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15 **UNITED STATES DISTRICT COURT**
16 **CENTRAL DISTRICT OF CALIFORNIA**

17 Federal Trade Commission,
18
19 Plaintiff,
20 v.

22 Loss Mitigation Services, Inc., et al.,
23 Defendants.

} Case No. SACV09-800 DOC(ANx)
} **PLAINTIFF FTC'S OPPOSITION TO**
} **CLAIMANT TK GLOBAL PARTNERS,**
} **LP'S MOTION FOR DECLARATORY**
} **RELIEF, LEAVE TO INTERVENE,**
} **LEAVE TO SUE DEFENDANT LMS,**
} **AND LEAVE TO SUE DEFENDANT**
} **DEAN SHAFER**

} Judge: Hon. David O. Carter
} DATE: December 7, 2009
} TIME: 8:30 a.m.
} COURTROOM: 9 D

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1 **INTRODUCTION**

2 The primary remaining liquid asset of Defendant Loss Mitigation Services,
3 Inc. (“LMS”) is a merchant reserve account that LMS established at Monterrey
4 County Bank (“MCB”) as part of an agreement between the two entities, which
5 permitted LMS to charge its fees to consumers’ credit cards. The account was
6 funded by deductions taken from the fees that LMS charged consumers for purported
7 loan modification services. Pursuant to the Court’s August 18, 2009, Preliminary
8 Injunction Order with Receiver, Asset Freeze, and Other Equitable Relief as to
9 Defendants LMS and Synergy Financial Management Corporation d/b/a Direct
10 Lender and Direct Lender.com [Docket Itm #41] (“LMS PI Order”), the account
11 properly was placed under the control of the receiver in this action, where it can be
12 preserved for pro-rata distribution should Plaintiff FTC prevail in this action.

13 Notwithstanding, non-party TK Global Partners, LP (“TK Global”), a credit
14 card payment processor, has moved the Court for a panoply of alternate forms of
15 relief, all of which are designed to give TK Global a priority interest in the reserve
16 account. Specifically, TK Global moves for declaratory relief, leave to intervene,
17 and leave to pursue separate lawsuits against the defendants. Although TK Global
18 fails to show that it has any valid contract or security claim to the account, or that its
19 interest otherwise is sufficient to warrant depriving consumers of the prospect of
20 relief from the reserve account, that is precisely what its motion would do.
21 Moreover, TK Global asserts its priority over consumers’ claims despite having had
22 actual knowledge that the credit card charges TK Global processed for LMS were for
23 advance fees collected in violation of relevant consumer protection laws.

24 For these reasons, and those set forth below, TK Global’s motion should be
25 denied in its entirety.

26 **SUMMARY OF THE RELEVANT CONTRACTS**

27 TK Global’s Motion for Declaratory Relief, Leave to Intervene, Leave to Sue
28 Defendant LMS, and Leave to Sue Defendant Dean Shafer [Docket Itm. #51]

1 (“Motion for Declaratory Relief, Etc.”), relies on contractual rights and obligations
2 purportedly established by three agreements: a “Merchant Processing Agreement”
3 between LMS and MCB; a “Referral Agreement” between TK Global and MCB; and
4 an “Assignment Agreement” between TK Global and MCB.

5 The “Merchant Processing Agreement” between LMS and MCB was executed
6 on June 25, 2008, to give LMS the ability to charge consumers’ Visa and MasterCard
7 credit cards for LMS’s purported loan modification services. *See* Decl. of Herrera
8 [Docket Itm. #52-4], Ex A (“Merchant Processing Agreement”). MCB, as a member
9 of the Visa and MasterCard exchange network, had the right to make charges to
10 consumers’ credit cards. Through another contract, however, MCB had outsourced
11 responsibility for processing these credit card transactions to TK Global. This
12 “Referral Agreement” between MCB and TK Global was dated February 25, 2008.
13 *Id.*, Ex. B (“Referral Agreement”). Under the Referral Agreement, MCB gave TK
14 Global 75% of the net profits generated by credit card transactions in return for TK
15 Global handling the processing. *Id.* § 2.1. No contract existed between TK Global
16 and LMS, and the Referral Agreement between TK Global and MCB did not
17 mention LMS.

18 Under the Merchant Processing Agreement, LMS agreed to establish a reserve
19 account at MCB to cover “chargebacks” – instances in which consumers’ credit card
20 accounts are reimbursed for disputed a charges. *See* Merchant Processing
21 Agreement § 2.05. In establishing the account, LMS retained certain rights to the
22 funds. For example, the paperwork setting up the account acknowledged that LMS
23 was entitled to “periodically (on average, a weekly basis) apply debits to the account
24 to sweep the balance of the account and transfer funds to an account they hold at an
25 outside financial institution.” Ex. 1 (Redding), Att. A at 4. Additionally, statements
26 for the account furnished by MCB listed Loss Mitigation Services as “pledgor” on
27 the account, a status that reserved to LMS certain property rights in the account.
28 MCB was listed as “pledgee,” on the account. Consistent with the Merchant

1 Processing Agreement, however, TK Global was not listed on the account. *Id.*, Att.
2 B at 6.

3 After the Court entered the LMS PI Order on August 18, 2009, TK Global
4 apparently sought to obtain what rights MCB had in the reserve account by procuring
5 from MCB an “Assignment Agreement.” *See* Decl. of Dunn [Docket Itm. #52-3],
6 Ex. C (“Assignment Agreement”). The Agreement was executed on October 2, 2009
7 and purported to transfer to TK Global MCB’s “right, title, and interest in and to any
8 and all claims” that MCB had against LMS, and any claims MCB had against Dean
9 Shafer. *Id.*

10 ARGUMENT

11 **I. THE RESERVE ACCOUNT IS PART OF THE RECEIVERSHIP AND** 12 **IS SUBJECT TO THE ASSET FREEZE**

13 The reserve account is not just an asset of LMS – it is the primary liquid asset
14 of LMS, and pursuant to the LMS PI Order, it properly has been placed under the
15 control of the receiver. TK Global nevertheless requests a declaratory ruling that the
16 reserve account is “outside the receivership,” which TK Global maintains would
17 permit it to “obtain the funds” in the account. *See* Mot. for Decl. Relief, Etc. [Docket
18 Itm. # 51] at 5. This request disregards the plain language of the LMS PI Order,
19 which clearly defines what constitutes “[a]ssets,” and prescribes what should be done
20 to protect them. Accordingly, TK Global’s request for declaratory relief should be
21 denied.

22 TK Global argues that the funds in the account are not an asset of LMS
23 because “LMS’s right to any of those reserve funds is contingent merely.” *Id.* The
24 LMS PI Order, however, unambiguously establishes that the LMS reserve account is
25 an asset of LMS and is properly under the control of the Receiver. The Order
26 defines “[a]ssets” as “any legal or equitable interest in, right to, or claim to, any real
27 or personal property, including, without limitation . . . accounts, credits, contracts,
28 receivables, shares of stock, and all cash, wherever located.” LMS PI Order

1 (Definitions) at 5. Taking the words in this definition at their plain meaning, the
2 reserve account is an asset of LMS if it had “*any* legal or equitable interest in, right
3 to, or claim to” the account (emphasis added).

4 Given that LMS was entitled to “apply debits to the account to sweep the
5 balance of the account and transfer funds to an account they hold at an outside
6 financial institution,” Ex. 1 (Redding), Att. A at 4, it is evident that LMS had, at a
7 minimum, *some* legal or equitable interest in, right to or claim to the account.
8 Moreover, LMS’s status as “pledgor” on the account, *id.*, Att. B at 6, reserved to
9 LMS certain property rights. *See, e.g., U.S. v. Kendrick*, 692 F.2d 1262, 1265 (9th
10 Cir. 1982) (“pledges transfer less than absolute title” and instead transfer only “an
11 ‘interest in a security’”) (quoting *Rubin v. United States*, 449 U.S. 424, 429 (1981));
12 *see also Blair Holdings Corp. v. Bay City Bank & Trust Co.*, 234 F.2d 513, 516 (9th
13 Cir. 1956) (pledge of stock did not transfer title from pledgor to pledgee). Indeed,
14 the funds were in the account only by virtue of LMS having obtained them from
15 consumers and by virtue of LMS’s agreement with MCB for the right to charge
16 consumers’ credit cards. TK Global’s role was merely to process the transactions
17 arranged between consumers, LMS and MCB for a 75% share of the bank’s
18 processing fee. TK Global had no contractual relationship with either consumers or
19 LMS.

20 In similar circumstances, courts have held that “it defies common sense that
21 funds collected by [the payment processor] – which is essentially nothing more than
22 a middleman – for the Receivership should be considered the property of” the
23 payment processor. *FTC v. NHS Sys., Inc.*, No. 08-2215, 2009, WL 3072475, at *6
24 (E.D. Pa. Sept. 24, 2009). In *FTC v. NHS Sys., Inc.*, the FTC alleged that the
25 defendants had employed a “vast telemarketing scheme” to sell health plans to
26 consumers, for which defendants sought payment by soliciting consumers’ bank
27 account information. *Id.* at *1. Non-party Teledraft processed the payments, which
28 came directly out of consumers’ bank accounts, on behalf of the defendants. *Id.* On

1 the FTC's motion, the court entered an ex parte TRO, and subsequently a stipulated
2 preliminary injunction order freezing the defendants' assets and requiring them to be
3 transferred to a receiver. *Id.* at *2. Teledraft, however, refused to transfer the
4 contents of its reserve account to the receiver, arguing that the funds were not part of
5 the receivership estate because the defendants "merely possess a contract claim to
6 those funds, as opposed to the funds themselves." *Id.* at *5. The court rejected this
7 argument, reasoning that Teledraft was merely a "middleman" and did not obtain
8 greater rights to the funds than the defendants. *Id.* at *6.

9 TK Global's assertion that "LMS's right to any of those reserve funds is
10 contingent merely" under LMS's contract with MCB makes essentially the same
11 argument that the court rejected in *FTC v. NHS Sys. Inc.* Even if accepted as true,
12 however, TK Global's assertion concedes that LMS held *some* right to the funds.
13 Accordingly, under the plain language of the LMS PI Order, the funds in the reserve
14 account are an asset of LMS for purposes of the asset freeze and receivership.

15 In addition to defining the reserve account as an asset of LMS, the Order
16 unambiguously transferred control of the account to the receiver, and required MCB
17 to cooperate in the transfer. The Order provided that "the Receiver is directed and
18 authorized to . . . [c]ollect, marshal, and take custody, control and possession of all
19 the funds, property, premises, accounts, mail and other assets of, or in the possession
20 or under the control of Receivership Defendants." LMS PI [Docket Itm. # 41] § XX
21 at 21. The Order further stated that all "persons in possession, custody and control of
22 assets . . . of the Receivership Defendants shall" transfer to the Receiver "all assets of
23 the Receivership Defendants." *Id.* § XXIII(A). As set forth above, LMS had
24 sufficient rights and interest in the account to fit squarely within these provisions.
25 The receiver therefore properly took control of the account.

26 TK Global's further argument that the funds in the account are not LMS assets
27 because they were "held back" by TK Global and never "received by" or "held by"
28 LMS, Mot. for Decl. Relief, Etc. [Docket Itm. #51] at 5, is inapposite, as neither of

1 these criteria corresponds to provisions in the Order. The Order does not address the
2 implications of whether or not funds are “received by” or “held by” a defendant.
3 Rather, under the actual language of the Order, LMS need only have “any legal or
4 equitable interest in, right to, or claim to” the funds for them to be considered an
5 asset and therefore subject to the receivership. LMS PI Order (Definitions) at 5.

6 This broader protective language exists for good reason – to preserve assets so
7 that the Court may order final effective relief. The “purpose of the court’s
8 Preliminary Injunction Order was to account for and to preserve the assets of the
9 receivership estate.” *FTC v. Productive Mktng, Inc.*, 136 F. Supp. 2d 1096, 1110
10 (C.D. Cal. 2001). Thus, “[u]pon imposition of a receivership, all property in the
11 possession of the debtor passes into the custody of the receivership court, and
12 becomes subject to its authority and control.” *Id.* at 1105. TK Global’s restrictive
13 interpretation of the Court’s Order would deprive the Court of jurisdiction over the
14 primary liquid asset that exists to redress consumers. Accordingly, the Court should
15 deny TK Global’s request for a declaration that the reserve account is outside of the
16 receivership and not subject to the LMS PI Order.

17 **II. TK GLOBAL FAILS TO DEMONSTRATE THAT IT SATISFIES THE**
18 **REQUIREMENTS FOR INTERVENTION**

19 TK Global also fails to show that it is entitled – or should be granted leave in
20 the Court’s discretion – to intervene in this action and seek a declaratory ruling that it
21 is entitled to the funds in the reserve account. TK Global nevertheless asks for
22 permission to do just that if the Court finds the reserve account to be within the
23 receivership. *See* Mot. for Decl. Relief, Etc. [Docket Itm. #51] at 5. In making this
24 request, TK Global “ignore[s] the letter and spirit of this court’s Order by attempting
25 to leverage its claims by intervening so as to gain payment beyond its pro-rata share,
26 while at the same time ignoring the Injunction’s stay on all actions against the
27 defendants.” *FTC v. First Capital Consumer M’ship. Servs., Inc.*, 206 F.R.D. 358,
28 365 (W.D.N.Y. 2001). Rather than intervening to seek priority over consumers, TK

1 Global should be permitted to submit a claim to the receiver for pro-rata distribution
2 based on its purported claims as a creditor.

3 In its brief, TK Global fails to articulate, let alone to explain how it satisfies,
4 the requirements for intervention under the Federal Rules of Civil Procedure.
5 Instead, TK Global argues merely that “[I]eave to sue a receiver should be granted
6 where it appears that a cause of action is stated upon which it can be said there is a
7 reasonable probability of recovery.” Mot. for Decl. Relief, Etc. [Docket Itm. #51] at
8 6. In support of this proposition, TK Global relies on *Driver Harris Co. v. Indus.*
9 *Furnace Corp.*, 12 F. Supp. 918 (W.D.N.Y. 1935), a case that predated the 1937
10 adoption of the Federal Rules. While this statement may reflect a rule that once
11 applied, the Federal Rules set forth different standards for intervention.¹

12 Federal Rule 24(a) provides that to intervene as of right in a federal court
13 action, a person must timely file a motion demonstrating: (1) that the person has an
14 interest in the action; (2) that the interest may as a practical matter be impaired by the
15 disposition of the action; and (3) that the person’s interest would not adequately be
16 protected absent intervention. *See* Fed. R. Civ. P. 24(a)(2). The failure to satisfy any
17 one of these criteria justifies denial of the motion to intervene. *See FTC v. First*
18 *Capital Consumer M’ship Servs., Inc.*, 206 F.R.D. at 362. Rule 24(a) further
19 provides that, in the court’s discretion, permissive intervention may be allowed if the
20 proposed intervenor has “a claim or defense that shares with the main action a
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23 ¹ Even accepting its proffered standard, TK Global might face significant
24 challenges in recovering on its breach of contract and assignment claims. For
25 example, TK Global will have to overcome the fact that its contract claims depend
26 entirely on asserting MCB’s rights pursuant to an assignment agreement that was
27 made in violation of the LMS PI Order. *See infra*, Part II.A.1. Moreover, given
28 that TK Global had actual knowledge that LMS’s advance fee scheme violated
relevant consumer protection laws, it might face unclean hands and estoppel
defenses as well. *See infra*, Part II.A.3.

1 common question of law or fact.” Fed. R. Civ. P. 24(b)(1)(B). As set forth below,
2 TK Global fails to satisfy these standards.

3 **A. TK Global Does Not Have Sufficient Interest to Intervene and**
4 **Should Not Be Granted Priority Relief over Consumers**

5 TK Global fails to demonstrate that it has sufficient interest to intervene as of
6 right for several reasons. *First*, TK Global does not have a legitimate interest in
7 rights allegedly held by MCB pursuant to its Merchant Processing Agreement with
8 LMS. *Second*, the funds in the reserve account are held in constructive trust on
9 behalf of the consumers from whom they were taken – those who fell victim to
10 Defendants’ deceptive scheme. *Third*, TK Global is not a bona fide recipient
11 because it had actual knowledge that LMS’s collection of up-front fees through the
12 credit card transactions violated consumer protection laws.

13 **1. TK Global’s Interest Is Entirely Based on MCB’s Invalid**
14 **Assignment of its Purported Rights to the Reserve Account In**
Violation of the Court’s Preliminary Injunction Order

15 TK Global has no contractual relationship with LMS or any other defendant in
16 this case, let alone with any consumer, on which to base its claims. Rather, it has a
17 relationship only with MCB. Pursuant to the Referral Agreement with MCB, TK
18 Global agreed to maintain reserve funds with MCB for each merchant on whose
19 behalf MCB processed transactions. *See* Referral Agreement § 3. TK Global agreed
20 further to indemnify MCB for 75% of chargebacks resulting from transactions
21 processed by TK Global to the extent that such chargebacks exceeded the account
22 balance and were not reimbursed by the merchants. *Id.* Notably, TK Global did not
23 enter the Referral Agreement with MCB in conjunction with LMS entering its
24 Merchant Processing Agreement with MCB; the Referral Agreement pre-dated
25 LMS’s relationship with MCB by several months and applied generally to any
26 merchant for whom TK Global processed transactions.

27 TK Global, in fact, expressly acknowledges that its claims in intervention are
28 based on an assignment of contract rights allegedly held by *MCB* under its Merchant

1 Processing Agreement with LMS. *See* Decl. of Brewer, Ex. B [Docket Itm. #52-2]
 2 (Proposed Complaint in Intervention) ¶ 15.² However, the instrument by which TK
 3 Global purports to have procured those rights – the Assignment Agreement – was
 4 executed in violation of the LMS PI Order, which prohibited any person holding an
 5 asset of LMS from transferring the asset, which by definition includes any “claim to”
 6 an asset, through, among other things, “assignment.” Specifically, the Order
 7 provided that:

8 “A. any financial or brokerage institution, any business entity,
 9 or any other person having possession, custody, or control of . . . any
 10 account . . . or other asset titled in the name of Corporate Defendants . . .
 11 or held for the benefit of any of the Corporate Defendants . . . shall:

12 1. hold and retain within such Asset Holder’s control,
 13 and *prohibit the . . . assignment . . .* of any funds, documents,
 14 property, or assets, held by or under such entity’s or person’s
 15 control (1) on behalf of, or for the benefit of, any Corporate
 16 Defendant; (2) in any account maintained in the name of, or
 17 subject to withdrawal by, any Corporate Defendant; or (3) that are
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19 ² TK Global asserts without explanation that “LMS was only entitled to any
 20 amount in the Reserve Fund which remained after all charge-back amounts are
 21 paid to Intervenor.” Decl. of Brewer, Ex. B [Docket Itm. #52-2] (Proposed
 22 Complaint in Intervention) ¶ 11. Nothing in the agreements TK Global attached to
 23 its papers supports this statement. Under the Merchant Processing Agreement,
 24 MCB had the right to withhold funds to create a reserve account. *See* Merchant
 25 Processing Agreement § 2.05. Under the separate Referral Agreement, TK Global
 26 was required to pay MCB 75% of chargebacks that were unreimbursed by
 27 merchants (such as LMS) for whom TK Global processed transactions. *See*
 28 Referral Agreement § 3. While MCB thus limited its liability by arranging for
 reimbursement by two separate parties, nowhere in these agreements is an
 obligation created requiring LMS to pay chargeback amounts directly to TK
 Global. TK Global’s claims, therefore, can only be read to depend entirely on the
 invalid Assignment Agreement between TK Global and MCB.

1 subject to access or use by, or under the signatory power of, any
2 Corporate Defendant.”

3 LMS PI Order § IX(A) (emphasis added). Although the FTC served a copy of the
4 Order on MCB on August 19, 2009, *see* Ex. 2 (Murphy), Att. A at 12-45, on October
5 2, 2009, MCB purported to assign for collection to TK Global the Bank’s “right,
6 title, and interest in and to any and all claims that Bank has or may have against
7 LOSS MITIGATION SERVICES, INC. (“LMS”) for fees, chargebacks, and any
8 other amounts due to Bank . . . pursuant to that Merchant Agreement dated July 7,
9 2009 between bank and LMS.” *See* Assignment Agreement. This assignment of
10 claims violates the plain language of the LMS PI Order and is therefore invalid. *See*
11 *In re Carpio*, 213 B.R. 744, 748 (W.D. Mo. 1997) (agreement made in violation of a
12 court’s order is void ab initio).³ TK Global thus has no standing to assert a contract
13 claim pursuant to the Merchant Processing Agreement and cannot show that it has
14 sufficient interest to satisfy the first part of the test under Rule 24(a)(2).

15 “The kind of ‘interest’ contemplated by Rule 24(a)(2) refers not to any interest
16 the applicant can put forward, but only to a legally protectable one.” *FTC v. First*
17 *Capital Consumer M’ship Servs., Inc.*, 206 F.R.D. at 362 (internal quotations
18 omitted). To be sufficient, the interest must be “significantly protectable, direct, and
19 immediate, as opposed to one which is remote or contingent.” *Id.* TK Global has no
20 direct contractual relationship with any defendant in this case; its asserted claims are
21 once-removed, based entirely on the invalid Assignment Agreement between TK
22 Global and MCB. Such derivative claims are not sufficient to give rise to an interest
23 under Rule 24(a)(2). Accordingly, TK Global cannot intervene as of right.

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27 ³ Indeed, the Assignment Agreement would subjugate the very purpose of
28 the LMS PI Order’s asset preservation provisions by disposing of LMS’s primary
liquid asset in advance of any opportunity to enter effective relief for consumers.

1 **2. The Funds in the Reserve Account Are Held in Constructive**
2 **Trust for Defrauded Consumers And Cannot Be Transferred**
3 **Even to Bona Fide Recipients**

4 TK Global also cannot assert an interest sufficient to support intervention
5 because the funds to which it claims entitlement are held in constructive trust for
6 LMS's consumer victims. "In a constructive trust, a person who has engaged in
7 fraud or other wrongful conduct holds only bare legal title to the property subject to a
8 duty to reconvey it to the rightful owner." *FTC v. Crittenden*, 823 F. Supp. 699, 703
9 (C.D. Cal. 1993). Such wrongful conduct includes conduct that violates Section 5 of
10 the FTC Act. *See id.* Given that the legal basis for a constructive trust lies in state
11 law, "the Court must look to California law to determine whether a constructive trust
12 exists over the present receivership estate." *Id.* In California, the requirements for a
13 constructive trust are: "(1) the existence of a res; (2) the plaintiff's right to the res;
14 and (3) the defendant's acquisition of the res by some wrongful act." *Id.* (citing
15 *Calistoga Civic Club v. City of Calistoga*, 191 Cal. Rptr. 571, 576 (Cal. Ct. App.
16 1983)). Each of those requirements has been satisfied in this case. The reserve
17 account is the res; the FTC, on behalf of consumers, asserts a right to the res; and
18 LMS acquired the res by its wrongful conduct.

19 In *FTC v. Crittenden*, the IRS sought to attach a lien and gain first priority to
20 funds in the possession of a receiver that had been obtained by defendant Crittenden
21 in violation of the FTC Act. *FTC v. Crittenden*, 823 F. Supp. at 704. The court
22 rejected this request, finding that "those funds belong to Crittenden's customers
23 under a constructive trust, not to Crittenden himself." *Id.* The Court reasoned that
24 because "the funds do not belong to Crittenden, the IRS lien does not attach to the
25 receivership funds." *Id.*

26 Indeed, regardless of whether the funds are deemed to have been held in
27 constructive trust, courts have found that funds obtained in violation of the FTC Act
28 were properly considered receivership assets. In *FTC v. Productive Marketing, Inc.*,
the court entered a finding of contempt and sanctioned a marketing company that

1 refused to turn over the proceeds of credit card transactions processed for a
2 defendant that had been charged with violations of Section 5 of the FTC Act. 136 F.
3 Supp. 2d at 1111-12. In *FTC v. Ameridebt, Inc.*, 373 F. Supp. 2d 558, 565 (D. Md.
4 2005), the court found that “even if the IRS has placed liens on Defendants’ assets,
5 those liens would not attach to property that was wrongfully taken from consumers,
6 precisely what the FTC alleges in this case.”

7 To the extent that TK Global argues that it may avail itself of whatever
8 secured position MCB may have had by virtue of the Merchant Processing
9 Agreement, such an argument also would be unavailing. Courts have held that
10 “claims *either* to ownership of the funds in the Receiver’s Account, or to their
11 security interests in those funds, are necessarily dependent on the Defendants having
12 had ‘rights in the collateral’ at the time that the banks claim to have acquired their
13 ownership or security interests.” *FTC v. J.K. Pubs.*, 2001 WL 36086354, at *12
14 (emphasis original). Even a bona fide recipient may not obtain good title to funds
15 that were dishonestly procured. *See id.; Morgold, Inc., v. Keeler*, 891 F. Supp. 1361,
16 1366 (N.D. Cal. 1995). And, persons holding such funds “may not . . . claim that
17 they have an ownership interest superior to that of the very consumers from whom
18 the money was procured.” *FTC v. J.K. Pubs., Inc.*, No. CV 99-00044 ABC (AJWx),
19 2001 WL 36086354, at *12 (C.D. Cal. Jan. 17, 2001).

20 Because the funds in the reserve account were obtained through the
21 Defendants’ deceptive scheme, they are held in constructive trust for the consumers
22 who paid them, and no interest in the funds (security or otherwise) could be
23 transferred.

24 **3. TK Global’s Actual Knowledge of LMS’s Unlawful Collection**
25 **of Advance Fees Negates Any Assertion that TK Global**
26 **Should Be Deemed A “Bona Fide” Recipient With Priority**
27 **Over Blameless Consumers**

28 Even if the funds in the reserve account were not deemed to be held in
constructive trust, TK Global’s actual knowledge that the funds were proceeds of

1 LMS's unlawful conduct precludes any claim TK Global might make that it should
2 be considered a "bona fide recipient," or that it otherwise should be entitled to the
3 funds based on equitable principles. TK Global's actual knowledge is evident from
4 contemporaneous correspondence between TK Global and LMS.

5 In early 2009, LMS sought from TK Global an increase in what was then
6 LMS's \$150,000 per month transaction limit. In emails discussing the request,
7 Jeffrey Dunn (apparently the same individual who filed a declaration supporting TK
8 Global's instant motion) candidly discussed LMS's noncompliance with laws
9 governing loan modification services and the risks associated with noncompliance.

10 In one email dated February 18, 2009 to Defendant Dean Shafer, the CEO of LMS,
11 Mr. Dunn stated:

12 Upon further review of your account, we did not see any
13 public record of your company or its owners having a DRE
14 Broker License. Per state law, as dictated by the Civil
15 Code and DRE requirements, a loan modification company
16 needs to have a DRE broker license. . . . Lastly, our
17 research indicates that all loan mod companies in
18 California that collect advance fees, which your company
19 does, need to have a DRE-approved advance fee
20 agreement. All companies with an approved agreement
21 appear on a list located at the DRE website. I saw that your
22 company is not listed there. Can you please explain?

23
24 I apologize in advance for all of the questions. However,
25 there has been a recent crack-down on loan mod
26 companies, and if we do not ensure the proper levels of
27 compliance there may be future risk exposure.

28

1 Ex. C (Pisano), Att. B at 56.⁴ In response, Defendant Shafer acknowledged that he
2 was not complying with the requirements referenced in Mr. Dunn's email. He
3 asserted instead that LMS was on a "trek to compliance" in which "[m]y attorneys
4 are aggressively trying to become FEASIBLY compliant"; and "[m]y attorneys
5 believe we will get a decent AFA [advance fee agreement] . . . however, it will be a
6 couple months and I am crossing my fingers." *Id.* at 53-54. Mr. Shafer also attached
7 to his email an outline that he had prepared for an interview with a news reporter
8 acknowledging that LMS was unlicensed but challenging DRE's interpretation of the
9 law. *See id.*, Att. C at 60.

10 Despite these acknowledgments of non-compliance and outright defiance of
11 the relevant licensing agency's interpretation of its own statute, one of Mr. Dunn's
12 colleagues, who had been copied on the prior correspondence, wrote to Mr. Shafer
13 on February 24, 2009, "[d]on't worry, we have a strong relationship with MCB. We
14 will get the volume increase for you." *Id.*, Att. D.⁵

16 ⁴ Email correspondence between Mr. Shafer and Mr. Dunn and his
17 colleagues suggest that TK Global operated its business with LMS interchangeably
18 through "Meritus Payment Solutions" and "Primus Payment Solutions." In
19 correspondence, Mr. Dunn listed his title as Director of Risk Management,
20 alternately, for Primus Payment Solutions and Meritus Payment Solutions. *See Ex.*
21 *C (Pisano), Att. B at 56 (Primus); id., Att. E at 80 (Meritus).* Emails also reflect
22 that Mr. Dunn maintained email accounts with addresses at both
23 *merituspayment.com* and *primuspayment.com*. *See id., Att. B at 56*
24 *(primuspayment.com); id., Att. E at 80 (merituspayment.com).* Additionally, in
25 emails sent from Mr. Dunn's *primuspayment.com* account he addressed issues
26 related to LMS's reserve account, *see id., Att. B at 55-56*, and in emails sent from
27 his *merituspayment* account, he addressed similar issues, copying his colleagues on
28 their accounts at *primuspayment.com*, *see id., Att. E at 80*.

26 ⁵ Documents also demonstrate that MCB entered its relationship with LMS
27 with its eyes open as to the risks. In the paperwork setting up the account, MCB
28 acknowledged its understanding that LMS was in the loan modification business
and indicated that "[a]ll deposits will come from merchant credit card processing

1 As was the case in *J.K. Pubs., Inc.*, “[t]he basic question presented by the
 2 instant Motion[] . . . is not whether the [claimaint has] *any* right to the funds on
 3 deposit in the ‘Receiver’s Account’ at each bank, but whether [it] should be allowed
 4 to assert a *priority* in their rights in those funds over the rights in those funds
 5 belonging to the consumers from whom most or all of the funds” were taken. *Id.* at
 6 *12 (emphasis original). TK Global’s “argument is, basically, that it wants to be first
 7 in line to collect funds held by the Receiver. . . . It seeks, in George Orwell’s words,
 8 to be ‘more equal’ than the other injured consumers.” *FTC v. Consumer M’ship*
 9 *Servs., Inc.*, 206 F.R.D. at 365. In light of TK Global’s actual knowledge that the
 10 funds in the account were proceeds of LMS’s unlawful conduct, TK Global should
 11 not be accorded priority rights.

12 **B. TK Global’s Asserted Interest Would Not Be Impaired And Would**
 13 **Be Adequately Represented**

14 Even if TK Global could show that it had a valid interest, it could not
 15 demonstrate that its purported interest would be impaired by the disposition of this
 16 matter absent intervention, or that its interest would not be adequately protected. For
 17 example, nothing would prevent TK Global from participating in a pro-rata
 18 distribution of the proceeds of the reserve account along with other creditors.
 19 Moreover, nothing would prevent TK Global from bringing a suit against the
 20 defendants once the stay imposed by the Court is lifted.⁶ In similar circumstances,
 21

22 _____
 23 with an average ticket size of \$3500.” Ex. 1 (Redding), Att. A at 4. LMS agreed
 24 to maintain “a 7% rolling reserve,” which the bank indicated was necessary “due
 25 to: Risk exposure and chargebacks for high risk business types.” *See* Decl. of
 26 Herrera [Docket Itm. # 52-4], Ex. A (Reserve Acknowledgment Form).

27 ⁶ To this end, “the Preliminary Injunction in this case has tolled the statute
 28 of limitations.” *FTC v. Connelly*, No. SACV 06-701 DOC (RNBx), 2007 WL
 6492931, at *3 (C.D. Cal. Aug. 27, 2007).

1 courts have found that proposed intervenors do not satisfy the requirements of Rule
2 24(a)(2).

3 In *FTC v. First Capital Consumer M'ship Servs., Inc.*, the FTC obtained a
4 TRO, and subsequently a PI, against a defendant that allegedly had marketed credit
5 card protection services to the public deceptively in violation of Section 5 of the FTC
6 Act. 206 F.R.D. at 360. EPX, a non-party credit card processor that had processed
7 these transactions, sought to intervene to assert its entitlement to the contents of an
8 account that had been set up to reimburse it for chargebacks. *Id.* at 360-62. The
9 account had been frozen and placed under receivership pursuant to the TRO and PI.
10 *Id.* at 360-61. EPX argued that it had satisfied the requirements of Rule 24(a)(2) and
11 should be allowed to intervene to seek an order directing that the funds in the
12 account be remitted by the receiver to EPX. *Id.*

13 In denying EPX's motion, the court found that the FTC action would not
14 impair or impede EPX's interests, in part because EPX would be permitted to "join
15 the line of consumers [and creditors] who have not yet received refunds and be paid,
16 on a pro-rata basis, its share of the Receivership funds (in whatever manner those
17 funds are ultimately distributed)." *Id.* at 363.⁷ If EPX were not satisfied with its
18 distribution, "it would be free to bring an action against" the defendants "once the
19 stay is lifted." *Id.* The court also rejected EPX's argument that its interests would be

20 _____
21 ⁷ Notably, although the court found that the payment processor had asserted
22 sufficient interest in the action to satisfy the first part of Rule 24(a)(2), its finding
23 was limited to the payment processor joining in the claims process by filing a claim
24 with the receiver. 206 F.R.D. at 363. The court expressly rejected the payment
25 processor's assertion that its contract-based claim in the reserve account
26 constituted a "significant, legally protectable interest." *Id.* In this case, TK Global
27 asserts *only* a contract-based claim – MCB's ineffectively assigned claim under the
28 Merchant Processing Agreement – as its legally protectable interest. To the extent
that TK Global asserts a more generalized claim in funds held by the receiver, the
FTC would not object to TK Global filing a claim along with other consumers and
creditors.

1 impaired absent intervention because EPX’s “prospects for reimbursement would be
2 substantially diminished” if it had to share the contents of the chargeback account
3 with the consumers whose credit cards had funded the account. *Id.* at 363.⁸ Given
4 that the FTC had obtained an asset freeze and the appointment of a receiver, the court
5 reasoned that the FTC’s action “protects, and does not impair, consumer rights, and
6 makes it easier for consumers – and creditors – to protect their interests.” *Id.* at 364.

7 The court also rejected EPX’s argument that its interests would not adequately
8 be represented in the FTC action absent intervention, noting that what is typically a
9 “minimal standard changes when a government entity is a party and asserts its status
10 as a guardian of all of its citizens, as the FTC does here.” *Id.* at 364. In such cases,
11 “the governmental entity deserves . . . special consideration and deference as an
12 adequate representative of the interests of would-be intervenors.” *Id.* at 364 (adding
13 that a “particularly strong showing of inadequacy” is required for intervention)
14 (citing *United States v. City of New York*, 198 F.3d 360, 367 (2d Cir. 1999)). In this
15 case, the preliminary relief obtained by the FTC has operated to protect the
16 remaining assets of LMS rather than impede recovery. Moreover, TK Global can
17 file a claim with the receiver, and if it is not satisfied with the results, bring an action
18 against LMS or Dean Shafer after the stay is lifted. Accordingly, TK Global’s
19 interests would not be impaired or impeded, and its interests would be adequately
20 represented.

21 **C. TK Global’s Claims Do not Sufficiently Implicate Common**
22 **Questions of Law or Fact to Support Permissive Intervention**

23 TK Global does not articulate a valid basis for this Court to exercise its
24 discretion and provide for permissive intervention under Rule 24(b). Specifically,
25

26
27 ⁸ The court further elaborated that it “does not view EPX’s concern that it
28 may not be paid in full as supporting its argument that the FTC/Receiver will not
adequately represent its interests.” *Id.*

1 TK Global fails to demonstrate that its claims share sufficiently common questions
2 of law and fact with those of the FTC. On the contrary, while the FTC brings this
3 proceeding in the public interest seeking equitable relief for violations of Section 5
4 of the FTC Act, TK Global requests declaratory relief based on contract claims at
5 law.

6 Here again, *FTC v. First Capital Consumer M'ship Servs., Inc.* is instructive in
7 applying the standards set forth under Rule 24. In this case, as in *FTC v. First*
8 *Capital*, although the FTC and the proposed intervenor have claimed entitlement to
9 the same funds, "that is where the similarity ends." *FTC v. First Capital Consumer*
10 *M'ship Servs.*, 206 F.R.D. at 366. A mere "'coincidence of financial interests' does
11 not satisfy the standard for permissive intervention." *Id.* In the instant case, the FTC
12 seeks "equitable relief against the . . . defendants as a result of alleged
13 misrepresentation made to consumers," while TK Global "seeks essentially legal
14 relief on the basis of its [alleged] Agreement . . . with defendant[s]." *Id.* As was the
15 case in *FTC v. First Capital*, TK Global's claims "would implicate collateral issues
16 relating to its contract[s]." *Id.* Such collateral issues could include, for example, the
17 adjudication, under state law, of purported contractual rights held by MCB under the
18 Merchant Processing Agreement, and the meaning and validity of the assignment
19 agreement by which TK Global says it procured those contractual rights. As a result,
20 "including this private action in FTC's proceeding would delay the granting of relief
21 to consumers whose credit cards have been assessed charges by defendants." *Id.*
22 Such delay would prejudice consumers and the original parties to this action.

23 As the parties advised the Court in their Joint Report and Discovery Plan
24 Pursuant to Federal Rule of Civil Procedure 26(f) [Docket Itm. #50], at 4,
25 Defendants LMS and Dean Shafer have indicated an interest in principle in
26 settlement. Even that potential avenue for efficient resolution would be complicated
27 by the addition of TK Global's separate interests and collateral issues. "Additional
28 parties always take additional time. Even if they have no witnesses of their own,

1 they are the source of additional questions, objections, briefs, arguments, motions
2 and the like.” *FTC v. First Capital Consumer M’ship Servs., Inc.*, 208 F.R.D. at 366
3 (internal quotation omitted). This is yet another reason why “[i]ntervention can
4 impose substantial costs on the parties and the judiciary.” *FTC v. Med Resorts*
5 *Intern., Inc.*, 199 F.R.D. 601, 607 (N.D. Ill. 2001) (citing *Solid Waste Agency of N.*
6 *Cook County v. U.S. Army Corps of Eng’rs*, 101 F.3d 503, 507-08 (7th Cir. 1996).
7 Accordingly, permissive intervention is not warranted.

8
9 **III. TK GLOBAL SHOULD NOT BE GRANTED RELIEF FROM THE**
10 **COURT’S STAY TO PURSUE IN ANOTHER FORUM ITS CLAIMS**
11 **TO PROPERTY THAT IS SUBJECT TO THIS COURT’S EXCLUSIVE**
12 **JURISDICTION**

13 The litigation stay imposed by the Court as part of the LMS PI Order is
14 essential to the preservation and orderly distribution of the defendants’ remaining
15 assets should the FTC ultimately prevail on the merits (or should this case otherwise
16 be resolved through settlement). TK Global’s requests for leave to sue defendants
17 LMS and Dean Shafer would no less jeopardize the Court’s ability to grant
18 meaningful relief than would TK Global’s intervention in this case. Indeed, a
19 separate suit by TK Gobal would be little more than an alternate method by which
20 TK Global could pursue its objective of obtaining priority over the claims of
21 consumers.

22 The power to impose a blanket stay is a corollary of the inherent power of a
23 court of equity to impose a receivership and grant other forms of ancillary relief. *See*
24 *SEC v. Wencke*, 622 F.2d 1363, 1366-67 (9th Cir. 1980). “Where a court has taken
25 property into its possession through a receivership, the court has exclusive ancillary
26 jurisdiction to hear and determine all questions with respect to possession and
27 control of the property.” *FTC v. Connelly*, No. SACV 06-701 DOC (RNBx), 2007
28 WL 6492931, at *4 (C.D. Cal. Aug. 27, 2007); *see also Penn Gen. Casualty Co. v.*
Pennsylvania, 294 U.S. 189, 195 (1935).

1 Through its request for leave to sue LMS and Dean Shafer, TK Global asks the
2 Court to permit it to initiate an action asserting purported legal claims to the same
3 property that is at issue in this proceeding. Although TK Global does not specify the
4 forum in which it proposes to file such actions, it is likely that they would have to be
5 filed in state court, given that TK Global does not appear to have diversity of
6 citizenship with any of the defendants,⁹ or any other basis to proceed in federal court.
7 Such actions would require a state court impermissibly to assert jurisdiction over
8 property already under the jurisdiction of this Court. These kinds of duplicative
9 proceedings long have been disfavored by courts. *See, e.g., Penn Gen. Casualty Co.*
10 *v. Pennsylvania*, 294 U.S. at 195 (“[t]o avoid unseemly and disastrous conflicts in
11 the administration of our dual judicial system, and to protect the judicial processes of
12 the court first assuming jurisdiction, the principle, applicable to both federal and
13 state courts, is established that the court first asserting jurisdiction over the property
14 may maintain and exercise that jurisdiction to the exclusion of the other.” (internal
15 citations omitted)); *FTC v. Connelly*, No. SACV 06-701 DOC (RNBx), 2007 WL
16 6492931, at *4.

17 Importantly, denying TK Global leave to intervene and to file separate
18 lawsuits despite the stay, would not deprive TK Global of remedies for its purported
19 claims. The proper procedure for TK Global to assert its claims in light of this
20 proceeding is for it to “join the line of [creditors] who have not yet received refunds
21 and be paid, on a pro-rata basis, its share of the Receivership funds (in whatever
22 manner those funds are ultimately distributed).” *FTC v. First Capital*, 206 F.R.D. at
23 363. After the receiver makes the distribution, If TK Global were “not satisfied, it
24 would be free to bring an action against” LMS. *Id.*

25
26 ⁹ TK Global’s Motion for Declaratory Relief, Etc., indicates that TK Global
27 is a California limited partnership. *See* Mot. for Decl. Relief, Etc. [Docket Itm.
28 #51] at 7. LMS is a California Corporation and Dean Shafer resides in California.
See Complaint [Docket Itm. #1] ¶ 6.

1 TK Global also should not be granted leave to sue individual defendant Dean
2 Shafer based on his personal payment guarantee under the Merchant Processing
3 Agreement. While TK Global points out that the order against Defendant Shafer
4 does not expressly stay actions against him, an action of the sort proposed by TK
5 Global would violate the spirit and purpose, if not the terms, of the LMS PI Order
6 and the Preliminary Injunction Order with Asset Freeze and Other Equitable Relief
7 as to Defendant Dean Shafer [Docket Itm. #44] (“Shafer PI Order”). TK Global
8 wishes to sue Mr. Shafer merely as a guarantor of LMS’s payment obligation. *See*
9 *Mot. for Decl. Relief, Etc.* [Docket Itm. #51] at 6. To establish Mr. Shafer’s liability
10 in a separate action, therefore, TK Global would have to prove first that LMS was
11 liable. Such a case would be no less disruptive to this proceeding than would be a
12 case brought directly against LMS. It would likely involve many if not all of the
13 same witnesses, legal issues, and property at issue in this proceeding.

14 Moreover, the FTC has alleged that Mr. Shafer should be held personally
15 liable in this action for consumer injury caused by LMS. Finding a “likelihood of
16 ultimate success on the merits,” the Court has entered a preliminary injunction order
17 against Mr. Shafer individually that includes, among other things, an asset freeze.
18 *See* Shafer PI Order [Docket Itm. #44] §§ VI, IX. The Court thus has asserted
19 jurisdiction over Mr. Shafer’s assets as well as those of LMS. To permit another
20 court to conduct a concurrent trial concerning those same assets would contravene
21 the principle articulated in *Penn Gen. Casualty Co.* that “[t]o avoid unseemly and
22 disastrous conflicts in the administration of our dual judicial system, and to protect
23 the judicial processes of the court first assuming jurisdiction . . . the court first
24 asserting jurisdiction over the property may maintain and exercise that jurisdiction to
25 the exclusion of the other.” *Penn Gen. Casualty Co.*, 294 U.S. at 195 (internal
26 citations omitted). Accordingly, leave to sue Mr. Shafer should be denied.

27 //

28 //

1 **CONCLUSION**

2 For the reasons set forth above, the FTC respectfully requests that the Court
3 deny TK Global's Motion for Declaratory Relief, Etc. in its entirety.

4 Dated: November 20, 2009

Respectfully submitted,

5 Willard K. Tom
6 General Counsel

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28

CERTIFICATE OF SERVICE

I, Mark Glassman, certify as follows:

I am over the age of 18 and am employed by the Federal Trade Commission. My business address is 600 Pennsylvania Avenue, NW, Mail Stop NJ-3158, Washington, DC 20580.

On November 20, 2009, I caused the attached document entitled "PLAINTIFF FTC'S OPPOSITION TO CLAIMANT TK GLOBAL PARTNERS, L.P.'S MOTION FOR DECLARATORY RELIEF, LEAVE TO INTERVENE, LEAVE TO SUE DEFENDANT LMS, AND LEAVE TO SUE DEFENDANT DEAN SHAFER, to be served, by the following means on the following individuals:

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Defendant Pro Se

Defendant Pro Se; Registered Agent for Synergy Financial Management Corporation

I declare under penalty of perjury that the foregoing is true and correct.

Dated: November 20, 2009

/s/ Mark L. Glassman
Mark L. Glassman