

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO.: 9:14-CV-80468-MIDDLEBROOKS

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

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

Defendants.

**PLAINTIFF'S RESPONSE TO RECEIVER'S MOTION FOR SUMMARY
ADJUDICATION OF THE CLAIMS OF FIRST DATA MERCHANT SERVICES, LLC
AND FIRST DATA'S CROSS-MOTION FOR SUMMARY ADJUDICATION**

In response to the Receiver's Motion for Summary Adjudication of the Claims of First Data Merchant Services, LLC ("First Data") and First Data's Cross-Motion for Summary Adjudication, Plaintiff, Securities and Exchange Commission, respectfully states the following:

The Commission fully supports the Receiver's efforts to distribute to the investor victims the maximum possible from the limited pool of funds the Receiver has been successful in raising through his Herculean efforts. The Receiver was appointed to maximize the value of the estate for the benefit of the aggrieved investors. The Commission believes that the Receiver's actions here are in complete conformance with the Receiver's goal and purpose.

As in most offering frauds, however, there is not enough money left to fully repay the investors that the Defendants defrauded. Here, the Receiver holds approximately \$10 million while facing about \$35 million in investor losses. Since the very first Ponzi scheme case in 1924, Courts have addressed such situations by making distributions to victims based on the guiding

principle that “equality is equity.” *Cunningham v. Brown*, 265 U.S. 1, 13 (1924). Thus, the Receiver has proposed an equitable distribution plan, recommending that the defrauded investors each get a share of the Receivership estate. The SEC fully supports the Receiver’s distribution recommendation and his efforts to distribute the estate without further delay to the defrauded victim investors.

As detailed in the competing motions, the Receiver has been delayed from such a distribution by a dispute with one of Defendants’ vendors, First Data. Bucking longstanding equitable principles, First Data argues that it deserves to be paid 100% of its claim (some \$7.1 million) before any victim investor receives a dime. First Data asks that this Court treat the Receivership as an ordinary business wind-down governed by the terms of private contracts and inapplicable law. In doing so, First Data stands equity on its head by arguing that the terms of its contracts (both with the Defendants and non-party credit card companies) mandate that its claims get special treatment. But, the one guiding principle for a distribution from an equitable receivership is fairness. The approach advocated by First Data-where it is paid in full while the investor victims receive a pittance-clearly fails that standard. Thus, the Commission disagrees with First Data’s argument that it should have a “first priority” over and to the exclusion of the defrauded investor victims, as such argument is not supported by law and would be inequitable.

While the Commission is not unsympathetic to First Data’s argument that the Receiver’s estate has benefited and the investors’ claims have decreased due to the chargebacks it paid directly to some of the victim investors, the Commission does not believe that First Data has sufficiently set forth facts to prove its claims to priority. To the contrary, to the extent First Data is entitled to any recovery, it would be under the doctrine of subrogation, but under subrogation principles First

Data would not be entitled to priority over other investors and would be subject to any defenses to those investors' claims that are available to the Receiver.

MEMORANDUM OF LAW

In SEC enforcement actions, district courts have “broad equitable power to fashion appropriate remedies for federal securities law violations.” *SEC v. Whittemore*, 659 F.3d 1, 9 (D.C. Cir. 2011); *SEC v. Elliot*, 953 F.2d 1560, 1566 (11th Cir. 1992). Courts have held that within that broad authority lies the power to approve a plan of distribution proposed by a federal receiver. *SEC v. Credit Bancorp., Ltd*, 290 F.3d 80, 82-83 (2d Cir. 2002); *SEC v. Forex Asset Mgmt., LLC*, 242 F.3d 325, 332 (5th Cir. 2001) (“Because we find that the district court did abuse its discretion when it approved the Receiver’s plan, we AFFIRM”). Nearly every plan to distribute funds obtained in SEC enforcement actions requires choices to be made regarding the allocation of funds among potential claimants within the parameters of the amounts recovered. To that end, district courts have broad authority to approve plans of distribution in SEC enforcement actions upon a finding that such a plan is “fair and reasonable.” *SEC v. Wang*, 944 F.2d 80, 85 (2d Cir. 1991) (“unless the consent decree specifically provides otherwise once the district court satisfies itself that the distribution of proceeds in a proposed SEC disgorgement plan is fair and reasonable, its review is at an end.”). In recognition of the difficulty of this task, Courts have accorded the Commission wide discretion in the development of plans to distribute such funds. *Wang*, 944 F.2d at 88.

I. First Data’s Attempt to be Given First Priority Over the Claims of JCS’s Investor Victims Should be Denied as Inequitable and Without Legal Support

While First Data argues it too was defrauded by JCS, it takes the untenable position that because it paid back several of JCS investor victims’ claims through chargebacks, its claims should be put ahead of the actual investor victims and be given first priority. In support, First Data relies

almost exclusively on *FTC v. IAB Mktg. Assocs.*, LP, 2013 U.S. Dist. LEXIS 136502 at *5-6 (S.D. Fla. Sept. 19, 2013), a matter in which the Receiver agreed to return \$6,500 of chargebacks to the bank that funded the chargebacks to the investor victims. In *IAB Mktg*, Judge Scola agreed with the Receiver that it would be equitable to reimburse the bank for the chargebacks that it had already made and had been required to make under banking regulations. Nowhere in his two paragraph opinion on the chargeback issue does Judge Scola state that the bank's claim took a first priority over those of the defrauded investors or that it would be equitable for the bank to exercise a first priority that would result in the investor victims receiving little to nothing from the receivership estate. Indeed, Judge Scola placed a cap on what the receiver was authorized to reimburse for the consumer chargebacks "up to a maximum of \$6,500." *Id.* at *6. Nowhere in Judge Scola's opinion is there a discussion of the priority of claims or equitable subrogation. Indeed, First Data has failed to provide any case law in which a bank, credit card processor or similar company that provided chargeback services was entitled to a first priority in an equitable distribution, such as here, to the exclusion of defrauded investors. The reason for such failure is obvious, to grant such a first priority claim would be inequitable.

II. First Data is not Entitled to Priority Under Principles of Equitable Subrogation

Next, First Data argues that it is entitled to a first priority under the principles of equitable subrogation. Clearly, First Data is not entitled to priority under the threshold requirements of equitable subrogation. Granting it first priority would work an injustice to the victim investors who will receive a pittance in that scenario. *See 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) (setting forth the elements that must be pled to state a claim for equitable subrogation).

First Data asks this Court to award 100% of its preferred claim (\$7,190,693) before any other investors receive a dime. If First Data were to receive a priority claim, less than \$2.9 million would be left in the Receivership estate to resolve the approximately \$27 million in claims of the hundreds of defrauded victim investors. In other words, while First Data would receive 100% of its claim, defrauded investors would receive 10% or less of their claims. Such a result is facially inequitable. The Receiver was appointed to maximize the value of the estate, not to act as an underwriter for First Data's obligations under its Merchant Agreement.

In securities fraud cases, the Court is granted very broad authority to determine how assets should be distributed; rather than merely implementing a system of contractual or legal preferences, and the Court can fashion a scheme with fairness as the overriding goal. *See SEC v. Homeland Communications Corp.*, 2010 U.S. Dist. Lexis 57961 (S.D. Fla. May 24, 2010) (holding that in equity receiverships "no specific distribution scheme is mandated as long as the distribution is fair and equitable"). Indeed, awarding First Data a first priority claim would violate the principle that equitable subrogation should "work no injustice to the rights of . . . third part[ies]." *MSPA Claims I*, at *11. Here, First Data has failed to show how it receiving a priority claim awarding it 100% of its claim while leaving defrauded investors with a pittance is equitable.

III. If First Data Satisfies The Elements Of Equitable Subrogation, It Would Acquire No Rights Or Priorities Beyond Those Of The Paid-off Investors

Although not entitled to a first priority claim, the Commission recognizes that the Receivership estate has benefited from First Data's actions to the extent the investors' claims have been decreased due to the chargebacks paid directly to some of the victim investors by First Data. Thus, the Commission submits that the Court should evaluate First Data's claim under the rubric of subrogation. The Receiver's filings list several reasons why despite such payments a distribution to First Data would be inequitable and why the elements of equitable subrogation have

not been met. In its response, First Data, provides few facts to support the equitable claims it may have or to dispute the Receiver's arguments that it acted with unclean hands. The Commission takes no position in the dispute between First Data and the Receiver as to whether the elements of equitable subrogation are satisfied here. However, if the Court were to find First Data entitled to subrogation, it would step into the shoes of the investors it paid, be subject to any defenses the Receiver would have against those investors' claims, and be paid proportionately with other investors.

Under the doctrine of equitable subrogation, First Data would "acquire[] the rights and defenses" of the investors, "*but not more.*" *Weitz Co., LLC v. Lexington Ins. Co.*, 786 F.3d 641, 648 (8th Cir. 2015) (emphasis added) (applying Florida and Illinois law). Thus, if the investors had "no rights *or priorities* against [the Receiver], then [First Data] has nothing to inherit as against the [Receiver]." *Century Surety Co. v. Hartford Fire Ins. Co.*, No. 05-22517-CIV, 2006 WL 8433282, *4 (S.D. Fla. Sept. 6, 2006) (emphasis added) (quoting *Dade County. Sch. Bd. v. Radio Station WQBA*, 731 So. 2d 638, 646 (Fla. 1999)). Therefore, the Receiver would be entitled to assert against First Data any defenses the Receiver could have asserted against the investors First Data paid off.¹ Moreover, First Data suggests no reason why any of the paid-off investors would have had any basis for priority over other investors, and therefore to the extent First Data's claim is allowed, it should be paid proportionately with other investors.

Ultimately, underlying these considerations are factual issues that the Commission is not in a position to advise on, but are clearly within the Court's discretion to decide. *See e.g. Broadbent v. Advantage Software, Inc.*, 2011 WL 754838, *5 (10th Cir. March 4, 2011) (holding that in an equity receivership a district court has discretion to summarily reject formalistic arguments that

¹ According to the Receiver's reply, at least 115 investors never submitted a claim to which the Receiver could have responded and asserted defenses, but those investors are part of First Data's requested recovery.

would otherwise be available in a traditional lawsuit”); *Homeland Communications Corp.*, 2010 WL 2035326, at *2.²

CONCLUSION

In implementing an equitable distribution, courts have broad discretion in making the difficult choices that must be made, and are guided merely by what is fair and equitable. The Commission believes that awarding First Data a priority claim would be beyond the bounds of the law and the Court’s discretion because it would result in an inequitable distribution to the defrauded investors who would receive very little of the monies out of which they were defrauded and is not legally supported.

Respectfully submitted,

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² The Commission is concerned that this dispute is draining the limited resources of the Receivership and respectfully suggests if the Court determines that it will require an evidentiary hearing to resolve the motions, that prior to conducting such hearing, the parties be given an opportunity to mediate or otherwise attempt to resolve the motions.