed enforcement of a promissory note that, *by its own terms*, was subordinated to claims of trade creditors. 398 B.R. at 827. Even if the Court determines First Data can be a trade creditor for something other than its processing fees, the Court still must determine whether it is equitable to subordinate First Data’s claim under the circumstances where banking laws *legally mandated* First Data to fund the reimbursement of JCS’s customers, and where First Data’s payments reduced claims made against the Estate by millions of dollars. This District has already recognized that these circumstances make First Data’s claim unique. In *FTC v. IAB Mktg. Assocs., LP*, 2013 U.S. Dist. LEXIS 136502, at *5-6, after IAB entered receivership, North Dallas Bank and Trust (NDBT) “could no longer deduct the chargebacks from IAB’s accounts,” even though—like First Data—it “was still *required by banking regulations* to honor chargebacks and return the requested funds.” *Id.* at *6 (emphasis supplied). Thus, the receiver in that case moved for the court’s permission to “pay NDBT for these chargebacks because doing so would [] be equitable.” *Id.* Judge Scola agreed,

⁸⁶ Deposition of Robert Tenenbaum (“Tenenbaum Depo”) at 182:19-23 (**Exh. 25**); Saka Depo 223:24-224:6, 226:25-227:4 (**Exh. 5**).

⁸⁷ See Program Guide at 2 (Depo Exh. 86) (**Exh. 14**).

holding that “NDBT is unique: no other creditor or Defendant has incurred direct liability through reimbursing consumers. Reimbursing NDBT in turn for these payments that it has already made and that it was required to make is equitable.” *Id.* In our case, the Receiver’s only response to this holding is the argument (Motion at 36 n.58) that First Data’s claim is bigger than NDBT’s so the Court should ignore it. But the banking regulations that required NDBT and First Data to honor chargebacks make no such distinction between large and small claims, and they certainly do not hold that “bigger” claims can somehow be ignored.

The court in *In re Frigitemp Corp.*, 34 B.R. 1000 (Bankr. S.D.N.Y. 1983), *aff’d* 753 F.2d 230 (2d Cir. 1985), reached a similar conclusion.⁸⁸ In that case, Frigitemp’s bankruptcy trustee sought to avoid certain transfers to creditors. *Id.* at 1003. The court found that many of those creditors *were* trade creditors—a travel agent, an electricity utility, a fixture-supply company—but that Frigitemp’s bank, Hancock Bank, was “neither an insider like [a member of the board] nor a financially unsophisticated trade creditor.” *Id.* at 1008-11. The bank and the debtor had an agreement under which the bank would cover overdrafts and deduct the overdrawn amounts from future deposits. *Id.* at 1018. The trustee, seeking to avoid those deductions, “creatively argue[d] that [the Bank’s] overdraft practices were the equivalent of conventional short term loans,” and that the bank was “selling a commodity like any other [trade creditor].” *Id.* at 1018-20. The court disagreed. As here, the bank was not in the business of making loans, and the overdraft agreement was simply a “routine” way for the bank to manage its relationship with the debtor. *Id.* at 1018. The court found “compelling reasons” *not* to treat the bank as a trade creditor, for example that overdraft protection is a “necessary banking service[]” that should be protected “in recognition of [its] critical place in commercial transactions.” *Id.* at 1020. *See also Laws v. United Mo. Bank, N.A.*, 98 F.3d 1047, 1051 (8th Cir. 1996) (holding that a bank’s routine advances on uncollected deposits was not an avoidable preference recoverable by the trustee because a contrary rule “might

⁸⁸ “When fashioning a fair and reasonable decision, courts often look to analogous principles found in bankruptcy and other non-federal receivership cases.” *SEC v. Mgmt. Solutions, Inc.*, No. 2:11-cv-01165-BSJ, 2013 U.S. Dist. LEXIS 21552, at *11 (D. Utah Feb. 15, 2013).

cause banks to terminate a service that is invaluable to today’s economy”); *see also Pereira v. Summit Bank*, No. 94-Civ-1565, 2001 U.S. Dist. LEXIS 1712, at *26 (S.D.N.Y. Feb. 21, 2001) (stating that, “[a]bsent a departure from its normal course of behavior in dealing with a customer, a bank generally enjoys a protected right to reduce indebtedness incurred from extension of provisional credit”); *Sklar v. Susquehanna Bank (In re Global Prot. USA, Inc.)*, 546 B.R. 546, 617 (Bankr. D.N.J. 2016) (“[T]he April advances . . . were intended to be short term loans to cover ‘cash flow shortfalls’ of the company. Appellant was not a trade creditor of the Debtor. Nor can it be said that this transaction was in the ordinary course of the Debtor’s or Appellant’s business affairs.”).

The same logic applies here. Just as overdraft protection, where a bank “fronts” funds and recoups them later, is necessary to the banking industry, the funding flow for chargebacks—where a Processor like First Data “covers” the amount of charged back transactions withheld from daily settlement from the issuing banks, and then deducts that amount from the disputed merchant—is essential to the bankcard industry. Like all merchants, JCS *agreed* it was responsible to fund all disputes of its sales, just as a bank’s customers agrees to be responsible for overdrafts.⁸⁹ In short, the Court should protect the chargeback process, without which the bankcard processing industry could not function, due to its critical role in consumer commercial transactions. *See, e.g., FTC v. World Travel Vacation Brokers, Inc.*, No. 87-C-8449, 1991 U.S. Dist. LEXIS 17890, at *5 (N.D. Ill. Dec. 6, 1991) (holding that a bank did not violate a receivership’s temporary restraining order on assets by repaying investor chargebacks as required by contractual obligations); *FTC v. Transcon. Warranty, Inc.*, No. 09-C-2927, 2009 U.S. Dist. LEXIS 119381, at *14 (N.D. Ill. Dec. 22, 2009) (noting that a bank, responsible for covering chargebacks, “may have an interest in the reserve account superior to that of Transcontinental’s other creditors (including injured consumers)”).

⁸⁹ *See* Program Guide at 2 (Depo Exh. 86) (**Exh. 14**).

B. First Data Is Entitled to Priority Under Principles of Equitable Subrogation

An independent basis for prioritizing First Data’s claim is equitable subrogation, which is available where a party shows that (1) it made the payment at issue to protect its own interest; (2) the payment was non-voluntary; (3) it was not primarily liable for the debt paid; (4) it paid the entire debt; and (5) subrogation would not work any injustice to the rights of third parties. *MSPA Claims I, LLC v. Century Sur. Co.*, No. 16-20752-CIV, 2017 U.S. Dist. LEXIS 37040, at *11 (S.D. Fla. March 15, 2017). “As an equitable remedy, Florida courts broadly apply the principle ‘in almost every conceivable type of transaction where the party invoking the doctrine has been required to pay a debt for which another is primarily answerable.’” *Ameegy Bank Nat’l Ass’n v. Deutsche Bank Corp.*, 917 F. Supp. 2d 1228, 1233 (M.D. Fla. 2013). First Data satisfies all five requirements.

First, First Data funded the chargebacks of the JCS customers’ transactions to protect First Data’s own interest, as it was mandated under federal banking law, card brand regulations and its contract with its acquirer Wells Fargo.

Second, First Data’s funding of the chargebacks was non-voluntary, because of its contractual obligations and card brand regulations and because the chargeback amounts were automatically subtracted or debited from the daily settlement funds transferred to Wells Fargo/First Data by Bankcard Companies.⁹⁰ Wells Fargo/First Data, regardless of that debit, had an obligation to fund the rest of the rest of their respective merchant portfolios’ settlement.

Third, First Data was not primarily liable for the debt to JCS’s customers. As shown above, First Data only *provisionally* funded chargebacks.⁹¹ Under the Merchant Agreement, JCS bore the primary responsibility to pay for them.⁹² Indeed, the chargeback process works *because* merchants like JCS agree to be “responsible for all Chargebacks.” *See Banknorth, N.A. v. BJ’s Wholesale*

⁹⁰ Aufiero Decl. at ¶¶ 10(d), 12 (**Exh. 4**).

⁹¹ *See* Program Guide at § 16.3 (Depo Exh. 86) (**Exh. 14**).

⁹² *See Id.* at 2.

Club, Inc., 394 F. Supp. 2d 283, 288 (D. Me. 2005) (holding that an issuing bank, which funded refunds to customers made necessary by a merchant’s breach of its credit card security requirements, adequately pleaded equitable subrogation).

Fourth, First Data paid the entire debt associated with each card transaction for which there was a chargeback. *See Banknorth*, 394 F. Supp. 2d at 288 (“Plaintiff’s averment that it reimbursed its customers for all amounts lost by them as a result of Defendants’ conduct established that Plaintiff paid the cardholders’ debt or obligation.”).

Fifth, subrogation would not be unjust to third parties. Claims against the Estate were reduced by millions of dollars because of chargebacks funded by First Data.⁹³ Thus, First Data’s claims should be prioritized over claims of JCS customers, or at least be classed alongside them. Subordinating First Data’s claims—leaving it with zero recovery—when JCS fraudulently (and, later, its Receiver improperly) used First Data to fund over \$7 million of its investor obligations would be the height of inequity. It is likewise inequitable that the Receiver—after welcoming and accepting the benefits of First Data’s extensive cooperation in documents and expertise under the pretense of treating First Data’s claims equitably—could now be allowed to switch course and dismiss First Data as a “trade creditor.” The Receiver does this with barely an explanation and no legal authority, demanding this Court place First Data’s claim—the largest of any against the Estate—last in line so First Data will receive absolutely nothing from an Estate that now exceeds \$10,000,000.

“Equitable subrogation arises when an innocent party pays the debt that should have been paid by another.” *Jeld-Wen, Inc. v. Nebula Glass Int’l, Inc.*, No. 07-22326, 2008 U.S. Dist. LEXIS 44277, at *54 (S.D. Fla. June 5, 2008). That is the case here, where First Data’s losses stem solely from JCS’s fraudulent breach of its obligations to fund the disputes of its own transactions. Indeed, JCS’s principal—who was convicted of fraud and resides in a federal penitentiary⁹⁴—encouraged

⁹³ Kaufman Rossin Expert Report at 12-14 (Depo Exh. 112) (**Exh. 19**).

⁹⁴ Receiver Depo. at 12:14-22 (**Exh. 7**).

his customers to seek chargebacks from First Data knowing that JCS would never repay them. The Receiver cannot in good faith distance himself from JCS's fraudulent acts and penalize First Data for fulfilling its regulatory and contractual obligations. This is especially true as the Receiver took advantage of the Mr. Signore's direction to his investors, doing virtually *nothing* to stop or dispute the chargebacks, knowing that under banking regulations and card brand rules an acquirer cannot just choose to "short-fund" settlement to its other merchant customers if one merchant fails to fund its chargeback disputes.

C. The Court Should Reimburse First Data Between \$7.19 Million and \$5.62 Million for Paid-In-Full Chargebacks

This Court should adopt the findings of First Data's expert and award First Data \$7,190,693 for the chargebacks that it paid to JCS customers.⁹⁵ Alternatively, if the Court determines First Data's entire claim is not entitled to first priority treatment, it should either (1) grant First Data a first priority claim for Receiver Non-disputed Chargebacks, plus the amount by which Pre-Receiver Chargebacks enriched the Estate, and award First Data \$6,536,747,⁹⁶ or (2) grant First Data a first priority claim for Receiver Non-disputed Chargebacks, plus a pro rata distribution, on par with other investors, by way of the "Rising Tide" method, and award First Data \$5,621,313.⁹⁷

II. FIRST DATA'S OPPOSITION TO RECEIVER'S MOTION FOR SUMMARY ADJUDICATION – NONE OF THE RECEIVER'S THIRTEEN NEW "REASONS" SUPPORT THE SUBORDINATION OF FIRST DATA'S CLAIM

With little to no legal support, the Receiver advances thirteen new arguments that First Data's claim should be subordinated. None of them has any merit.

A. Reason 1: This Proceeding Is to Benefit the Investors, not First Data

In his first reason, the Receiver advances nine sub-reasons, none of which is persuasive.

First, the Receiver argues, incorrectly, that the law requires investors to be repaid first. He cites cases for the noncontroversial propositions that the Court has discretion to approve his

⁹⁵ Kaufman Rossin Expert Report at 11-12 (Depo Exh. 112) (**Exh. 19**).

⁹⁶ *Id.* at 12-21.

⁹⁷ *Id.* at 21-24.

decisions and that treating similarly situated parties alike is “fair and equitable” (Motion at 9-10). But he also argues that investors should be given the highest priority (*see id.* at 9-11). His cases, however, apply to “general creditors” and actually support that First Data’s claims be prioritized.

For example, in *SEC v. HKW Trading LLC*, No. 8:05-cv-1076, 2009 U.S. Dist. LEXIS 77215 at *16-17 (M.D. Fla. Aug. 14, 2009), the court prioritized a claim for attorney’s fees over investor claims because it was an administrative expense of the estate, noting that there was no evidence of the claimant’s “participation in the fraud and/or her *knowingly* benefitting from it.” Here, the Receiver admits both that First Data had no knowledge of the fraud and was financially harmed by it.⁹⁸ In *Quilling v. Trade Partners, Inc.*, No. 1:03-cv-236, 2006 WL 36944629, at *1 (W.D. Mich. Dec. 14, 2006), the Court subordinated a law firm’s claim for legal fees where there was no evidence the firm “contribut[ed] any funds to the Receivership estate” and “no evidence that there was an attempt to defraud” the firm. In contrast, here the evidence is undisputed that First Data contributed *millions* to the Estate by funding chargebacks,⁹⁹ and that JCS defrauded First Data into funding those chargebacks.¹⁰⁰ In *SEC v. Megafund Corp.*, No. 3:05-CV-1328, 2007 U.S. Dist. LEXIS 102742, at *6 (N.D. Tex. Feb. 14, 2007), the court disallowed claims of Ponzi scheme *employees*, who made general creditor claims for lost wages and the return of purported loans, because there was no evidence that the employees acted in “good faith.” Here, there is no dispute that First Data was a victim of JCS’s fraud.¹⁰¹ In *CFTC v. PrivateFX Global One*, 778 F. Supp. 2d 775, 786 (S.D. Tex. 2011), the court denied a bank’s objection to a receiver’s distribution plan where the bank claimed the Ponzi scheme had not repaid a line of credit, noting that, because it was the bank’s business to extend credit and the bank failed to link any misrepresentation about the loan to the fraud at issue, it should not be placed on “the same plane

⁹⁸ Receiver Depo. at 109:6-11, 151:25-152:9 (**Exh. 7**).

⁹⁹ *See* Kaufman Rossin Expert Report (Depo Exh. 112) (**Exh. 19**); May 28, 2014 Letter from James Sallah at 1 (Depo Exh. 102) (**Exh. 23**).

¹⁰⁰ *See* Receiver Depo 74:16-75:6 (**Exh. 7**).

¹⁰¹ *Id.* at 114:19-115:14.

as the duped investors.” Here, First Data is *not* in the business of loaning money, much less over \$7 million to JCS, and its losses are a direct result of JCS’s Ponzi scheme, including continuing to defraud and misrepresent the nature of its business to First Data. And in *SEC v. Mutual Benefits Corp.*, No. 0:04-cv-60573, Order Granting Receiver’s Motion for Final Determination of Allowed Claims at (S.D. Fla. Oct. 23, 2008), the subordinated trade creditors included four firms seeking legal or lobbying fees and two printing and design companies, all classic trade creditors.

The Receiver also cites *SEC v. Byers*, 637 F. Supp. 2d 166 (S.D.N.Y 2009), but in that case the court subordinated claimants that, unlike First Data, were part of a fraudulent scheme.¹⁰² And in *SEC v. P.B. Ventures*, No. 90-5322, 1991 WL 269982, at *3 (E.D. Penn. Dec. 11, 1991), the court decided only whether to subordinate one group of investors to another.

Second, the Receiver (Motion at 11) argues that the Court should subordinate First Data’s claim because the SEC filed an action and moved to appoint the Receiver “for the benefit of[] the investors, not creditors (such as First Data).” As a preliminary matter, and as noted above, First Data’s claim is one of an *involuntary* investor as it funded over \$7 million of investments disputed by JCS’ customer/investors. Therefore, First Data is included in the appointment language, as “all investors” must surely include involuntary ones.

Furthermore, although SEC actions do protect investors, they also seek to do equity among other fraud victims. *See, e.g. Homeland Commc’ns Corp.*, 2010 U.S. Dist. LEXIS 57961, at *23 (rejecting argument that the court should “subordinate any trade creditor” when the estate cannot pay all claimants, and prioritizing a trade creditor with a statutory lien over investors). And investors do not automatically receive priority in equitable proceedings. *See IAB Mktg. Assocs.*, 2013 U.S. Dist. LEXIS 136502, at *6 (reimbursing a bank for chargebacks “that it has already made and was required to make is equitable”); *SEC v. Feronia*, No. 05-cv-00621-WDM-BNB, 2008 U.S. Dist. LEXIS 93904, at *6 (D. Colo. Nov. 18, 2008) (distributing proceeds to creditor over investor claimants). The Receiver cites no case subordinating an admittedly unique claim

¹⁰² *Id.* at 74: 16-75:6.

like First Data's, and the Receiver cannot rely on *Marion v. TDI, Inc.*, No. 02-7032, 2006 U.S. Dist. LEXIS 90761 (E.D. Penn. Dec. 15, 2006), because in that case the court analyzed whether a receiver had standing to pursue claims against defendants that *participated in the fraud*.

Third, the Receiver (Motion at 11) argues that JCS "targeted investors in carrying out the JCS Ponzi scheme, not service providers (such as First Data)." As a threshold matter, this is simply wrong, as the Receiver already admitted in his deposition that JCS defrauded and misled First Data regarding the nature of its business.¹⁰³ Therefore, it is inaccurate for the Receiver to now argue that JCS did not "target" First Data to carry out its Ponzi scheme. In any event, the Receiver also admits there are no other service providers in First Data's "unique" position.¹⁰⁴ His statement that JCS simply "provided First Data with false information" (Motion at 11 n.3) ignores that JCS (and the Receiver) then specifically used—or targeted—First Data as the funding source to refund JCS's customers, thereby reducing claims against the Estate.¹⁰⁵

Fourth, the Receiver argues (Motion at 11-12) that JCS's Ponzi scheme did not "depend on capital infusions from First Data . . . because First Data never invested any money with JCS" and provided only "credit card/bankcard processing *services* to JCS" so that its customers could pay by credit card. Again, the Receiver puts forth an argument that is factually wrong. The Receiver cannot dispute that JCS depended on the daily credit card settlement from its transactions processed through First Data to fund its Ponzi scheme. In addition, and as established previously, after First Data started holding JCS funding and then terminated JCS altogether, JCS encouraged its customers/investors to charge back transactions that it knew it could not fund. JCS then encouraged customers to reinvest those charged back paid sums back into the Ponzi scheme.¹⁰⁶ Given this unique position, First Data should be repaid first. *See IAB Mktg. Assocs., LP*, 2013 U.S. Dist. LEXIS 136502, at *5-6.

¹⁰³ *Id.* At 74:16-75:6.

¹⁰⁴ *Id.* at 187:9-11.

¹⁰⁵ May 28, 2014 Letter from James Sallah at 1 (Depo Exh. 102) (**Exh. 23**).

¹⁰⁶ *See* Email Chain between Stephen Johnson and Marlys Armstrong (Depo. Exh. 94) (**Exh. 17**).

Fifth, the Receiver argues (Motion at 12) that First Data’s processing services allowed JCS to continue to operate, and that very fact should defeat First Data’s claim. However, the Receiver fails to explain how that can be the case where the Receiver admits First Data had no knowledge of JCS’s Ponzi scheme. Indeed, the Receiver’s own authority, as noted above, shows that subordination of a claim is improper where a claimant without knowledge of a fraud has a valid priority claim. *See HKW Trading*, 2009 U.S. Dist. LEXIS 77215 at *16-17.

Sixth, the Receiver argues (Motion at 12) that First Data is a trade creditor. As established in detail above, that is incorrect. First Data’s claim is not for the payment of processing fees that JCS failed to pay for the processing of its credit card transactions. Rather it is for reimbursement of funding investor chargebacks that, by law, should have been funded directly from JCS and then the Estate. *See IAB Mktg. Assocs., LP*, 2013 U.S. Dist. LEXIS 136502, at *6.

Seventh, the Receiver argues (*id.*) that JCS customers should be prioritized over First Data because the funds available for distribution “mainly consist of: 1) false profits recovered by the Receiver from investors; and 2) money the Receiver raised through the sale of property and/or assets purchased or financed with investors’ funds.” Yet, the Receiver concedes First Data enriched the Estate by reimbursing investors that *would otherwise be making claims*.¹⁰⁷ Neither of his cited cases involve subordinating a claimant that paid investor claims owed by the receivership estate. Indeed, the Receiver’s suggestion that First Data might have a viable claim if First Data had received assignments from the investors¹⁰⁸ whose chargebacks it funded shows that, at the very least, First Data should receive distributions on par with JCS’s other investors.

Eighth, the Receiver argues (Motion at 13) that “First Data did not invest as an investor in JCS.” This is really a duplication of the Receiver’s fourth reason which, as shown above, is not

¹⁰⁷ Receiver Depo 44:6-22, 45:18-46:2 (**Exh. 7**).

¹⁰⁸ *Id.* at 150:18-151:11. Notably, the banking regulations and card association rules that mandated the reimbursement do not allow (or provide a process) for claim assignment from a cardholder to an acquirer/processor as a condition for funding a chargeback. That unconditionally funding obligation is likely one of the reasons that Judge Socla in *IAB Mktg. Assocs., LP* found the acquirer to be in a “unique” position.

accurate. First Data was required by applicable regulations and JCS's chargeback scheme, to effectively invest over \$7 million in JCS. As noted, JCS's principals even advised their customers to reinvest chargeback funds back into the Ponzi scheme. Under those circumstances, First Data was an investor in JCS whether or not it signed an investment contract.

Ninth, the Receiver's argument (Motion at 13) that "chargebacks are a part of [First Data's] business" either misunderstands or deliberately misstates how chargebacks work. As shown above, *administratively processing* chargebacks (disputes of its merchants' transactions) is part of First Data's business, but *funding* the chargeback is the merchants' responsibility. In support, the Receiver cites First Data's state court complaint against JCS. In that case, First Data alleged that its services include "handling with reversals or chargebacks."¹⁰⁹ First Data does not dispute that one of the services it provides to merchants is the administration of the dispute or chargeback process between the merchant and the issuing banks for its cardholder customers that disputes the transaction. First Data sometimes charges a fee for that service and, in fact, the JCS Merchant Agreement notes a Chargeback Fee of \$30.00. This administration of the chargeback process (*i.e.*, providing the dispute notification to the merchant, and submitting the merchant's response back through to the card brands, etc.) stands in stark contrast to the actual funding of the chargebacks themselves that is an obligation of the merchant. Indeed, the purpose of that state court lawsuit was to *recover* from JCS and its principals the *funding* of those disputes.¹¹⁰

The Receiver (Motion at 14) also relies on SEC filings of First Data's parent company to argue that "the card companies' rules" state that First Data *could* be liable for funding chargebacks, but First Data's contracts with merchants are designed to prevent that from ever happening.¹¹¹ The Receiver (Motion at 13, 15-16) also relies on testimony that First Data must *front* chargebacks,

¹⁰⁹ See Complaint at ¶ 2, *First Data Merch. Servs. Corp. v. JCS Enters., Inc.*, Case No. 14-006801 (Depo Exh. 72) (**Exh. 26**)

¹¹⁰ See *id.* at 13 ("First Data demands judgment against JCS for all Chargebacks due and owing under the Merchant Agreement").

¹¹¹ Saka Depo at 226:6-14 (**Exh. 5**); Tenenbaum Depo at 168:17-21 (**Exh. 25**).

but First Data employee Robert Tenenbaum testified “card association rules dictate that [First Data] has to pay them,” (due to its ultimate funding obligation to the rest of its merchants) but that First Data “still has rights against JCS.”¹¹² And in the Receiver’s own quotation from the testimony of another First Data employee, Nadia Serves (Motion at 15), she testified that, although First Data “initially bears the financial loss,” First Data “of course debit[s] the merchant’s account for that financial adjustment.” Likewise, when Andrew Saka was asked whether chargebacks were part of the business, he responded, “I mean, servicing them, helping merchants” (*id.* at 15-16). First Data administratively processes chargebacks for its merchants, but that service does not include funding those chargebacks. That is because—like the flow of funds in a sale transaction is the process by which money is transferred from the customer cardholder to the merchant—a chargeback is simply a reversal of that process, where the merchant’s money is sent back to fund the customer cardholder.

B. Reason 2: First Data’s Parent Company is Worth Billions

The Receiver (*id.* at 16) argues that First Data’s parent company is worth billions and that the financial disclosures of a related entity, Wells Fargo Merchant Services, LLC,¹¹³ show that it did not experience material chargebacks in 2014 and 2015. But the Receiver cites no authority that the Court should consider the holdings of First Data’s parent company or a related entity’s Form 10-K. *U.S. v. Doran*, 854 F.3d 1312, 1315 (11th Cir. 2017) (holding that, despite an affiliation between two entities, the Court could not treat the two entities as one). The Receiver argues (Motion, Exh. F ¶ 9) that, based on alleged conversations with “dozens of individuals who invested with JCS,” First Data is in a better position to sustain \$7 million in losses. But JCS had hundreds, not dozens, of customers, and the record contains no evidence of their ability to sustain losses, as well as no evidence of First Data’s holdings. The Receiver’s statement is evidence of

¹¹² Tenenbaum Depo at 182:24-183:11 (**Exh. 25**).

¹¹³ As the Receiver is aware, Wells Fargo Merchant Services, LLC is a joint venture between First Data and Wells Fargo Bank, and is unrelated to this matter as First Data Merchant Services—not Wells Fargo Merchant Services—was the processor for JCS.

nothing, other than to say First Data should be subordinated because of its balance sheet. To allow the Receiver to prevail on this argument would be to reward the Receiver's inequitable conduct of ignoring JCS investor chargebacks in his "marshalling of the assets" simply because he had First Data's bank account as a funding source, all the while knowing he was going to subordinate any claim by First Data to be reimbursed for those payments.

C. Reason 3: Investors Include People Who Have Lost Their Life Savings, Are Elderly, Live on Fixed Incomes, and Are Unsophisticated Victims

The Receiver's third reason (Motion at 17) merely restates his second, and fails for the same reasons.

D. Reason 4: First Data Is Sophisticated and Had Greater Access to Information

The Receiver argues (Motion at 17) that First Data is a "highly-sophisticated, experienced and knowledgeable bankcard servicing company" that had access to (1) applications submitted by JCS and related entities; (2) background checks and credit reports on JCS's principals; (3) JCS's financial statements and banking information; (4) JCS's tax returns; and (5) JCS site inspections. Because that information was not available to JCS's customers, the Receiver argues (*id.* at 17-22) that First Data's claim must be subordinated.

What the Receiver conveniently omits from his Motion is that when all this information was gathered by First Data, as previously acknowledged by the Receiver,¹¹⁴ *JCS's Ponzi scheme had not even begun*. No amount of underwriting would have uncovered a scheme that did not exist. Although the Receiver argues (Motion at 22) that "First Data also had actual knowledge of several red flags and problems with JCS's account," the Receiver admitted that the "hallmarks of a Ponzi scheme" were concealed from First Data.¹¹⁵ There *was* an imbalance of relevant information, but that imbalance favored JCS's customers, who knew that JCS's business was an investment scheme that promised exorbitant returns. The Receiver (Motion at 25) cites to First Data's discussions with JCS's other bank as support that First Data had knowledge, but First Data

¹¹⁴ Receiver Depo at 107:17-20 (**Exh. 7**).

¹¹⁵ *Id.* at 58:15-18, 61:7-11, 62:2-9.

was not able to confirm that second-hand information and First Data did terminate JCS shortly thereafter.¹¹⁶

Moreover, neither of the Receiver's cases involved a Ponzi scheme that developed *after* initial due diligence, but rather dealt with a *present* issue. See *PrivateFX Global One*, 778 F. Supp. 2d at 786 & n.5 (subordinating bank's claim because, even though a borrower may have misrepresented his ability to repay a loan, the bank had the documents necessary to make the determination); *SEC v. Nadel*, No. 8:09-cv-87-T-26, 2013 WL 12323969, at *5 (M. D. Fla. Aug. 29, 2013) (overruling a claimant's objection because "there were many indicia that would lead a sophisticated institutional investor to question the prudence of investing"). There were no such documents or indicia here.

E. Reason 5: First Data Was not an Alleged Bad Actor in Its Industry

The Receiver argues (Motion at 23) that "First Data failed to inform others in its industry, including subsequent processors, regarding its discoveries concerning JCS and Signore." The Receiver contends (*id.*) First Data admitted on its Claim Form that it terminated JCS because it discovered JCS was offering investments to investors, which, according to the Receiver, is "factoring," a practice forbidden by the Merchant Agreement. But the Receiver misrepresents First Data's Claim Form, which actually states JCS's factoring was *unknown* to First Data at that time.¹¹⁷

Citing two arbitration decisions involving First Data, the Receiver also argues (Motion at 23-25) First Data should have reported JCS to other banks by placing it on the industry's TMF/MATCH lists as soon as JCS was terminated. However, although First Data was aware of another bank's suspicion of JCS, it had no knowledge of JCS's Ponzi scheme when it terminated JCS, and JCS's credit card processing was clean at termination.¹¹⁸ Even if First Data reported JCS

¹¹⁶ See October 29, 2013 Letter from Michael Aufiero to JCS (Depo Exh. 32) (**Exh. 15**).

¹¹⁷ See First Data Claim Form at 14 (Depo Exh. 3) (**Exh. 11**).

¹¹⁸ See October 2013 Periodic Review (Depo Exh. 25) (**Exh. 12**) (showing 0.00% chargeback ratio with 0.23% refund rate and "no other processing issues" other than the increased transaction

to the TMF/MATCH lists earlier, the Receiver has no authority that supports subordination of First Data's claim for this reason, and the Receiver identifies no damages. First Data is not seeking to recover its losses from payments to JCS's subsequent processors as a result of the arbitration decisions, and it excluded these losses from its claim.¹¹⁹

The Receiver also argues (Motion at 24) that First Data's post-termination communications with JCS show that First Data had self-serving reasons not to report JCS's conduct. But First Data communicated with JCS because it had a contractual obligation to its Merchant to respond to chargebacks, and the Receiver admits that only JCS had the relevant information.¹²⁰

F. Reason 6: After Termination, First Data Continued to Speak with Signore About Chargebacks and Returned \$700,000 from the Reserve Account

The Receiver again argues (Motion at 25) that First Data should not have corresponded with JCS after termination because it should have "f[ou]ght incoming chargebacks to limit or eliminate its exposure." But the Receiver admits that JCS, as the merchant, was responsible for disputing chargebacks.¹²¹ The Receiver also argues (Motion at 25) that First Data should not have returned \$700,000 from its reserve account to JCS. But JCS chargebacks were low up until that partial return from JCS's reserve account, and JCS stated that it needed the funds to fulfill kiosk orders.¹²² Thus, after requesting additional information, First Data made a partial return of reserve

prices); Email November 27, 2013, Email from Kathleen Collins to Mike Aufiero, Todd Dellomo and Steve McDermott with Attachment of Daily MIS report for JCS, (Depo Exh. 90) (Exh. 22) (showing total year to date chargebacks under \$15,000 through November 2013).

¹¹⁹ Kaufman Rossin Expert Report at 11 (Depo Exh. 112) (**Exh. 13**) (deducting compliance cases from total claim amount).

¹²⁰ See, e.g. Receiver Depo at 135:13-22 (**Exh. 7**); Excerpted email between First Data and JCS (Depo Exh. 35 at FD-JCS-0000889-90) (**Exh. 27**).

¹²¹ Receiver Depo at 69:22-70:3; 135:13-24 (**Exh. 7**).

¹²² Excerpt of email between First Data and JCS (Depo Exh. 35 at FD-JCS-0000990-995) (**Exh. 28**).

funds to allow JCS to meet its obligations to its customers.¹²³ First Data had no knowledge of JCS's fraud,¹²⁴ and there is no basis for a \$700,000 offset to First Data's claim.

G. Reason 7: First Data Failed to Perform Sufficient Diligence or Verification

The Receiver argues (Motion at 26-29) that First Data failed to perform sufficient diligence and monitoring. But the Receiver does not claim that First Data's review of JCS's Application violated any industry standards, and he concedes (*id.* at 23) that two subsequent processors approved JCS as clients *after* First Data terminated JCS, *when JCS's Ponzi scheme was in full swing*. When First Data reviewed JCS's Application, that scheme had not begun. The Receiver also argues (*id.* at 26) that First Data failed to perform a background search of Signore in November 2010. But Signore was not listed as an owner on JCS's Application; he was only a point of contact, and that information was not sent to First Data and is not considered during underwriting.¹²⁵

First Data's Application listed Brown as JCS's 51% owner, and the Receiver argues (Motion at 26-27) that First Data should have done more to verify that Brown was an owner. But First Data followed its standard procedure, which, based on the size of JCS's account, was to verify that Brown was a legitimate person by confirming his name, birthdate, home address and social security number.¹²⁶ First Data also requested Brown's bank account information from Merchant One, its ISO.¹²⁷ Although the Receiver argues First Data should have known that Signore was the person behind JCS because he incorporated it, JCS's certificate of incorporation lists Mark Williams as "incorporator" and Signore as a director, which is irrelevant to ownership.¹²⁸

Relying on an agreement between First Data and Merchant One, the Receiver argues (Motion at 27-29) that "First Data clearly bore the risk regarding losses resulting from a retail

¹²³ Tenenbaum Depo at 93:11-21 (**Exh. 25**).

¹²⁴ Receiver Depo at 74:16-75:6 (**Exh. 7**).

¹²⁵ DeAngelis Depo at 40:16-41:6 (**Exh. 2**).

¹²⁶ *Id.* at 35:5-36:24.

¹²⁷ Email chain between First Data and Merchant One (Depo Exh. 87 at FD-JCS-0149802-804) (**Exh. 29**).

¹²⁸ *Id.* at FD-JCS-0149800.

merchant account, including for chargebacks.” But any allocation of risk between First Data and Merchant One has no bearing on JCS’s ultimate responsibility for all chargebacks.¹²⁹ And it does nothing to show that First Data failed to perform reasonable diligence, especially because the Receiver has acknowledged that nothing in the Application, underwriting materials, or other documents provided to First Data indicate that JCS was operating a Ponzi scheme.¹³⁰

H. Reason 8: First Data Admitted After-the-Fact that it Made Mistakes

The Receiver argues (Motion at 29-32) that the Court should subordinate First Data’s claim because, after JCS’s fraud was exposed, emails show that First Data considered how JCS’s fraud occurred and how it might amend its fraud detection procedures. The Court should not consider those emails because they reflect inadmissible subsequent remedial measures. *See* Fed. R. Evid. 407; *Torres v. Rock & River Food Inc.*, 201 F. Supp. 3d 1373, 1373 (S.D. Fla. 2016) (stating that “subsequent remedial measures are of limited probative value and there is a strong social policy of encouraging people to take . . . steps in furtherance of added safety”).¹³¹

Even if the Court considers the emails, they are no basis to subordinate First Data’s claim. Indeed, written in 2013, they do not show that First Data made mistakes in 2010. The Receiver cites an email stating that the analyst “was not aware of information being provided was false and he was being set up by the Joseph [Signore],” but Signore was not listed as an owner on JCS’s application.¹³² First Data did not receive Signore’s information until May 2013,¹³³ and it terminated JCS months later. And the “Hawk Alert” on Signore actually helped him defraud First

¹²⁹ *See* Program Guide at 2 (Depo Exh. 86) (**Exh. 14**); Receiver Depo at 122:6-10 (**Exh. 7**).

¹³⁰ Receiver Depo at 58:15-18 (**Exh. 7**).

¹³¹ First Data rejects the Receiver’s claim that First Data intentionally withheld documents from its initial production (*see* Motion at 30 n.44).

¹³² *See* Application § 2 (Depo. Exh. 4) (**Exh. 6**).

¹³³ *See* Aufiero Depo Vol. II at 50:9-25 (**Exh. 1**).

Data. The Receiver admits (Motion at 31) that a Hawk Alert indicates that a person may be a victim of identity theft, which is precisely the excuse that Signore made to First Data.¹³⁴

The Receiver's next argument is based on pure speculation. Although First Data's 2014 post-mortem analysis concludes that First Data may have denied the JCS Application (in 2010) if Signore had been listed as an owner,¹³⁵ First Data's corporate representative, Ms. DeAngelis, disagreed. The Receiver argues (Motion at 32 n.47) that her testimony—purportedly showing that First Data would have approved JCS even if it had known about Signore—supports subordination of First Data's claim. But Ms. DeAngelis testified that she could not be certain of First Data's decision in 2010 because “there's a lot of judgment calls in underwriting.”¹³⁶ And Mr. Saka testified that, although uncommon, some merchants with criminal convictions *do* get approved for a merchant account.¹³⁷ In short, JCS's fraud prevented First Data from performing an underwriting analysis on Signore in 2010, and the Receiver cannot subordinate a claim based on speculation. *See BGW Design Ltd., Inc. v. Serv. Am. Corp.*, No. 10-20730, 2010 U.S. Dist. LEXIS 128029, at *18 (S.D. Fla. Dec. 3, 2010) (holding that speculative allegations about whether a potential business relationship would have materialized is insufficient to support a claim).

The Receiver argues that (Motion at 32) that Mr. Aufiero's testimony was “highly inaccurate” because, despite the post mortem emails, he testified that First Data did nothing wrong. But Mr. Aufiero testified that First Data followed its periodic review process,¹³⁸ which is not inconsistent with later reviewing that process to identify potential areas for improvement.

I. Reason 9: First Data Violated its Own Internal Policies

The Receiver argues (Motion at 32-36) that First Data violated its own policies, but, even if true, a party's violation of its own policy does not establish a legal duty. *See Boutilier v. Chrysler*

¹³⁴ *See* Aufiero Depo Vol. II at 50:14-20 (**Exh. 1**); PR Financial Addendum – June 2013 (Depo Exh. 23) (**Exh. 30**).

¹³⁵ First Data Post Mortem Analysis at 2 (Depo Exh. 139)(**Exh. 31**).

¹³⁶ DeAngelis Depo at 155:11-156:6 (**Exh. 2**).

¹³⁷ Saka Depo at 284:1-9 (**Exh. 5**).

¹³⁸ Aufiero Depo Vol. II at 110:25-111:16 (**Exh. 1**)

Ins. Co., No. 99-cv-2270, 2001 U.S. Dist. LEXIS 5526, at *4 (M.D. Fla. Jan. 31, 2001) (finding that the existence of an internal corporate policy does not “create a legal duty or cause a breach of that duty”). Courts have cautioned that using a party’s internal procedures to establish an objective standard of liability would create “the perverse incentive” for parties to create weak internal policies. *Briggs v. Wash. Metro. Area Transit Auth.*, 481 F.3d 839, 848 (D.C. Cir. 2004) (“internal policies—standing alone—cannot demonstrate the applicable standard of care”).

The Receiver cites no case holding that a party’s failure to adhere to its policies justifies subordinating its claim in an equitable proceeding, and none of his cases even involves equitable proceedings. *See Rogers v. S. Start Logistics, Inc.*, 661 F. App’x 667, 673 (11th Cir. 2016) (finding that policies were admissible in a car accident case that involved expert testimony); *Prager v. FMS Bonds, Inc.*, No. 09-80775, 2010 U.S. Dist. LEXIS 74820, at *20-21 (S.D. Fla 2010) (motion to dismiss where the court did not consider the sufficiency of evidence); *Saxon Mortg. Servs. v. Harrison*, 186 Md. App. 228, 290-91 (Md. Ct. Spec. App. 2009) (finding that expert testimony was unnecessary where a bank violated its policy to verify that the endorsement matched the payee on a check and released funds without the payee’s consent).

Moreover, First Data did *not* violate its internal procedures. The Receiver argues (Motion at 33) that First Data’s policies compel it to place a merchant on the MATCH list within five calendar days of the decision to cancel,” but at that time First Data did not have actual knowledge that JCS had committed fraud, much less “excessive” fraud or “excessive” chargebacks, which are bases for placing a merchant on MATCH.¹³⁹ As of October 2013, JCS’s refund ratio was 0.23% and its chargeback ratio was zero.¹⁴⁰ And, in 2010, First Data complied with its policy to seek the endorsement of the merchant’s owner because it required that JCS identify its majority owner and that the majority owner sign the application.¹⁴¹ JCS identified Brown, and First Data obtained his

¹³⁹ *See* Redacted Excerpts of First Data’s Policies (Depo Exh. 38, as produced by Receiver) at FD-JCS-0009935 (**Exh. 32**).

¹⁴⁰ October 2013 Periodic Review at 1 (Depo Exh. 25) (**Exh. 12**)

¹⁴¹ *See* Application § 2 (Depo. Exh. 4) (**Exh. 6**).

bank statements.¹⁴² Merchant One also spoke with Brown, who confirmed that he owned JCS.¹⁴³ The Receiver also argues (Motion at 34) that First Data violated its policies because it “did not run a credit report to confirm that Brown worked at JCS in 2010,” but Merchant One *did* run a credit report on Brown in 2010.¹⁴⁴

J. Reason 10: Merchant One Knew About Material Issues from the Beginning

The Receiver argues (Motion at 36) that First Data’s claim should be subordinated because Merchant One “was aware of material credit issues affecting the JCS account during the underwriting of the JCS account before First Data approved same.” But even if Merchant One knew Signore’s low credit score, there is no dispute that *First Data* did not receive Signore’s credit report in 2010,¹⁴⁵ and the Receiver does not explain why Merchant One’s knowledge should be imputed to First Data. *Doran*, 854 F.3d at 1315. The Receiver also does not show that Signore’s credit score would have been dispositive, and Ms. DeAngelis testified that an owner’s credit score, even a poor one, does not necessarily result in a denied application.¹⁴⁶ The Receiver reiterates that Brown was never a majority owner or an officer of JCS, but the record is clear that neither First Data nor Merchant One knew that in 2010, when JCS’s application was approved.¹⁴⁷

K. Reason 11: First Data Received Revenue from JCS

The Receiver argues (Motion at 37) that the Court should offset or deny First Data’s claim because it did not report on its Claim Form that it received \$120,000 to \$130,000 in revenue from the JCS account. But those processing fees are *de minimis* compared to First Data’s \$7 million claim, and are not even relevant to whether First Data is entitled to a distribution of JCS assets. *See Homeland Commc’ns. Corp.*, 2010 U.S. Dist. LEXIS 57961, at *23-24 (“The Court does not

¹⁴² April 2013 Periodic Review at 2 (Depo Exh.) (**Exh. 8**) and Email chain between First Data and Merchant One (Depo Exh. 87) (**Exh. 29**).

¹⁴³ Saka Depo at 232:25-233:6 (**Exh. 5**).

¹⁴⁴ *Id.* at 75:16-22.

¹⁴⁵ *Id.* at 97:24-98:1.

¹⁴⁶ DeAngelis Depo at 55:3-11 (**Exh. 2**).

¹⁴⁷ Saka Depo at 232:25-234:4 (**Exh. 5**).

believe that [defendant's] receipt of thousands of dollars in rental payments pursuant to lease contracts is a relevant factor to consider when determining how to equitably distribute frozen assets to similarly situated investors.”).

L. Reason 12: Equitable Subrogation Does not Apply

As shown above, First Data is entitled to priority based on equitable subrogation. The Receiver's own authority holds that equitable subrogation “is to be flexibly applied,” *In re Flamingo 55, Inc.*, 378 B.R. 893, 906 (Bankr. D. Nev. 2007), and each of his four arguments against equitable subrogation is without merit.

First, the Receiver argues (Motion at 37), without citing any authority, that giving First Data priority over JCS's customers would “work an injustice on third parties.” Although payment of First Data's claim will leave less for JCS's customers, First Data should be compensated for the \$7 million by which it reduced claims against the Estate. *See IAB Mktg. Assocs.*, 2013 U.S. Dist. LEXIS 136502, at *6.

Second, the Receiver argues (Motion at 37) that equitable subrogation does not apply where the requester behaved inequitably. But the Receiver identifies no “inequitable” conduct by First Data. Moreover, there is no dispute that JCS concealed its fraud from First Data,¹⁴⁸ and that First Data, just as much as JCS's customers, was a victim of the fraud.¹⁴⁹

Third, the Receiver argues (Motion at 37-38) that equitable subrogation does not apply “if the requestor is an obligor or guarantor of the money at issue,” citing *In re Flamingo 55, Inc.*, 378 B.R. at 914-15. But *In re Flamingo* precludes equitable subrogation only when the requestor is “primarily liable” on the debt paid. *Id.* at 913. Here JCS, not First Data, was primarily liable for JCS's chargebacks.¹⁵⁰

¹⁴⁸ Receiver Depo at 74:16-75:6 (Exh. 7).

¹⁴⁹ *Id.* at 114:19-115:14.

¹⁵⁰ *See* Program Guide at 2 (Depo Exh. 86) (Exh. 14).

Fourth, the Receiver argues (Motion at 38) that First Data voluntarily made chargeback payments, but those chargebacks were *automatically* debited from funds transferred to First Data.¹⁵¹ First Data repeatedly advised JCS and its principals that *they* were liable for the chargebacks.¹⁵² After JCS's principals were long gone, First Data also asked the Receiver to contest the chargebacks, but the Receiver refused to do so, resulting in more than \$4 million of additional chargebacks.¹⁵³ Equity requires that First Data be reimbursed first.

M. Reason 13: First Data's Priority Argument is Baseless

The Receiver argues (Motion at 38) that First Data's claim for priority treatment is "baseless" because (1) the Receiver never ratified JCS's pre-receivership contract with First Data, (2) the Receiver offered to seek a stay of chargebacks, (3) the Receiver "could not" dispute chargebacks, and (4) caveat emptor does not apply. Those arguments are meritless.

First, the Receiver argues (*id.*) that the "law is clear that a receiver is not bound to any pre-receivership contract," but courts routinely hold receivers to such contracts. *See SEC v. 1 Global Capital, LLC*, No. 18-cv-61991, 2019 U.S. Dist. LEXIS 26355, at *10-12 (S.D. Fla. Feb. 20, 2019) (allowing payment processor to maintain collateral to cover chargebacks under a pre-receivership contract); *In re Wiand*, No. 10-cv-71, 2011 U.S. Dist. LEXIS 113162, at *21 (M.D. Fla. June 8, 2011) (rejecting argument that pre-receivership contract did not bind the receiver). And the Receiver's cases (Motion at 39) do not apply. *See Citibank, N.A. v. Nyland, (CF8) Ltd.*, 839 F.2d 93, 98 (2d Cir. 1987) (decided under New York law, although the Receiver's ellipses elide that fact); *FTC v. Productive Mktg., Inc.*, 136 F. Supp. 2d 1096, 1103-06 (C.D. Cal. 2001) (holding that a preliminary injunction extended to a non-party holding receivership assets). Moreover, the Receiver ratified JCS's pre-receivership agreement with First Data by advising JCS's customers that they could pursue chargebacks up to the amount of their investments.¹⁵⁴

¹⁵¹ Aufiero Decl. ¶ 12 (**Exh. 4**).

¹⁵² *See* Letters from Michael Aufiero to JCS (Depo Exh. 96) (**Exh. 21**).

¹⁵³ Kaufman Rossin Expert Report at 22-23 (Depo Exh. 112) (**Exh. 19**).

¹⁵⁴ *See* May 28, 2014 Letter from James Sallah at 1 (Depo Exh. 102) (**Exh. 23**).

Second, the Receiver argues (Motion at 39) that First Data is not entitled to priority treatment because the Receiver offered to file a motion to stay or enjoin chargebacks. As the Receiver is aware, however, card brand rules prevent First Data from agreeing to any such motion,¹⁵⁵ and the Receiver does not explain how First Data's obligation to object to such a motion defeats its claim. If the Receiver intended to ignore its obligation to dispute chargebacks, it could have filed a motion to stay over First Data's objection.

Third, although the Receiver argues (Motion at 40) that "there was no way for the Receiver to dispute chargebacks" because "he would have needed to complete a full forensic reconstruction to properly evaluate and properly dispute the chargebacks," the record shows that the Receiver chose not to prioritize chargebacks or to devote much attention to understanding them. Indeed, the Receiver testified that he "was aware of [chargebacks] because there was literally a fax machine at JCS that was humming every hour as chargebacks were coming in," but the "decision [he] made was to not address the chargebacks at that point[.]"¹⁵⁶ Although the Receiver had the obligation, standing in JCS's shoes, to dispute chargebacks, he completely abdicated that duty.

Fourth, the Receiver argues (Motion at 40) that "caveat emptor does not apply to securities transactions," but First Data never argued that it does. First Data recognizes that JCS defrauded hundreds of its customer, and that those customers have valid claims against the Estate. First Data simply contends that, as an involuntary investor that knew nothing about JCS's business model and did not agree to participate in its Ponzi scheme, First Data should receive priority for the \$7 million it was forced to contribute to JCS's other investors.

¹⁵⁵ Receiver Depo at 38:17-22 (**Exh. 7**).

¹⁵⁶ *Id.* at 35:12-36:16.

CONCLUSION

For the reasons stated, First Data respectfully requests that the Court (1) deny the Receiver's Motion, and (2) grant First Data's Cross Motion for Summary Adjudication and award First Data \$7,190,693, or, in the alternative, \$6,536,747, or, in the alternative, \$5,621,313; and/or (3) enter an order setting a bench trial or evidentiary hearing to adjudicate First Data's claim, as well as any other relief the Court deems just and proper.

Dated: November 4, 2019

Respectfully submitted,

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CERTIFICATE OF SERVICE

I CERTIFY that on this 4th day of November, 2019, I electronically filed the foregoing document with the Clerk using the Court's CM/ECF system, which will serve the document on all counsel of record.

By: /s/ James N. Robinson

James N. Robinson