

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF FLORIDA

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

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.

**RECEIVER'S MOTION FOR SUMMARY
ADJUDICATION OF THE RECEIVERSHIP CLAIM OF FIRST DATA
MERCHANT SERVICES, LLC WITH INCORPORATED MEMORANDUM OF LAW**

James D. Sallah, Esq., not individually, but solely in his capacity as the Court-appointed Receiver (the “Receiver”) for JCS Enterprises Inc., d/b/a JCS Enterprises Services Inc. (“JCS”), T.B.T.I. Inc., My Gee Bo, Inc. (“Gee Bo”), JOLA Enterprise Inc., and PSCS Holdings, LLC (collectively, the “Receivership Entities” or “Receivership Estate”), through undersigned counsel, moves for summary adjudication of the receivership claim submitted by claimant First Data Merchant Services, LLC (“First Data”) and requests that the Court accept the Receiver’s recommended treatment to fully subordinate¹ First Data’s claim.

BRIEF BACKGROUND ON FIRST DATA

First Data submitted claim number 631 to the Receiver seeking \$7,315,647.62, which is by far the largest claim in the Receivership Estate.² A copy of First Data’s sworn and signed Proof of Claim Form (with the voluminous exhibits) is attached as Exhibit A.³ As explained below, the Receiver recommended, and continues to recommend, that the Court subordinate First Data’s claim to those of the investor victims. First Data timely submitted an objection to the Receiver’s recommendation.

It is undisputed that First Data is a wholly owned subsidiary of a Fortune 500, multi-billion-dollar company, and that it provided bankcard/credit card processing services via *pre*-receivership merchant applications/agreements to JCS, GeeBo, and GeeBo Sales. Hundreds of investors who invested in JCS paid by credit card and made chargeback requests during and after the JCS Ponzi scheme. First Data ultimately funded the chargebacks as it was required to do under its industry’s

¹ During the course of the Receivership, the Receiver and his professionals have successfully increased the Estate from approximately \$2.8 million to more than \$10 million. As discussed below, because the claim pool (approximately \$35 million) far exceeds the current amount of funds in the Receivership Estate (approximately \$10 million), the effect of the Court fully subordinating First Data’s claim will, indeed, result in no distribution of funds to First Data, which the Receiver recommends for the numerous reasons briefed herein.

² Pursuant to the Objection Procedure, because First Data has contested the Receiver’s Determination (defined below), First Data’s identity is now subject to disclosure.

³ This document was marked Exhibit 3 at First Data’s first corporate representative’s (Michael Aufiero) deposition. The various deposition exhibits attached hereto have been redacted where necessary in accordance with Local Rule 5.3(2).

“Card Brand Rules.”⁴ First Data’s claim amount is based on the net chargebacks it was required to pay investors as part of its business. Contrary to the Receiver’s recommendation, First Data is seeking priority treatment on par with the defrauded investors in its Claim Form.⁵ The Court should subordinate First Data’s claim based on the countless equitable reasons set forth below, which, among other things, collectively establish that First Data failed miserably to adequately underwrite, monitor, and perform due diligence on its former merchant, JCS, and JCS’s principal and architect of the JCS Ponzi scheme, Joseph Signore (“Signore”).

RELEVANT BACKGROUND ON THE CLAIMS PROCEDURE

On April 3, 2017, the Court issued an Order granting the Receiver’s Motion to Approve Claim Form, Manner and Notice of Claim Form, and Claims Bar Date filed on March 31, 2017 (DE 377). Subsequently, on July 20, 2017, the Court issued an Order permitting the Receiver to make a minor amendment to the claim form (DE 386). Accordingly, the Receiver did the following: 1) published the proof of claim form in *The Palm Beach Post* once a week for four (4) consecutive weeks; 2) provided the claim form along with an explanatory cover letter to all known or potential claimants via U.S. Mail and email, if known; 3) provided notice of the claim form on

⁴ According to First Data’s Claim Form (see Exhibit D to the Claim Form, p. 6), the Bankcard companies impose a series of rules on acquiring banks and their processors (such as First Data) to ensure a smooth, automatic chargeback process in which First Data is liable to pay chargebacks if its merchant has no funds in its merchant account to pay them.

⁵ As an alternative to its argument for priority treatment on par with the defrauded investors, and nearly two (2) years *after* submitting its Claim Form, First Data recently served its Expert Report of its retained forensic accountant/expert, Patrick Gannon, CPA, CFF, CVA, ABV. In the Expert Report, First Data is apparently now seeking – for the first time – *100% priority treatment* over all defrauded investors, which means that it apparently will be *now* requesting that the Court authorize the Receiver to pay it all of its \$7.3 million claim amount. Put differently, if the Court accepts First Data’s apparent 100% priority demand, only about less than \$3 million would remain in the Receivership Estate to compensate the hundreds of remaining approved investor claims. This would amount to a small return, if any, for investor victims compared to full compensation for the Fortune 500 subsidiary. The amount remaining to pay investor victims would be less than \$3 million because the amount would need to account for pending unpaid receivership fees and expenses and also a future reserve to pay future receivership fees and expenses.

In addition, in his Expert Report, Mr. Gannon has quantified First Data’s claim amount as \$7,190,693, not the higher amount of \$7,315,647.62 submitted in its Claim Form. Therefore, the question remains why First Data is seeking more than \$124,000 in its Claim Form more than its own expert’s calculation.

the receivership website; and 4) requested that notice of the claim form be posted on the investors' page on Facebook. Specifically, the Receiver mailed the cover letter and claim form to at least 1,030 potential claimants and/or creditors for whom the Receiver had gathered contact information.

The Receiver's notice made clear that the Claims Bar date was November 27, 2017. In response, the Receiver received approximately 700 claim forms (most of which contained supporting documentation) either prior to or after the Claims Bar date. The submitted claims seek a total of more than \$35 million.

Beginning in December 2017, the Receiver's professionals and staff began reviewing the submitted claim forms and supporting documents. That was a time-consuming, tedious process that involved, among other things, the Receiver and his forensic accountants comparing documents submitted with the proof of claim forms to the financial reconstruction of the Receivership Entities' bank and financial accounts, as well as to other records under his control.

On November 30, 2018, the Receiver filed his Motion to: 1) Approve Determination and Priority of Claims, 2) Approve Plan of Distribution, and 3) Establish Objection Procedure (the "Claims Motion") (DE 413). The Claims Motion listed, among other things, the claims that the Receiver recommended that the Court accept (and approve payment) and the claims that he recommended that the Court deny (and reject payment, whether in whole or in part, and whether permanently or temporarily). The Receiver's recommended disposition of each claim was listed by claim number on either Exhibit A, B, C, or D to the Claims Motion. The Claims Motion also addressed the Receiver's recommended procedure for resolving and/or litigating the claims to which he objected and recommended that the Court deny.

On December 14, 2018, the Court granted the Claims Motion in the Order Granting Receiver's Motion to: 1) Approve Determination and Priority of Claims, 2) Approve Plan of Distribution, and 3) Establish Objection Procedure (the "Claims Order") (DE 416). The Claims Order granted the Claims Motion, meaning the Court approved the Receiver's various recommendations in the Claims Motion, including the procedure if a claimant has an objection to the Receiver's recommendations in the Claims Motion, whether as to the claim amount, the priority of the claim, or otherwise. The approved Objection Procedure includes, among other things, the following:

- a) Any claimant that is dissatisfied with the Receiver's determination of a claim, claim priority, or plan of distribution (collectively, the "Receiver's Determination") must serve the Receiver (c/o Jeffrey L. Cox, Esq., Sallah Astarita & Cox, LLC, 3010 N. Military Trail, Suite 210, Boca Raton, FL 33431), in accordance with the service requirements of Rule 5 of the Federal Rules of Civil Procedure with a written response within forty-five (45) calendar days from the date of this notice letter. During this 45-day period, each claimant shall have the opportunity to cure the claim deficiency and/or to respond and contest in writing the Receiver's Determination. Forty-five (45) calendar days from the date of this letter was February 21, 2019, and therefore February 21, 2019 was the deadline for each claimant's response to the Receiver.
- b) Claimant objections should not be filed with the Court. Claimant objections shall clearly state the nature and basis of the objection, and provide all supporting statements and documents the claimant wishes the Receiver and the Court to consider.
- c) If a claimant responds and does not adequately cure the claim deficiency, the claimant's claim shall be subject to the objection procedure discussed herein.
- d) After a claimant's response/objection is served in writing on the Receiver, the claimant and the Receiver shall have one hundred and twenty (120) calendar days from the date of this notice letter to conduct any discovery permitted under the Federal Rules of Civil Procedure and Local Rules of the Southern District of Florida, including producing documents and taking depositions, file discovery motions (such as motions to compel) and file any dispositive motions (such as motions for summary adjudication of the claim).⁶
- e) Pursuant to the executed proof of claim forms, claimants have already submitted to the exclusive jurisdiction of the Court and also have waived the right to a jury trial, and therefore any discovery and/or dispositive motions in regards to objections shall be conducted and resolved by the Court in a summary proceeding. All depositions shall be conducted at the Receiver's counsel's office: Sallah Astarita & Cox, LLC, 3010 N. Military Trail, Suite 210, Boca Raton, FL 33431.
- f) The Court may make a final claim determination based on the submissions identified above or may set the matter for hearing and, following the hearing, make a final determination on the specific claim.

⁶ Initially, one hundred and twenty (120) calendar days from the date of the notice letter was May 7, 2019. However, as discussed below, that deadline was extended to October 7, 2019 (DE 425).

The claimant shall have the burden of proof. The Receiver shall provide notice of any hearing to the specific claimant.

Some claim forms had a deficiency that the claimant has since cured pursuant to the above Objection Procedure, such as providing proof of identity. In addition, many claimants had an incorrect claim amount that has likewise since been cured by the claimant by simply accepting the Receiver's Recommended Amount of Allowed Claim. Other than this Motion, there is only one other dispositive claim motion regarding a handful of similar claimants from the same family that the Receiver is filing pursuant to the Objection Procedure.⁷

Pursuant to the Objection Procedure, since February 2019, First Data and the Receiver have engaged in discovery concerning First Data's claim. First Data and the Receiver both served on the other a first request for production and a subpoena on the other's forensic accountant. The Receiver's and First Data's respective discovery requests were significant and resulted in voluminous waves of productions of documents and electronically stored information for several months.

Pursuant to the Objection Procedure, May 7, 2019 was the initial deadline for First Data (as well as other disputed claimants) and the Receiver to conclude discovery and file any dispositive motions on their claims (such as motions for summary adjudication of the claim). The Receiver previously moved for, and the Court promptly granted, a three-month extension of the initial May 7th deadline – *i.e.*, through August 7, 2019 – given that the Receiver and First Data needed additional time to complete discovery (DE 420, 421).

When the Receiver filed the prior extension motion (for the August 7, 2019 deadline), the Receiver and First Data had discussed and anticipated completing all relevant depositions by mid-July 2019, which would have ensured sufficient time for the Receiver and First Data to draft and file their respective dispositive motions on First Data's claim by the deadline of August 7, 2019. However, the productions of documents by both the Receiver and First Data, including electronically stored information, were more voluminous and time-consuming than the parties anticipated and resulted in several productions that continued through mid-July. In addition, one of the material witnesses that the Receiver requested to depose ultimately became unavailable

⁷ The Receiver intends to file a motion to approve a first distribution/payment within thirty (30) to forty (40) days of the Order adjudicating First Data's claim. The Receiver has not been able to make a first distribution/payment until he finishes litigating the First Data claim, which is the largest in the Estate.

during July and was only available for deposition in late August. That specific deposition was scheduled for, and occurred on, August 30, 2019. Thus, the parties obtained an additional two (2) month extension until October 7, 2019 (DE 425).

The parties then completed the document productions, analyzed the data, and took several depositions of both fact and expert witnesses. First Data took the Receiver's deposition on September 17, 2019, and the Receiver's forensic accountant (Melissa Davis, CPA, CIRA, CFE) on September 18, 2019. The Receiver took First Data's first corporate representative's (Michael Aufiero) deposition on August 22, 2019, First Data's former head of the Special Accounts Group (Robert Tenenbaum) on August 30, 2019, First Data's second corporate representative's (Suzanne DeAngelis) deposition⁸ on September 19, 2019, and First Data's forensic accountant/designated expert (Patrick Gannon, CPA, CFF, CVA, ABV) on September 23, 2019. Based on the above deposition schedules, the Receiver requested and obtained an extension regarding the Objection Procedure deadline of August 7, 2019, for an additional two (2) months through and including October 7, 2019 (DE 425).

As stated above, the Claims Motion listed, among other things, the claims that the Receiver recommended that the Court accept (and approve payment) and the claims that he recommended that the Court deny (and reject payment, whether in whole or in part, and whether permanently or temporarily). The Receiver's recommended disposition of each claim was listed by claim number on either Exhibit A, B, C, or D to the Claims Motion. First Data's claim was listed on page 3 of Exhibit D (DE 413-4), and the Receiver recommended to fully subordinate First Data's claim.⁹ For the many below-discussed reasons, which are based on undisputed or uncontested facts

⁸ This deposition involved topics of underwriting including due diligence, and it occurred after Mr. Aufiero could not testify factually regarding what specifically happened and was reviewed, requested, and obtained during First Data's underwriting of the JCS, GeeBo, and GeeBo Sales merchant accounts. (M. Aufiero Dep. Tr. 116-19, 128, 137-43, 147-48, excerpted copies of which are attached as part of Composite Exhibit B). The various attached deposition excerpted transcripts currently include electronic transcript copies, not original transcripts, because the Receiver had not received the original transcripts at the time of having to file this Motion. The Receiver will supplement the record with a notice of filing of the excerpted original deposition transcripts in the near future.

⁹ The Receiver also included the reasons mentioned in his letter to First Data dated August 31, 2018, a copy of which is attached as Exhibit MM.

through the completion of claims discovery, the Court should accept the Receiver's prior and continued recommended treatment, and fully subordinate First Data's claim.¹⁰

MEMORANDUM OF LAW

A. Standard for This Summary Proceeding

The subject Motion is a dispositive motion by the Receiver on First Data's submitted receivership claim pursuant to the previously-approved Objection Procedure (discussed item-by-item in the "Relevant Background Regarding the Claims Procedure" section, *supra*). The Objection Procedure created a standard, traditional summary proceeding format for resolving any claims litigation between the Receiver and claimants who objected to the Receiver's recommended treatment of the claim in the Claims Motion. One of the most important components of a receivership summary proceeding is to ensure that claimants have due process to litigate their claim with the Receiver and a right to be heard before the Court. *See SEC v. Byers*, 637 F. Supp. 2d 166, 185 (S.D.N.Y. 2009). The Objection Procedure has provided adequate due process to First Data (and all other claimants), given the ability and rights afforded to all claimants (including First Data) to object to the Receiver's recommended treatment of claims,¹¹ to take written and deposition discovery, and to file motions including a dispositive motion on the relevant claim and a response to the same. In addition, and as quoted above in the "Background" section above, First Data as the claimant, not the Receiver, has the burden of proof for purposes of prevailing in this summary proceeding, which is standard in equity receivership claims proceedings. *See SEC v. Nadel*, 2013 WL 12323969, at *3-4 (M.D. Fla. Aug. 29, 2013).

Again, the effect of fully subordinating First Data's claim will result in no distribution of funds to First Data because the claim pool far exceeds the amount of funds in the Receivership Estate. After conducting an extensive factual investigation, reviewing a comprehensive financial reconstruction, considering all of the submitted claims, and reviewing the relevant law, the

¹⁰ The entire purpose of claims discovery was for the Receiver and First Data to further develop the record for their respective positions to either further support the subject claim (*i.e.*, First Data's continued position) or further subordinate the claim (*i.e.*, the Receiver's continued position). After all, and as repeated herein, this is an equitable receivership claims proceeding and there are no limits to the Receiver's equitable arguments herein or in his future Reply.

¹¹ First Data previously served its written Objection on the Receiver pursuant to the Objection Procedure.

Receiver submits that subordinating Firm Data's claim is appropriate, as set forth below, for the following reasons: 1) this proceeding was brought for the benefit of defrauded investors and not companies that engaged in business with the Receivership Entities; 2) First Data's parent company is a Fortune 500 company worth billions of dollars; 3) the investors include many individuals who have lost their life savings, are elderly, live on fixed incomes, and are unsophisticated victims; 4) First Data is a sophisticated creditor/claimant who had prior access to extensive financial, personal, credit-related, and otherwise sensitive information regarding JCS and Signore; 5) First Data was a bad actor in its own industry; 6) First Data continued to seek Signore's assistance to fight chargebacks and returned \$700,000 from reserve funds to him after terminating the JCS account and despite knowing that JCS was a potential Ponzi scheme; 7) First Data failed in its obligation to perform sufficient due diligence or verification when underwriting, approving, and later monitoring the JCS account; 8) First Data admitted after-the-fact in several internal documents that it made mistakes regarding JCS; 9) First Data violated its own internal written policies; 10) First Data's own sales contractor, Merchant One, knew about material issues from the outset of the relationship; 11) First Data generated and received revenue directly from the JCS account and did not disclose this fact to the Receiver in its sworn claim form; and 12) equitable subrogation is inapplicable.

B. First Reason to subordinate the Claim – This Proceeding Is for the Benefit of Defrauded Investors, Not Companies That Did Business with JCS (Such as First Data)

1. Case Law Supports Repaying Investors First

The Court's power to approve the Receiver's claim determinations and priority of claims is settled. *See SEC v. Elliot*, 953 F. 2d 1560, 1566 (11th Cir. 1992) (District Courts have "broad powers and wide discretion" to ensure equitable distributions). These powers include prioritizing investor victim claims above other creditors.

In *SEC v. Mutual Benefits Corp.*, Case No. 0:04-cv-60573, Order Granting Receiver's Motion for Final Determination of Allowed Claims at 3 (S.D. Fla. Oct. 23, 2008), attached as Exhibit C, the Honorable Federico A. Moreno identified several factors that weighed in favor of giving investor claims the highest priority:

[T]his is an SEC enforcement action designed to protect the *investors*, not the creditors, (2) [the receivership entity's] fraudulent conduct was directed toward its *investors*, not its creditors (which were paid substantial amounts already), [and] (3)

the investors as a whole are less able to bear the financial costs of [the receivership entity's] conduct than are the creditors. . . .

(Italics in original.)

Like Judge Moreno, the Receiver recommends that investor claims be prioritized above other creditors such as First Data. Typically, receivership distributions to claimants whose property was unlawfully taken from them, such as investors who had no reason to know of the scheme, are given a higher priority than payments to general creditors. *SEC v. HKW Trading LLC*, 2009 WL 2499146, at *3 (M.D. Fla. 2009); *Quilling v. Trade Partners, Inc.*, 2006 WL 3694629, at *1 (W.D. Mich. 2006) (“As an equitable matter in receivership proceedings arising out of a securities fraud, the class of fraud victims takes priority over the class of general creditors with respect to proceeds traceable to the fraud.”); *see also* III Clark on Receivers § 667 at 1154 (Anderson 3d ed. 1959). This is the appropriate priority because “[t]he equitable doctrine of constructive trusts gives ‘the party injured by the unlawful diversion a priority of right over the other creditors of the possessor.’” *Id.* (quoting Clark on Receivers § 662.1 at 1174); *see also SEC v. Megafund Corp.*, 2007 WL 1099640, at *2 (N.D. Tex. 2007) (holding that general creditors “will not be paid until all defrauded investors are fully compensated”); *CFTC v. PrivateFX Global One*, 778 F. Supp. 2d 775, 786-87 (S.D. Tex. 2011) (overruling objection of bank that extended line of credit and adopting receiver’s argument that “courts regularly grant defrauded investors a higher priority than defrauded creditors”).

The Receiver recognizes that courts have consistently found that treating similarly situated parties alike in claims processes is fair and equitable. *Elliot*, 953 F. 2d at 1570; *United States v. Petters*, 2011 WL 281031, at *7 (D. Minn. 2011) (citing *SEC v. Credit Bancorp, Ltd.*, 2000 WL 1752979, at *28 (S.D.N.Y. 2000)). However, there is no requirement that all claimants be treated in the same manner. *See, e.g., Quilling*, 2006 WL 3694629, at *1 (distinguishing between fraud victims and general creditors, and finding that “[a]s an equitable matter in receivership proceedings arising out of a securities fraud, the class of fraud victims takes priority over the class of general creditors with respect to proceeds traceable to the fraud”); *Byers*, 637 F. Supp. 2d at 184 (“The Receiver’s proposal to treat differently those involved in the fraudulent scheme when distributions are being made is eminently reasonable and is supported by caselaw.”). Further, no specific plan or method of distribution is required; the plan of distribution should simply be “fair and equitable.” *SEC v. P.B. Ventures*, 1991 WL 269982, at *2 (E.D. Pa. 1991). In the end, “[a]n equitable plan is

not necessarily a plan that everyone will like.” *Credit Bancorp*, 2000 WL 1752979 at *29. Indeed, “when funds are limited, hard choices must be made.” *Byers*, 637 F. Supp. 2d at 176 (quoting *Official Comm. of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 84 (2d Cir. 2006)). Accordingly, the case law supports prioritizing investor victims over creditors such as First Data.

2. The SEC Brought This Proceeding for the Investors, Not for First Data

The United States Securities and Exchange Commission (“SEC”) filed the underlying enforcement action and moved for the Receiver’s appointment to protect, and for the benefit of, the investors, not creditors (such as First Data). (*See* DE 9). In addition, the SEC’s Complaint (DE 1), which repeatedly references the defrauded investors (see ¶¶ 1-3, 5-7, 20-40, 42-48), is undisputed proof of the Receiver’s position.¹² It is also undisputed that SEC proceedings are to remedy violations of the securities laws for the benefit of the defrauded investors. *Marion v. TDI, Inc.*, 2006 WL 3742747, at *2 (E.D. Pa. Dec. 14, 2006).

3. Signore and Schumack Targeted Investors, Not Service Providers, in the JCS Ponzi Scheme

From the Receiver’s investigation, and as further confirmed by the SEC’s Complaint, Signore and Schumack targeted investors in carrying out the JCS Ponzi scheme, not service providers (such as First Data). Without question, Signore and Schumack offered and sold JCS’s fraudulent securities to the investing public, not vendors providing JCS with services.¹³

4. The JCS Ponzi Scheme Depended on Investors’ Capital Infusions

The JCS Ponzi scheme depended on investors’ capital infusions to survive, and when the scheme could no longer attract enough additional investments to cover losses, pay bogus gains, return existing investors’ funds or cover other improper diversions of investors’ money, the scheme collapsed. These facts are undisputed because JCS was a Ponzi scheme. The Ponzi scheme did not depend on capital infusions from First Data to survive because First Data never

¹² The SEC maintains that its “mission” is to “protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public’s trust.” See <https://www.sec.gov/about.shtml>.

¹³ The Receiver recognizes that JCS and Signore provided First Data with false information over the course of the business relationship. However, the targets of the scheme to defraud were individual investors.

invested any money with JCS. Instead, First Data merely provided credit card/bankcard processing services to JCS so that JCS could offer its victims investment contracts via credit cards.

5. First Data Provided Services to JCS That Helped It Continue Its Operations

First Data had a pre-receivership contract with JCS and provided services to JCS as a credit card/bankcard processor. Such card processing services helped JCS to continue its operations and survive from November 2010 through April 7, 2014. Copies of JCS's application/agreement with First Data and the addendum/personal guaranty signed by Signore were attached as exhibits to First Data's submitted Claim Form and are attached herein as Exhibits D and E, respectively.¹⁴

6. First Data Is a Trade Creditor

First Data is, indeed, a trade creditor under the case law First Data previously provided to the Receiver. That case law provides that a trade creditor is owed money or some debt for providing goods or services. *See, e.g., In re Nutritional Sourcing Corp.*, 398 B.R. 816, 827 (Bankr. D. Del. 2008). The chargebacks underlying First Data's claim wholly derive from the credit card/bankcard processing services that First Data provided to JCS. (*See* Exhibit A). First Data's argument that it is a trade creditor only to the extent of credit card/bankcard processing fees charged to JCS and that it is an investor to the extent of all the chargebacks paid to investors is a complete red herring and rank fallacy. Again, it is undisputed that the chargebacks arose from First Data's credit card/bankcard processing services – the very services that First Data is in the business of providing. Therefore, First Data is a trade creditor, not an investor.

7. Distributions That the Receiver Will Make Derive from Investors and Therefore Should Go to Investors

The funds available for distribution by the Receiver consist of proceeds of the JCS Ponzi scheme; for example, they 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. Therefore, as a matter of equity, defrauded investors should be compensated before general creditors (such as First Data). *See Megafund Corp.*, 2007 WL 1099640 at *2 (“The assets recovered to date by the Receiver are all traceable to investor funds. Thus, to the extent the Starks have valid claims against Sardaukar, they are general creditors who will not be paid until all defrauded investors are fully compensated. This objection should be overruled.”); *Quilling*, 2006 WL 3694629 at *1 (“The funds available for distribution are the result

¹⁴ These documents were marked Exhibits 4 and 21 at Mr. Aufiero's deposition.

of investments by the investors. . . . These funds are subject to a constructive trust which arose in favor of the investors when each investor contributed funds to TPI.”).

8. It Is Undisputed That First Data Did Not Invest with JCS

It is undisputed that First Data did not invest as an investor in JCS. First Data never signed an investment contract or transferred money to JCS for investment purposes. (M. Aufiero Dep. Tr. 99:2-7, excerpted copies of which are attached as part of Composite Exhibit B). Therefore, the Court should reject First Data’s argument that it “involuntarily” invested in JCS, or was an “involuntary investor” in JCS, by virtue of paying chargebacks to investors.¹⁵

9. Chargebacks Are, Indeed, Part of First Data’s Business

First Data contends that chargebacks are not part of its business. First Data is not being intellectually honest about its own business, which naturally includes its liabilities, financial risks, exposures, and the like (*i.e.*, chargebacks). The Court need look no further than a couple representative documents and prior First Data deposition testimonies on this issue.

For example, in First Data’s previously-filed, pre-receivership state court complaint in Miami-Dade Circuit Court in the case styled *First Data Merchant Services Corporation v. JCS Enterprises Inc.*, Case No. 14-006801, First Data took the position in ¶ 2 that “First Data provides bankcard processing services . . . [which] include authorization, processing, and settlement services for merchants, **as well as handling with reversals or ‘chargebacks’ of those transactions in the event a cardholder or card issuing bank disputes the transaction.**” (Emphasis added). This pre-receivership statement by First Data proves that chargebacks are part of its business. Attached as Exhibit F is a Declaration of James D. Sallah, Esq. (“Sallah Dec.”) containing a copy of First Data’s state court complaint.¹⁶ First Data filed the state court complaint shortly before the SEC sued, and thus before the commencement of this receivership proceeding. Now, First Data has taken the opposite position in the receivership in hope of securing an approved claim. First Data should be estopped from making contradictory arguments, and the Court should reject the same. *See Reisner v. Ge. Motors Corp.*, 511 F. Supp. 1167, 1172 & n.10 (S.D.N.Y. 1981) (court denied leave to amend, in part, because proposed new factual allegations were

¹⁵ The Receiver is unaware of any legal authority supporting First Data’s “involuntary investor” contention. The reason is because there is no such legal authority.

¹⁶ The complaint was marked Exhibit 72 at Mr. Tenenbaum’s deposition. The complaint as to JCS and Signore was ultimately stayed pursuant to the stay provision in the Receivership Order.

inconsistent with prior allegations and raised “substantial doubt” as to good faith in asserting allegations).

Similarly, First Data’s parent’s public filings with the SEC, namely its Form 10-K for the fiscal years ending in 2014 and 2015, provide that chargebacks are a required legal obligation or guarantee of its chosen business. Specifically, the Form 10-K (for 2014 and 2015) provide:

(9) Guarantees and Reserve for Merchant Credit Losses

Under the card companies’ rules, when a merchant processor acquires card transactions, it has certain liabilities for the transactions. This liability arises from disputes between cardholders and merchants due to the cardholders’ dissatisfaction with merchandise quality or the merchants’ service, which are not resolved with the merchant. In such cases, the transactions are “charged back” to the respective merchants and the related purchase amounts are refunded to the cardholders by the card issuer. **If the merchant does not fund the refund due to insolvency, bankruptcy or other extraneous reasons, the Company, in certain circumstances is liable for the full amount of the transaction. This liability is considered a guarantee under FASB ASC 460, Guarantees.**

The Company’s legal obligation under these rules is to settle any individual chargeback for which an individual merchant fails to fulfill as noted above. Contractually, the maximum exposure for this obligation is the total amount of transactions processed for the preceding four months period, or from the date of delivery of the goods and services by the merchant, if longer than four months for all merchants, which in the case of the Company is in the billions of dollars. **It should be noted that the Company has not experienced material chargeback loss activity as a result of merchant processing activities and advises that caution should be used when assessing the maximum exposure described above.** The Company records a provision for this estimated obligation based upon a number of factors which include historical losses, credit risk of specific customers and other relevant factors. As shown below, for the years ended December 2015 and 2014, the Company incurred aggregate merchant credit losses of \$12,430 and \$9,229 [dollars in thousands], net of recoveries, on total processed volumes. The Company calculates its provision and evaluates the appropriateness of its reserves on a monthly basis.

(Emphasis added; italics in original). A copy of the excerpted First Data's parent's Form 10-K for the fiscal years ending 2014 and 2015 is attached as Exhibit G.¹⁷

Similarly, First Data, through its former employee Robert Tenenbaum (former head of First Data's Special Accounts Group), also confirmed that it voluntarily chose to adhere to the required Card Brand Rules, which require First Data to pay chargebacks when the merchant does not, as part of First Data's chosen business. (R. Tenenbaum Dep. Tr. 188:17 – 189:15, excerpted copies of which are attached as part of Composite Exhibit H).

In addition, First Data, through another former employee Nadia Serves (one of Mr. Tenenbaum's former analysts), previously testified in the first-filed state court case that First Data bears the initial loss and risk for all chargebacks:

Q. Just to be clear, so when a cardholder initiates a charge back, is it fair to say that First Data is the one who **initially bears the financial loss** associated with that transaction?

A. **Yes**, it would be a financial adjustment with the dispute, the claim that comes in, there is a financial adjustment that comes to First Data from the association, and then we of course debit the merchant's account for that financial adjustment.

(N. Serves Dep. Tr. 57:17-25 (emphasis added), excerpted copies of which are attached as part of Composite Exhibit I).¹⁸

Moreover, Andrew Saka of Merchant One, which was First Data's sales contractor with the JCS account, known in the industry as an "ISO" (Independent Sales Organization), testified in this proceeding that chargebacks are part of First Data's business:

Q. Are chargebacks part of this business?

A. Yes.

Q. Are they part of Merchant One's business?

¹⁷ The attached excerpted Form10-K page is part of a public filing with the SEC found at <https://www.sec.gov/Archives/edgar/data/883980/000162828016011729/a12311510-k.htm>, and is also subject to judicial notice. *See Gault v. SRI Surgical Express, Inc.*, 2012 WL 12905183, at *1 (M.D. Fla. Sept. 26, 2012); *see also* Exhibit F, Sallah Dec. at ¶4.

¹⁸ The attached transcript is the copy that First Data filed in the pre-receivership state court case. First Data was a party participating in the attached deposition transcript and therefore had due process regarding all questioning. Therefore, the attached transcript can be used and considered here. *See* Fed.R.Evid. 804(b)(1); *see also*, Exhibit F, Sallah Dec. at ¶5

A. I mean, servicing them, helping merchants.

Q. Are they part of First Data's business?

A. Yes.

(A. Saka Dep. Tr. 42:19-24, excerpted copies of which are attached as part of Composite Exhibit J).

Based on the above, chargebacks are a contemplated, necessary and ultimately an assumed risk inherent in First Data's financial services business. First Data voluntarily elected to engage in this business subject to certain industry rules. First Data also has certain obligations flowing from its business. For example, and as provided in its Form 10-K, First Data knew that in order to conduct its business, it had to agree to the Card Brand Rules, which provide that First Data must cover the loss of a chargeback if there are insufficient funds in its merchant's account. (See Exhibit G).

Based on the numerous above items, chargebacks are clearly part of First Data's business.

C. Second Reason to Subordinate – First Data's Parent Company Is a Fortune 500 Company Worth Billions of Dollars

First Data is a subsidiary of First Data Corporation, (stock ticker "FDC"), which is publicly traded on the New York Stock Exchange. First Data Corporation is a multi-billion-dollar, Fortune 500 company. (M. Aufiero Dep. Tr. 83:9-13, excerpted copies of which are attached as part of Composite Exhibit B). Recently, on or about July 29, 2019, First Data Corporation was acquired by Fiserv via merger for **\$22 billion**. A copy of a Form 8-K regarding these facts is attached as Exhibit K.¹⁹ Without question, First Data is (much) better able to bear the financial costs of its chargeback losses than the hundreds of victim investors with proposed approved claims.

Moreover, as set forth in its parent company's Form 10-K for the relevant time period, First Data admitted "the Company [did] not experience[] material chargeback loss activity as a result of merchant processing activities." (Exhibit G). Contrary to First Data's admitted position that its instant chargeback loss is immaterial, many victim investors' claims have told the Receiver that their losses have been life-altering. (Exhibit F, Sallah Dec. at ¶9). Indeed, investors who lost their

¹⁹ The attached Form 8-K is a public filing with the SEC found at <https://www.sec.gov/ix?doc=/Archives/edgar/data/883980/000119312519205586/d783417d8k.htm>, and is subject to judicial notice. See *Gault*, 2012 WL 12905183 at *1; see also Exhibit F, Sallah Dec. at ¶6.

living expenses, retirement nest eggs, or children's education funds consider such losses as "material."

D. Third Reason to Subordinate – The Investors Include People Who Have Lost Their Life Savings, Are Elderly, Live on Fixed Incomes, and Are Unsophisticated Victims

From the Receiver's investigation, the investors include, among others, people who have lost their life savings, live on fixed incomes, are elderly, and are unsophisticated victims. (J. Sallah Dep. Tr. 103:16 – 104:6, excerpted copies of which are attached as Composite Exhibit L). Taken as a whole, the victimized investors are undoubtedly less able to bear the financial costs of their losses than a multi-billion-dollar company such as First Data's parent company.

E. Fourth Reason to Subordinate – First Data Is a Sophisticated Creditor/Claimant Who Had Prior Access to Enormous Financial, Personal, Credit-Related, and Otherwise Sensitive Information Regarding JCS and Signore

Among other things, First Data's own attached Proof of Claim Form (see Exhibit A) and the attached SEC filings (see Exhibit G) prove that First Data is a highly-sophisticated, experienced, and knowledgeable bankcard servicing company. In addition to its sophistication, experience and knowledge, First Data had access to, requested, and received documents and information from JCS and others in connection with underwriting the JCS account. Furthermore, First Data conducted its own investigation wherein it obtained documents and information regarding financial, personal, credit-related, and otherwise sensitive information of JCS, its business, its principal (the protagonist of the Ponzi scheme, Signore), and their credit worthiness.

As set forth below, First Data requested and obtained numerous documents and detailed information that it requested and obtained regarding JCS and Signore, which placed it in an even superior position of sophistication, experience, and knowledge compared to the defrauded investors who did not have access to, or knowledge of, the same. Thus, First Data cannot be placed on equal footing, or "similarly situated," with the defrauded investors. *See PrivateFX Global One*, 778 F. Supp. 2d at 786 & n.5 (denying that Wells Fargo, which extended line of credit and submitted a receivership claim for those losses, should be "on equal footing with the investors" because "it is Wells Fargo's business to review applications for credit and determine whether they are valid," and because "Wells Fargo is a sophisticated financial institution[,] and because "it is difficult to place Wells Fargo's claim of victimization on the same plane as that of the duped investors"); *see also Nadel*, 2013 WL 12323969 at *5 & n.28 (denying institutional investors'

claim because institutional investors were sophisticated, therefore knew or should have known about certain red flags, therefore were not similarly situated with normal investors, and therefore were properly differentiated from normal investors). As such, First Data is far from a “similarly situated” victim investor. It should, therefore, be differentiated based on its undisputed sophistication, experience, and knowledge.

As specifically explained below, First Data had, or had access to, among other things, the following concerning JCS and/or Signore: 1) detailed, completed applications; 2) sophisticated background check software; 3) credit reports; 4) financial statements; 5) bank statements and related banking information; 6) tax returns; 7) the ability to communicate with JCS’s bank to obtain information; and 8) JCS site inspections. And because First Data had such information regarding JCS and Signore compared to the investors, First Data is a knowledgeable, sophisticated and experienced claimant whose claim should be subordinated under such circumstances.

1. Applications

First Data had the ability to request, indeed requested, and obtained applications for JCS and other Receivership Entities (such as GeeBo and GeeBo Sales) to open a credit card/bankcard processing account with First Data. The JCS/First Data application/agreement is dated November 2010. (See Exhibit D). An individual named Richard Brown (“Brown”), not Signore, signed the first application/agreement.²⁰ First Data ultimately asked Signore to sign an addendum/personal guaranty years later in May 2013. (See Exhibit E). Additional applications for Receivership Entities GeeBo and GeeBo Sales (signed by Signore in January and February 2013) are attached as Exhibits M and N, respectively.²¹

The above documents include financial, personal, credit-related, and otherwise sensitive information regarding JCS and Signore. Investors did not have access to this information; however, First Data did. See *PrivateFX Global One*, 778 F. Supp. 2d at 786 & n.5 (same parenthetical cited above); *Nadel*, 2013 WL 12323969 at *5 & n.28 (same parenthetical cited above).

²⁰ The Receiver will address other relevant issues regarding Brown below.

²¹ These documents were marked Exhibits 6 and 8 at Mr. Aufiero’s deposition.

2. Background Checks

First Data had the ability to perform and ultimately performed a background check regarding Signore with sophisticated software. Attached as Exhibit O is a LexisNexis background check that First Data ran on Signore.²² The LexisNexis background check for Signore is dated October 2013, nearly three years *after* the November 2010 JCS application/agreement.²³

Like the applications, the attached Signore background check includes financial, personal, credit-related, and otherwise sensitive information regarding Signore. Again, investors did not have access to this information; however, First Data did. *See PrivateFX Global One*, 778 F. Supp. 2d at 786 & n.5 (same parenthetical cited above); *Nadel*, 2013 WL 12323969 at *5 & n.28 (same parenthetical cited above).

3. Credit Reports

First Data had the ability to run, and ultimately ran, several credit reports on Signore. Attached as Composite Exhibit P are credit reports First Data ran on Signore.²⁴ First Data also ran credit reports on Brown, who signed the initial November 2010 application/agreement. Attached as Exhibit Q is at least one credit report that First Data ran on Brown.²⁵

Like the applications and the background check, the credit reports include financial, personal, credit-related, and otherwise sensitive information regarding JCS, Signore, and Brown. Again, investors did not have access to this information; however, First Data did. *See PrivateFX Global One*, 778 F. Supp. 2d at 786 & n.5 (same parenthetical cited above); *Nadel*, 2013 WL 12323969 at *5 & n.28 (same parenthetical cited above).

²² This document was marked Exhibit 28 at Mr. Aufiero's deposition.

²³ The Receiver will further discuss the relevant issues, and shocking discoveries, regarding this background check below.

²⁴ These documents were marked Exhibits 26 and 30 at Mr. Aufiero's deposition.

²⁵ This document was marked as part of Exhibit 17 at Mr. Aufiero's deposition. The first three pages have been included to show Mr. Brown's credit score and other information such as his employment (which did not list JCS as of April 2013, nearly three years after the November 2010 application). The remaining pages have not been attached.

4. Financial Statements

First Data had the ability to request, requested, and obtained JCS's financial statements, such as balance sheets and profit and loss statements. Attached as Composite Exhibit R are representative JCS financial statements that First Data obtained.²⁶ First Data also had the ability to request, indeed requested, and obtained Signore's personal financial statements.²⁷

Like the applications, the background check and the credit reports, the financial statements include financial, personal, credit-related, and otherwise sensitive information that investors did not have access to; however, First Data did. *See PrivateFX Global One*, 778 F. Supp. 2d at 786 & n.5 (same parenthetical cited above); *Nadel*, 2013 WL 12323969 at *5 & n.28 (same parenthetical cited above).

5. Bank Statements and Related Bank Information

First Data had the ability to request, indeed requested, and obtained JCS's bank statements. Attached as Composite Exhibit S are representative bank statements that First Data obtained.²⁸ Also, First Data did periodic review requests to JCS's banks, during which First Data would request certain banking information, such as account balances. Attached as Composite Exhibit T are representative periodic bank requests that First Data sent and obtained from JCS's banks.²⁹

Like the applications, the background check, the credit reports and the financial statements, the bank statements and periodic bank requests include financial, personal, credit-related, and otherwise sensitive information that investors did not have access to; however, First Data did. *See PrivateFX Global One*, 778 F. Supp. 2d at 786 & n.5 (same parenthetical cited above); *see also Nadel*, 2013 WL 12323969 at *5 & n.28 (same parenthetical cited above).

²⁶ These documents were marked Exhibit 18 at Mr. Aufiero's deposition.

²⁷ First Data never obtained audited financials for either JCS or Signore, which are undisputedly the most preferred and the most accurate documents to actually verify financial information. Had First Data requested audited financials for JCS and/or Signore, First Data should have realized that the submitted unaudited financials were false.

²⁸ These documents were marked Exhibit 12 at Mr. Aufiero's deposition.

²⁹ These documents were marked Exhibits 20 and 22 at Mr. Aufiero's deposition.

6. Tax Returns

First Data had the ability to request, requested, and obtained certain JCS tax returns. Attached as Exhibit U are representative tax returns that First Data obtained (tax year 2011).³⁰

Like the applications, the background checks, the credit reports, the financial statements and the bank statements/records, the tax return includes financial, personal, credit-related, and otherwise sensitive information that investors did not have access to; however, First Data did. *See PrivateFX Global One*, 778 F. Supp. 2d at 786 & n.5 (same parenthetical cited above); *Nadel*, 2013 WL 12323969 at *5 & n.28 (same parenthetical cited above).

7. Communications with BB&T Bank (JCS's Bank) and the Absolutely Shocking Discoveries

First Data had the ability to request, requested, and obtained “smoking gun” information regarding both JCS and Signore from JCS's banks. For example, JCS's bank, BB&T Bank, told First Data the following: 1) BB&T had investigated JCS; 2) investors were making investments with JCS; 3) Signore had made large personal transfers from JCS to himself, which were indicative of a potential Ponzi scheme; 4) BB&T did a site inspection of JCS and concluded that there was a lack of inventory compared to purported sales and actual banking volume; 5) TD Bank, JCS's prior bank, had closed JCS's bank account; 6) BB&T planned to do the same; 7) JCS was potentially a Ponzi scheme; 8) BB&T had informed Jupiter law enforcement, the Florida Attorney General's Office, and the Secret Service of these issues; and 9) BB&T had filed a Suspicious Activity Report (“SAR”) regarding JCS/Signore. Attached as Exhibit V is the First Data Periodic Review report dated October 2013 reflecting this shocking information (and other additional critical information discussed herein, such as Signore's prior felony criminal convictions for theft).³¹ As a result, First Data concluded at the bottom of the October 2013 report that JCS appeared similar to a “ ‘get rich quick’ scheme.” (Exhibit V).

³⁰ This document was marked Exhibit 19 at Mr. Aufiero's deposition.

³¹ This document was marked as part of Exhibit 25 at Mr. Aufiero's deposition. Prior similar Periodic Review reports authored by Mr. Aufiero are attached as Composite Exhibit W and were marked as part of Exhibits 16, 23, and 24 at his deposition. All of the attached Periodic Review reports show the enormous amounts of financial, personal, credit-related, and otherwise sensitive information that First Data knew, as opposed to the investors, regarding, among other things, JCS operating as a potential Ponzi scheme.

Again, like the above items, the investors did not have access to this shocking information; however, First Data did. *See PrivateFX Global One*, 778 F. Supp. 2d at 786 & n.5 (same parenthetical cited above); *see also Nadel*, 2013 WL 12323969 at *5 & n.28 (same parenthetical cited above).

Because First Data had more information regarding JCS/Signore, including the discovery of the above shocking and outrageous information, compared to the investors, First Data is a sophisticated and experienced claimant with significantly more knowledge regarding JCS/Signore. First Data also had actual knowledge of several red flags and problems with the JCS account (*i.e.*, Signore's prior felony convictions, Signore's prior personal bankruptcy, JCS's banks' closing of bank accounts, JCS's bank's belief that JCS was potentially a Ponzi scheme, large personal deposits by Signore that were indicative of a potential Ponzi scheme according to JCS's bank, JCS's bank's notification of potential crimes to law enforcement/Secret Service/Florida's Attorney General's Office, a SAR filing, etc.), which the investors knew nothing about. First Data's claim is properly subordinated under such circumstances.

8. Site Inspections

First Data had the ability to perform, and performed, a site inspection of JCS. The site inspection reports were part of the approved applications in 2010 and 2013 (Exhibits D, M, and N).³² According to its Claim Form (see Exhibit A at #39), First Data also requested an additional site inspection in December 2013, which Signore refused.

Investors did not have the same level of access to JCS's premises to inspect its operations, to check on inventory, to take pictures or the like, or knowledge of the fact that Signore refused a site inspection; however, First Data did. *See PrivateFX Global One*, 778 F. Supp. 2d at 786 & n.5 (same parenthetical cited above); *Nadel*, 2013 WL 12323969 at *5 & n.28 (same parenthetical cited above).

Because First Data had more information regarding JCS/Signore compared to the investors, First Data is a sophisticated and experienced claimant with more knowledge than the investors and whose claim is properly subordinated under such circumstances.

³² These documents were marked as part of Exhibits 4, 6, and 8 at Mr. Aufiero's deposition.

F. Fifth Reason to Subordinate – First Data Was a Bad Actor in Its Own Industry

First Data contends that it was not given the actual details of the JCS business or scheme (*i.e.*, First Data allegedly did not know that JCS was offering investment opportunities to investors until much later in October 2013). Similarly, First Data contends that JCS misrepresented to First Data the true nature of its business. Assuming that this is true, First Data failed to inform others in its industry, including subsequent processors, regarding its discoveries concerning JCS and Signore.

First Data contends that on or about October 2013, it discovered that JCS had changed its business model and was offering investments to investors. (*See* Exhibit V). Such investment practices violated the First Data/JCS merchant agreement because such conduct involved what is called “factoring,” a prohibited practice in the credit card/bankcard processing industry. *Id.* Factoring is also an undisputed violation of Visa’s Card Brand Rules to which First Data was bound. As admitted by First Data in question #44 of its sworn Claim Form (see Exhibit A), the discovery of JCS’s investment opportunities or “factoring” led First Data to terminate JCS’s account for cause shortly thereafter in a termination letter dated October 29, 2013 and effective as of November 1, 2013. However, First Data did not place JCS on the industry’s MATCH list,³³ also known as the Terminated Merchant File,³⁴ until months later on February 28, 2014.³⁵ (R. Tenenbaum Dep. Tr. 119-23, excerpted copies of which are attached as part of Composite Exhibit H).

The MATCH/TMF list is the file or database that MasterCard and Visa processing banks, known as “acquiring” banks, use to identify merchants and principals who have been previously terminated for violations of credit agreements. Once a merchant is on the MATCH/TMF list, processing/acquiring banks know it may be prudent to steer clear from any business with the merchant and not approve the merchant’s account application.

Visa Global Arbitration and Compliance found against First Data and in favor of at least two acquiring banks (Chesapeake Bank and Esquire Bank), which are JCS processing banks that

³³ MATCH stands for Member Alert to Control High-Risk Merchants.

³⁴ TMF stands for Terminated Merchant File.

³⁵ These facts are further detailed below.

followed First Data after First Data's termination that was effective as of November 1, 2013. Specifically, Visa Global Arbitration and Compliance found that First Data violated the Visa Card Brand Rules to which First Data was bound, because First Data did not place JCS on the MATCH/TMF list until months later on February 28, 2014.

Attached as Composite Exhibit X are Visa Global Arbitration and Compliance's findings of First Data's violations of industry rules regarding the JCS relationship.³⁶ Visa found as follows in both letters:

Visa has determined that a rule violation of "Terminated Merchant File Listing Requirements" did occur. The merchant received notification of termination from the opposing acquirer on 29 October 2013. According to documentation within the case filing related to court proceedings, the merchant was terminated due to their change of business model including factoring activities with a third party. **Visa rules require the merchant to be listed on the Terminated Merchant File (TMF) within 24 hours of notification of termination when the merchant deposits transactions representing sales of goods or services generated by a third party. The opposing acquirer did not list the merchant until 28 February 2014, which resulted in the requesting acquirer boarding the merchant and becoming exposed Visa determined that liability for the losses incurred by the requesting acquirer will be the responsibility of the opposing acquirer for failing to list the merchant on the TMF within 24 hours as required.**

(Composite Exhibit X) (emphasis added).

There is a simple, self-serving reason why First Data violated Visa Card Brand Rules and its own internal procedures by waiting months to place JCS on the MATCH/TMF list. After terminating the JCS account, First Data still wanted, and needed, Signore's assistance with two issues. From November 1, 2013 through February 25, 2014 (*i.e.*, three (3) days before finally submitting the MATCH/TMF listing), First Data repeatedly requested that Signore provide information and documents to help First Data fight incoming chargebacks. During the same period, First Data continually requested that Signore return money (ranging from \$70,000 to \$140,000) to First Data to reduce its chargeback exposure as of that time. Copies of the

³⁶ These documents were marked Exhibit 37 at Mr. Aufiero's deposition.

representative emails between Signore and First Data are attached as Composite Exhibit Y.³⁷ Following these Rules and placing JCS on the MATCH/TMF list would have eliminated any possibility of First Data getting Signore's assistance to reduce its own financial exposure. However, when Signore failed to respond to First Data's/Mr. Tenenbaum's final February 25, 2014 email, First Data realized that its continued efforts would be futile and *then* placed JCS on the MATCH/TMF list on February 28, 2014. (R. Tenenbaum Dep. Tr. 119-23, excerpted copies of which are attached as part of Composite Exhibit H). Based on the above, First Data pawned off JCS on other merchant banks in the industry by failing to provide them with the requisite MATCH/TMF notice. In turn, this failure permitted JCS to continue to operate its Ponzi scheme using the credit card services of other merchant banks. (J. Sallah Dep. Tr. 62:10-19, 65:6-13, excerpted copies of which are attached as part of Composite Exhibit L). Because of First Data's inexcusable conduct, the Court should fully subordinate First Data's claim.

G. Sixth Reason to Subordinate – After Terminating the JCS Account, and Despite Knowing That JCS Was a Potential Ponzi Scheme, First Data Continued to Seek Signore's Assistance to Fight Chargebacks and Incredibly Returned \$700,000 from the Reserve Funds to Him

As stated above, despite terminating the JCS account and despite knowing that JCS was a potential Ponzi scheme (see Exhibit V), First Data repeatedly requested that Signore provide information and documents to help First Data fight incoming chargebacks to limit or eliminate its exposure (see Composite Exhibit Y). Asking assistance from an individual that First Data knew was a convicted fraudster engaged in a potential Ponzi scheme is a material basis to fully subordinate First Data's claim.

If the above is not shocking enough, First Data made the additional decision in December 2013 – nearly two months after learning of the discoveries from BB&T Bank regarding Signore being a potential Ponzi schemer – to return \$700,000 from the reserves to him. At a minimum, this amount of \$700,000 – which was investor monies – should ultimately offset First Data's claim amount. Attached as Composite Exhibit Z are several representative emails and other communications between First Data and JCS/Signore regarding the return of \$700,000 to Signore post-termination and post-shocking discoveries from BB&T.³⁸

³⁷ These documents were marked as part of Exhibit 35 at Mr. Aufiero's deposition.

³⁸ These documents were marked as part of Exhibit 35 at Mr. Aufiero's deposition.

H. Seventh Reason to Subordinate – First Data Failed to Perform Sufficient Due Diligence or Verification When Underwriting, Approving, and Later Monitoring the JCS Account, Which First Data Was Obligated to Do

First Data failed to perform sufficient due diligence or verification regarding JCS and Signore at the time of the JCS/First Data application/agreement in November 2010 and during the course of the parties' relationship for the next three-plus years. In October 2013, which was approximately three (3) years into, and essentially at the end of, the relationship, First Data – for the very first time – finally performed due diligence and conducted its own internal investigation regarding Signore. For example, in October 2013, First Data did a LexisNexis background search of Signore, which revealed, among other things, that 1) he was an ex-felon who had prior criminal convictions for theft in New Jersey; and 2) he had previously filed for personal bankruptcy. A copy of the LexisNexis background search on Signore is attached as Exhibit O. Such due diligence did not occur in November 2010 when First Data approved the JCS account; it happened three (3) years later at the very end of the relationship.

In addition, First Data relied on Brown's signature on the November 2010 application/agreement that he had the authority to sign without independently confirming or corroborating that fact. (S. DeAngelis Dep. Tr. 35:12-21, excerpted copies of which are attached as part of Composite Exhibit AA). First Data relied on the representation in the application/agreement that Brown was a 51%, or majority, owner of JCS without taking any steps to confirm such information. (S. DeAngelis Dep. Tr. 34:18-23, excerpted copies of which are attached as part of Composite Exhibit AA). First Data's corporate representative in the prior state court case testified similarly:

Q. Is there any information that you were provided or that you sought to confirm that Mr. Brown had the authority to sign on behalf of JCS Enterprises?

A. The application itself was sufficient for us, and the additional information that he obtained which showed his whether all to support the exposure with an average DPA balance of like I think \$130,000 was sufficient for us. He represented that he was the owner and principal of the business.

(N. Serves Dep. Tr. 27:18 – 28:3, excerpted copies of which are attached as part of Composite Exhibit I).³⁹

First Data did not independently verify or corroborate whether Brown was a majority shareholder of JCS and/or that he had the authority to sign the JCS account application/agreement because the account was opened as a small account with small risk. (S. DeAngelis Dep. Tr. 39:17 – 40:3, excerpted copies of which are attached as part of Composite Exhibit AA). First Data chose to rely on the application information sent from the ISO, Merchant One, as opposed to independently verifying or corroborating the provided information because it believed that JCS was a small account. For larger accounts with naturally larger risk, First Data would, indeed, verify or corroborate information on the application. (S. DeAngelis Dep. Tr. 36-38, excerpted copies of which are attached as part of Composite Exhibit AA). First Data's determination to perform independent verification on large accounts, but not small accounts, was a clear weakness in its internal controls. First Data should have known that Signore was the person behind JCS from the outset of the relationship because he was the person who incorporated JCS in Delaware in 2010 and First Data received the incorporation document as part of its underwriting materials provided by Merchant One. Attached as Composite Exhibit BB are the email to First Data and attachments including the Delaware incorporation document.⁴⁰

But regardless of First Data's knowledge of Signore incorporating JCS, First Data made the decision to rely on Merchant One regarding certain JCS application information. Clearly, First Data made the wrong decision, but its course of conduct should not further harm the victim investors.⁴¹

³⁹ Again, First Data was a party participating in the attached deposition transcript and therefore had due process regarding all questioning. Therefore, the attached transcript can be used and considered here. *See* Fed.R.Evid. 804(b)(1); *see also*, Exhibit F, Sallah Dec. at ¶5.

⁴⁰ These documents were marked deposition Exhibit 87.

⁴¹ Apparently, First Data opted not to seek any relief from Merchant One. (M. Aufiero Dep. Tr. 62:8-12, 64:1-9). This is not surprising because of Merchant One's \$15 million in annual revenues, 80% is derived from First Data business. (A. Saka Dep. Tr. 282:4-10, excerpted copies of which are attached as part of Composite Exhibit J).

First Data shouldered the obligations regarding: 1) final approval of a merchant account, including the review of the application/agreement, requesting follow-up documents and information, and then making a final decision to approve or reject the new account; 2) monitoring a merchant account; 3) evaluating and determining credit risk during the account's life; 4) conducting investigations regarding credit risk from the start of the relationship to the end; and 5) terminating a merchant account. (M. Aufiero Dep. Tr. 53-67, excerpted copies of which are attached as part of Composite Exhibit B).⁴² Mr. Saka of Merchant One, First Data's contractor that referred the JCS account to First Data, also confirmed that First Data solely had the obligation to verify any and all information supplied in the merchant's account application. (A. Saka Dep. Tr. 287:2-7, excerpted copies of which are attached as part of Composite Exhibit J).

In fact, the First Data-Merchant One ISO agreement ("ISO Agreement") unequivocally places the responsibility of vetting potential merchants on First Data. For example, section 3 of the ISO Agreement provides, in part:

3. Obligations of Service Providers. In addition to its other obligations stated elsewhere in this Agreement, Service Providers [First Data] shall be responsible for all processing and accounting functions relating to the clearing and settlement of Transactions, including **(a) Merchant processing and settlement; (b) Merchant credit research (other than matters to be performed by ISO pursuant to Section 2(c) of this Agreement); (c) Merchant customer activation and credit approval; (d) Merchant security and recovery; (e) Merchant customer services; (f) Merchant Chargeback and retrieval service; (g) all other Back Office Services; (h) final classification of Merchants (e.g., high, medium or low risk) pursuant to the Program Standards in the sole discretion of Service Providers [First Data]; and (i) negotiation and termination of Merchant Agreements.**

(Emphasis added). Likewise, section 4 of the ISO agreement provides, in part:

4. Credit Risk.

(a) Service Providers [First Data] shall be under no obligation to enter into any Merchant Agreement with any Merchant solicited by ISO that does not, in the sole discretion of Service Providers [First Data],

⁴² First Data has withdrawn its prior purported confidentiality or protective order designation regarding the attached testimony and below attached excerpted pages of the First Data-Merchant One ISO agreement.

meet the Program Standards. Furthermore, in the event Service Providers [First Data] enter into a prospective Merchant Agreement with a Merchant, Service Providers [First Data] may terminate such Merchant Agreement(s) in accordance with the terms thereof.

- (b) **Service Providers [First Data] will perform credit reviews on prospective Merchants and ISO understands that Service Providers [First Data] will not accept those Merchants who do not meet the Program Standards or other credit criteria set forth by Service Providers.** Service Providers [First Data] will assume the risks associated with the Bank Card processing relationship for those Merchants with a valid Merchant Agreement signed by Service Providers [First Data], except as otherwise provided herein.

(Emphasis added). Finally, section 8 provides, in part:

8. Merchant Agreements.

[...]

- (b) Service Providers shall, in their sole discretion, make the final decision as to whether or not a prospective Merchant meets the Program Standards.

Excerpted copies of the First Data-Merchant One agreement are attached as Exhibit CC.⁴³

Based on the above, First Data clearly bore the risk regarding losses resulting from a retail merchant account, including for chargebacks. (A. Saka Dep. Tr. 22:23-23:5, excerpted copies of which are attached as part of Composite Exhibit J).

I. Eighth Reason to Subordinate – First Data Admitted After-the-Fact in Several Internal Documents That It Made Mistakes Regarding JCS

After Mr. Aufiero's deposition, it became clear to the Receiver that First Data had failed to produce internal emails and internal documents regarding the JCS debacle. This was obvious because Mr. Aufiero's supervisors and department supervisors were mentioned during his deposition, but First Data had not produced any documents involving or mentioning them. In

⁴³ This excerpted document was marked as part of Exhibit 2 at Mr. Aufiero's deposition.

addition, First Data's amended interrogatory answers served prior to the depositions never even mentioned them, including, but not limited to, Todd Dellomo, Stephen McDermott, and Steven Citarella. A copy of First Data's amended interrogatory answers is attached as Exhibit DD.

Immediately following Mr. Aufiero's deposition, the Receiver demanded that First Data produce the internal emails and internal documents before the next deposition, Mr. Tenenbaum. First Data ultimately produced them *after* Mr. Tenenbaum's deposition. Attached as Exhibit EE is the email correspondence demanding this supplemental production before Mr. Tenenbaum's deposition and First Data's agreement to produce afterwards. In the last email, First Data stated that the requested internal emails/documents were previously produced, but that statement was inaccurate, and the documents were withheld from the initial production.⁴⁴

The supplemental, after-the-fact documents contain First Data's undisputed admissions of multiple underwriting and monitoring failures. The material after-the-fact documents are attached as Composite Exhibit FF.⁴⁵

For example, the documents show that Signore provided a false credit report and a false social security number for himself to Mr. Aufiero earlier in the relationship, which Mr. Aufiero accepted. However, First Data admitted in internal documents that it should never accept and/or rely on a social security number from a merchant. One email from Mr. Aufiero's supervisor (see Exhibit FF, Bates FD-JCS-0151576) states:

Not until Mid 2013 did Joseph [Signore] provide his personal details but the social security number was fake. **Given lack of fraud experience PR analyst was not aware of information being provided was false and he was being set up by the Joseph [Signore].** There are many lesson learned here for example Pulling background checks on additional owners and guarantors via Lexus which is what I did when PR analyst expressed concern about the account at which point I learned all about Joseph Signore.

⁴⁴ The Receiver does not believe that either First Data's counsel or his firm intentionally did this; however, he believes otherwise with regards to First Data itself. The Receiver did not seek leave to recall these witnesses because doing so would have furthered delayed the future, Court-approved distribution to investors and would have cost the Estate additional resources.

⁴⁵ These documents were marked as Exhibits 135-139 during Ms. DeAngelis' deposition. Again, none of these documents were produced before Mr. Aufiero's or Mr. Tenenbaum's depositions, and obviously could not be used when questioning these First Data witnesses.

(Emphasis added) (*sic*). This email is telling. It should come as no surprise that First Data failed to properly monitor the JCS account when the analyst in charge of doing so had a “lack of fraud experience.”

Further, the internal documents (see Exhibit FF, Bates FD-JCS-0151142, 0151608) show that there was a “Hawk Alert”⁴⁶ regarding Signore earlier in the relationship, which should have alerted First Data that Signore was using a false, or had stolen another person’s, social security number. However, First Data admitted that the analyst did not properly understand Hawk Alerts and failed to catch this significant red flag.

In addition, the documents (see Exhibit FF, Bates FD-JCS-0151393) show that analysts (such as Mr. Aufiero) should not simply accept the word of merchants as the undisputed truth, but rather should further investigate to confirm material issues.

Moreover, the documents (see Exhibit FF, Bates FD-JCS-0150549, 151118, 151141-43) show that First Data evaluated new strategies for improvement following the lessons learned from the JCS debacle, including, among other things, “PR should have criminal background undertaken on newly added guarantors / owners via Lexus select high risk, speculative credit profile accounts[]”; “Do not rely upon any personal credit reports provided by the merchant they must be obtained from the credit bureau[]”; and “PR group should get training to understand how to interpret Hawk Alerts.”

Finally, First Data summarized and admitted many of the above items in its Post-Mortem Analysis (see Exhibit FF, Bates FD-JCS-0151607-10), in which the document states, among other things, on the third page (see Bates FD-JCS-0151609) that First Data would have rejected the JCS account if it knew about Signore from the start:

⁴⁶ A Hawk Alert is an alert on a credit report that the person may be a victim of identity theft. According to First Data (see Exhibit FF, Bates FD-JCS-0151142), the First Data analyst should have called the number on the report to speak with and confirm the victim, and would have revealed that Signore had stolen the ID of another person.

Richard Brown was likely listed on application since application would be declined if Joseph Signore had been listed given Joseph's background.⁴⁷

Many of the recommended items of improvement (see Exhibit FF, Bates FD-JCS-151118) came from Mr. Aufiero himself. Yet at his deposition, and without the use of the subject documents (again, because First Data had not produced them as of that time), Mr. Aufiero testified under oath that from a review/monitoring point-of-view, First Data did nothing wrong regarding JCS/Signore, did not make any mistakes, and was completely defiant on any admission of anything negative. (M. Aufiero Dep. Tr. Vol. II: 110:24 – 112:8, excerpted copies of which are attached as part of Composite Exhibit GG). However, given the attached documents, it appears that Mr. Aufiero's deposition testimony was, at a minimum, highly inaccurate.

J. Ninth Reason to Subordinate – First Data Violated Its Own Internal Written Policies

First Data did not follow, and therefore violated, its own internal written policies regarding the JCS account.⁴⁸

⁴⁷ Receiver's counsel asked First Data's underwriting corporate representative (Ms. DeAngelis) at her deposition whether she agreed with this statement. She testified that she disagreed with it and stated that First Data would have approved the JCS application/agreement in November 2010 if Signore had signed it. (S. DeAngelis Dep. Tr. 141:18 – 143:15, excerpted copies of which are attached as part of Composite Exhibit AA). That testimony, in and of itself, mandates the subordination and ultimate rejection of First Data's claim. Moreover, Ms. DeAngelis' testimony is even more troubling because she also testified that LexisNexis reports should be pulled as part of her underwriting training sessions (which here would have revealed Signore's prior criminal convictions for theft) and that she has denied a handful of merchant applications in the last year because the principal had prior theft/stealing convictions (like Signore did). (S. DeAngelis Dep. Tr. 28:3 – 30:9, 156:16 – 158:8, excerpted copies of which are attached as part of Composite Exhibit AA).

⁴⁸ First Data initially objected to producing these documents. The Receiver filed a Motion to Compel (DE 422), after which First Data conceded the issue and produced hundreds of pages of its written policies regarding, among other things, underwriting, monitoring, and terminating accounts. It is now apparent why First Data initially attempted to withhold these documents because they show that First Data, indeed, violated its own policies.

First, according to its policies regarding placing merchants on the MATCH/TMF⁴⁹ list, First Data was required to place JCS on the MATCH/TMF list within five (5) calendar days of the decision to terminate the account. Copies of the relevant excerpted policies are attached as Composite Exhibit HH.⁵⁰ It is undisputed that First Data sent a termination letter dated October 29, 2013 to JCS/Signore, the termination of which was effective as of November 1, 2013. However, as previously discussed, it is also undisputed that First Data placed JCS on the MATCH/TMF list several months later on February 28, 2014, which is significantly more than five (5) calendar days after the decision to terminate. Copies of representative documents showing that First Data terminated JCS in the October 29, 2013 letter and that First Data placed JCS on the MATCH/TMF list on February 28, 2014 are attached as Composite Exhibit II.⁵¹

Second, according to First Data's policies regarding opening a new merchant account, a majority owner, an officer, or a power of attorney was required to sign the merchant application/agreement (Composite Exhibit HH).⁵² This did not happen with JCS. Brown, not Signore, signed the initial JCS application/agreement in November 2010. (*See* Exhibit D). Brown was never a majority (*i.e.*, 51% or more) owner of JCS. (J. Sallah Dep. Tr. 97:5-9; 97:16 – 98:4; 109:12 – 110:7, excerpted copies of which are attached as part of Composite Exhibit L). In fact, Brown admitted in the prior state court case that he was never a majority or 51% owner of JCS:

Q. So, for example, where it lists the ownership, it says 51 percent.

A. That was not me.

Q. And was that accurate?

A. No.

⁴⁹ As stated above, MATCH stands for "Member Alert to Control High-Risk Merchants" and TMF stands for "Terminated Merchant File."

⁵⁰ These documents were marked as part of Exhibit 38 at Mr. Aufiero's deposition.

⁵¹ These documents were marked Exhibits 32 and 33 at Mr. Aufiero's deposition.

⁵² These documents were marked as part of Exhibit 38 at Mr. Aufiero's deposition.

(R. Brown Dep. Tr. 52:21-25, excerpted copies of which are attached as part of Composite Exhibit JJ).⁵³

Similarly, Brown was never an officer of JCS; Signore was. (J. Sallah Dep. Tr. 97:5-9, excerpted copies of which are attached as part of Composite Exhibit L). This fact also could have been confirmed from a simple search on the State of Florida's Division of Corporation's website at <https://dos.myflorida.com/sunbiz/> ("Sunbiz"). Attached as Exhibit KK are relevant Sunbiz records proving Brown was not an officer of JCS.⁵⁴ In addition, the driver's license provided in the JCS application/agreement was not for the person signing (Brown); it was Signore's (crossed-out) driver's license, another material inconsistency within the JCS application/agreement (see Exhibit D, which includes Signore's driver's license). As such, First Data violated its own policies in the most basic of ways in opening the JCS account at the start of the relationship in November 2010.

According to its policies regarding opening a new merchant account, First Data should run a credit report on the person signing the application to confirm, among other things, the person's date of birth, address, credit score, and place of employment. As stated above, copies of the relevant excerpted policies are attached as part of Composite Exhibit HH.⁵⁵ However, First Data did not run a credit report to confirm that Brown worked at JCS in 2010. Although First Data's underwriting representative testified that it was unnecessary to run a credit report to confirm employment, First Data nevertheless ran one on Brown in 2013 and it showed no employment at JCS. (S. DeAngelis Dep. Tr. 151:8 – 151:22; 152:5 – 153:10, excerpted copies of which are attached as part of Composite Exhibit AA). A copy of the April 2013 Brown credit report was

⁵³ The attached transcript is the copy that First Data filed in the pre-receivership state court case. First Data was the party asking questions in the attached transcript and therefore had due process regarding all questioning. Therefore, the attached transcript can be used and considered here. *See* Fed.R.Evid. 804(b)(1); *see also* Exhibit F, Sallah Dec. at ¶7.

⁵⁴ This document was marked Exhibit 123 at Ms. DeAngelis' deposition. First Data approved the JCS account, even though JCS was not authorized to do business in Florida at the time of opening the account. (*See* Exhibit KK (reflecting that JCS was not even approved to do business in the State of Florida as a foreign corporation until June 2011) (*See also* Exhibit F, Sallah Dec. at ¶4.)).

⁵⁵ These documents were marked as part of deposition Exhibit 38.

attached as Exhibit Q.⁵⁶ As it turned out, Brown met Signore – of all places – at a bar. (R. Brown Dep. Tr. 17:24 – 18:16, excerpted copies of which are attached as part of Composite Exhibit JJ)⁵⁷; (J. Sallah Dep. Tr. 97:16 – 98:4, excerpted copies of which are attached as part of Composite Exhibit L).

The fact that First Data violated its own policies should be a significant factor in considering the priority of First Data’s claim in this equity receivership proceeding; the violations are clear evidence of First Data’s own negligence of opening and supervising the JCS account. *See Rogers v. S. Star Logistics, Inc.*, 661 F. App’x 667, 673 (11th Cir. 2016) (“Defendants argue that the district judge erred in admitting evidence of South Star’s ‘following’ policy because the case did not involve a situation in which Defendants’ truck driver was arguably driving too close, meaning the policy was irrelevant. We find no abuse of discretion. The district court noted that there was evidence that would have supported a theory that the truck driver hit Plaintiff’s vehicle because the driver failed to keep enough distance between his vehicle and traffic ahead of him. In addition, Defendants had the opportunity to adduce evidence and argue that non-adherence to the above policy was irrelevant to the cause of the accident.”); *Prager v. FMS Bonds, Inc.*, 2010 WL 2950065, at *8 (S.D. Fla. July 26, 2010) (“Under Florida law, internal rules and procedures governing employees may be used as evidence to determine the correct standard of care in a negligence cause of action.”); *Saxon Mortgage Servs., Inc. v. Harrison*, 186 Md. App. 228, 290-91 (Md. Ct. Spec. App. 2009) (evidence of bank’s failure to follow internal guidelines was so basic that expert testimony was not required).

This is, after all, an equity receivership proceeding and the Court must ultimately decide if First Data, whose parent company is valued at \$22 billion based on its recent acquisition by Fiserv, is entitled to a massive claim in the receivership of approximately \$7.3 million at the expense of hundreds of investors for whom the SEC brought the underlying enforcement action. *See Elliott*, 953 F.2d at 1566, *rev’d in part on other grounds*, 998 F.2d 922 (11th Cir. 1993) (the Court’s power

⁵⁶ This document was marked as Exhibit 17 at Mr. Aufiero’s deposition.

⁵⁷ First Data was the party asking questions in the attached transcript and therefore had due process regarding all questioning. Therefore, the attached transcript can be used and considered here. *See Fed.R.Evid. 804(b)(1)*.

to supervise an equity receivership and determine the appropriate action to be taken in the administration of the receivership is extremely broad).

The Receiver submits that equity dictates that First Data's claim should be subordinated to defrauded investors.⁵⁸

K. Tenth Reason to subordinate – First Data's Own Sales Contractor, Merchant One, Knew about Material Issues at the Very Start

It is undisputed that Merchant One is First Data's own contracted sales organization and referred the JCS account to First Data

As discussed below, Merchant One was aware of material credit issues affecting the JCS account during the underwriting of the JCS account before First Data approved same. For example, Merchant One ran Signore's credit report for purposes of the JCS application/agreement and was aware that Signore had a very poor credit score on the report. A copy of the Signore (very poor) credit report run by Merchant One is attached as Exhibit LL.⁵⁹ Given Signore's low credit score, Merchant One ran Brown's credit report. Brown's credit score was better than Signore's, and Brown, not Signore, ultimately signed the JCS application/agreement. (A. Saka Dep. Tr. 248:4-7, excerpted copies of which are attached as part of Composite Exhibit J). And as discussed above in Section J, Brown was never a majority owner, nor an officer, of JCS.

Because this is an equity receivership, the Court should consider Merchant One's actions and inactions, as First Data's contracted sales organization, as one of the factors in ultimately subordinating First Data's claim.

⁵⁸ In its Claim Form and Objection, First Data relies on *FTC v. IAB Mktg. Assocs., LP*, No. 12-61830-CIV, 2013 U.S. Dist. LEXIS 136502 (S.D. Fla. Sept. 19, 2013) (Scola, J.) to support its position that equity requires that the Court at least place its claim alongside investors. A copy of the case is attached to First Data's Claim Form. In *IAB*, an FTC receiver recommended, and the Court found it equitable, to reimburse a bank \$6,500 in chargebacks. For numerous reasons, the limited facts in *IAB* are wholly distinguishable from the instant matter. Indeed, in *IAB*, the FTC receiver did not present the Court with more than a dozen reasons it should subordinate the bank's claim. If First Data relies on this case in its Response, the Receiver will further address its inapplicability in its Reply.

⁵⁹ This document was marked as part of deposition Exhibit 5.

L. Eleventh Reason to Subordinate – First Data Generated and Received Revenue Directly from the JCS Account and Did Not Disclose This Fact to the Receiver in Its Sworn Claim Form

First Data generated processing fees (*i.e.*, revenue) from the JCS merchant account, which were debited directly by First Data from the JCS merchant account. (M. Aufiero Dep. Tr. 40:17 – 41:6; 97:9-23; 110:3-21, excerpted copies of which are attached as part of Composite Exhibit B). First Data verbally stipulated through its counsel that the total amount of revenues/fees generated from JCS was approximately \$120,000 to \$130,000.⁶⁰ Therefore, the amount of revenues/fees should be considered with, and should ultimately offset, First Data's claim amount. However, First Data failed to include this information in questions #11, #12, #13, #27, #28, and #29 of its sworn Claim Form (see Exhibit A), which clearly requested that First Data confirm to the Receiver whether it made or received in any manner whatsoever any money from JCS. First Data's repeated failure to include this information in response to these unambiguous claim questions should alone be an automatic disqualifier of First Data's claim.

M. Twelfth Reason to Subordinate – Equitable Subrogation Does Not Apply

First Data contends that its claim should be approved under equitable subrogation. One of the required elements for equitable subrogation is that subrogation would not work an injustice on third parties. If the Court were to accept First Data's claim, there would be a massive injustice to the investors because they would get little to nothing back. In other words, if First Data had its way, it would receive \$7.3 million out of the approximately \$10 million currently in the Receivership Estate and then the approved investors would split the minimal remaining funds left.

In addition, equitable subrogation cannot be a remedy if the requester behaved inequitably. In other words, First Data must be innocent here. First Data behaved inequitably, as detailed above. First Data should be the one to bear its losses or try to recoup them from other potentially responsible third parties.

Further, equitable subrogation cannot be a remedy if the requester is an obligor or guarantor of the money at issue. *In re Flamingo 55, Inc.*, 378 B.R. 893, 914-15 (Bankr. D. Nev. 2007) (court denied subrogation to party liable on obligation). It is undisputed that First Data had direct legal obligations as an obligor or guarantor of unpaid chargebacks for the reasons in Section B.9, *supra*.

⁶⁰ Nothing in writing has been produced, despite First Data's repeated promises to do so since Mr. Aufiero's deposition more than six (6) weeks ago on August 22, 2019.

Therefore, First Data cannot step into the shoes of the investors who received chargebacks under a theory of equitable subrogation.

Finally, and as admitted by First Data in answering question #9 to its Claim Form (see Exhibit A), equitable subrogation cannot be a remedy if the requester such as First Data made the subject payments voluntarily. It is undisputed that First Data voluntarily chose to be in the credit card/bankcard processing industry and therefore voluntarily chose to abide by the Card Brand Rules that require First Data to pay chargebacks if the merchant fails to do so. (R. Tenenbaum Dep. Tr. 188:17 – 189:15, excerpted copies of which are attached as part of Composite Exhibit H). Therefore, First Data cannot step into the shoes of the investors who received chargebacks under a theory of equitable subrogation.

N. Thirteenth Reason to Subordinate – First Data’s Priority Argument Is Baseless

First Data is taking the position that it should be on par with all of the investor victims. As explained below, First Data’s priority argument is legally baseless because: 1) the agreement between JCS and First Data is a pre-receivership contract that the Receiver neither accepted nor ratified; 2) the Receiver offered from the outset to seek a stay from the Court to enjoin the issuance of chargebacks and First Data refused the offer; 3) the Receiver could not dispute chargebacks upon his appointment; and 4) caveat emptor does is inapplicable here.

1. The JCS/First Data Agreement Is a Pre-Receivership Contract

First Data is relying on its agreement with JCS for its claim. However, this agreement is like the thousands of investment contracts JCS entered into with investors - a pre-receivership contract to which the Receiver was not bound and which the Receiver did not assume or ratify. (J. Sallah Dep. Tr. 21-24, 41-42, 69, excerpted copies of which are attached as part of Composite Exhibit L).⁶¹ Case law is clear that a receiver is not bound to any pre-receivership contract unless he/she expressly assumes or ratifies it. *See Citibank, N.A. v. Nyland, (CF8) Ltd.*, 839 F.2d 93, 98 (2d Cir. 1987). In *Nyland*, the Second Circuit explained the policy rationale for not binding receivers to pre-receivership contracts that the receiver did not ratify or assume after the initiation of the receivership. In *Nyland*, the Second Circuit held:

Second, we believe that the **receiver’s fiduciary responsibilities to preserve the property during the course of the underlying litigation concerning the ownership of the property must be seen**

⁶¹ Indeed, under First Data’s logic, the investors who entered into investment contracts should receive all of the promised interest payments totaling more than \$240,000,000.

as superior to New York Land's contractual interest, if any, in the property. As receiver, Cushman & Wakefield is acting as an officer of the court and has the duty to preserve and protect the property pending the outcome of the litigation. **As a result, its authority is wholly determined by the order of the appointing court. . . . [R]eceivers are not bound by contracts of the entity that they are appointed to protect.** A receiver becomes bound only when it affirmatively adopts the obligations of the entity that it is protecting. . . . [W]e find that New York Land's management and leasing services contract is subordinate to Cushman & Wakefield's obligation to preserve the premises.

Id. at 98 (emphasis added; citations omitted). Similarly, in *FTC v. Productive Marketing, Inc.*, 136 F. Supp. 2d 1096 (C.D. Cal. 2001), although the nonparty agreed that the subject funds were receivership property, the nonparty still refused to relinquish assets located in reserve accounts, relying instead on a pre-receivership contract that required a hold-back of the reserves for a minimum amount of time. *Id.* at 1106. The District Court, however, found that the nonparty's reliance on the contract was misplaced, because its refusal to turn over the funds disrupted the District Court's power to enforce its receivership injunction:

If the court cannot compel [nonparty] ACCPC to turn over assets in its possession belonging to the receivership estate, the Receiver will be unable to provide adequate redress to consumers who have been defrauded by Defendants. Because ACCPC's conduct imperils the court's ability to render an effective judgment, the court may properly enjoin it, even though it is not a party to the action.

Id.

The Receiver does not accept, and has never accepted, the pre-receivership JCS/First Data merchant agreement, and the Receiver does not ratify/assume and has never ratified/assumed it. Therefore, the Receiver is not bound to honor it regarding chargebacks.

2. Shortly after the Receivership Began, the Receiver Offered to File a Motion to Stay or Enjoin the Issuance of Chargebacks, But First Data Refused the Receiver's Offer

Shortly after the receivership began, First Data contacted the Receiver. First Data's concern involved ways to limit, reduce, or completely eliminate its exposure resulting from the chargebacks from the JCS account. The Receiver offered to file a motion to stay or enjoin the chargebacks. First Data refused the Receiver's offer because, according to First Data, such a motion would violate the Card Brand Rules. (J. Sallah Dep. Tr. 38-39, 42-46, 48, 51-52, 148-49, excerpted copies of which are attached as part of Composite Exhibit L).

3. There Was No Way for the Receiver to Dispute Chargebacks upon His Appointment

First Data contends that the Receiver failed to dispute chargebacks post-receivership and should have done so. Notwithstanding the above arguments, which show the Receiver was not obligated to do anything with the chargebacks, there was no way for the Receiver to dispute chargebacks. Assuming the Receiver even wanted or chose to dispute chargebacks, he would not have been in a position to do so at the time they were submitted because he would have needed to complete a full forensic reconstruction to properly evaluate and properly dispute the chargebacks. Such reconstruction involving dozens and dozens of accounts took years to complete. (J. Sallah Dep. Tr. 40, 144, excerpted copies of which are attached as part of Composite Exhibit L).

4. Caveat Emptor Does Not Apply

First Data believes that the investors should not receive any priority treatment because they were speculator investors seeking large investment returns. However, caveat emptor does not apply to securities transactions and therefore the investors should not be penalized for investing in the JCS Ponzi scheme and seeking purported large investment returns. *SEC v. Zandford*, 535 U.S. 813, 819 (2002).

CONCLUSION

The Receiver respectfully requests that the Court grant this Motion and accept the Receiver's recommended treatment to fully subordinate First Data's claim. A proposed Order is attached as Exhibit NN.

LOCAL RULE 7.1(a)(3) CERTIFICATE

The undersigned has conferred with:

- 1) Anthony Natale, Esq., counsel for Paul L. Schumack, II, who without admitting or denying any of the allegations in this Motion or any findings in the proposed Order, has not provided his position as of this filing;
- 2) Andrew Schiff, Esq., counsel for the U.S. Securities and Exchange Commission, which reserves its right to file something after reviewing this Motion and its Exhibits;
- 3) Assistant United States Attorney Ellen Cohen, counsel for the United States of America, has not provided her position as of this filing; and
- 4) James N. Robinson, Esq., counsel for First Data, which opposes this Motion.

The Receiver has also conferred with Non-Party Christine Schumack, who has no objection to this Motion. In addition, the undersigned has been unable to confer with Defendant Joseph Signore and Non-Party Laura Grande, who are both incarcerated.

Dated: October 15, 2019

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on October 15, 2019, I electronically filed the foregoing document with the Clerk of the Court using CM/ECF. I also certify that the foregoing document is being served this day on all counsel of record or *pro se* parties and non-parties who may have an interest in the Motion identified on the attached Service List in the manner specified, either via transmission of Notices of Electronic Filing generated by CM/ECF or in some other authorized manner for those counsel or parties or non-parties who are not authorized to receive electronically Notices of Electronic Filing.

/s/ Jeffrey L. Cox

Jeffrey L. Cox

SERVICE LIST

Securities and Exchange Commission v. JCS Enterprises, Inc. et al.
Case No. 14-80468-CIV-MIDDLEBROOKS

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