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

17 Federal Trade Commission,
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19 Plaintiff,
20 v.

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

} Case No. SACV09-800 DOC(ANx)
} **PLAINTIFF FTC'S OPPOSITION TO**
} **CLAIMANT TK GLOBAL PARTNERS,**
} **LP'S MOTION FOR DECLARATORY**
} **RELIEF, LEAVE TO INTERVENE,**
} **LEAVE TO SUE DEFENDANT LMS,**
} **AND LEAVE TO SUE DEFENDANT**
} **DEAN SHAFER**
} Judge: Hon. David O. Carter
} DATE: December 7, 2009
} TIME: 8:30 a.m.
} COURTROOM: 9 D

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INTRODUCTION

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

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

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

SUMMARY OF THE RELEVANT CONTRACTS

TK Global's Motion for Declaratory Relief, Leave to Intervene, Leave to Sue Defendant LMS, and Leave to Sue Defendant Dean Shafer [Docket Item #51]

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

3 After the Court entered the LMS Order on August 18, 2009, TK Global
4 apparently sought to obtain what rights CM had in the reserve account by procur[ing] [gO6]

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

4 Given that LMS was entitled to “apply debits to the account to sweep the
5 balance of the account and transfer funds to an account they hold at an outside
6 financial institution,” Ex. 1 (Redding), Att. A at 4, it is evident that LMS had, at a
7 minimum, some legal or equitable interest in, right to or claim to the account.
8 Moreover, LMS’s status as “pledgor” on the account, Att. B at 6, reserved to
9 LMS certain property rights. See, e.g., *U.S. v. Kendrick*, 692 F.2d 1262, 1265 (9th
10 Cir. 1982) (“pledges transfer less than ~~sole~~ title” and instead transfer only “an
11 ‘interest in a security’”) (quoting *Rubin v. United States*, 449 U.S. 424, 429 (1981));
12 see also *Blair Holdings Corp. v. Bay City Bank & Trust Co.*

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

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

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

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

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

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

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

19 TK Global also fails to show that it is entitled – or should be granted leave in
20 the Court’s discretion – to intervene in this case and seek a declaratory ruling that it
21 is entitled to the funds in the reserve account. TK Global nevertheless asks for
22 permission to do just that if the Court finds the reserve account to be within the
23 receivership. See *Mot. for Decl. Relief, Etc.* [Docket Item #51] at 5. In making this
24 request, TK Global “ignore[s] the letter and spirit of this court’s Order by attempting
25 to leverage its claims by intervening solely to gain payment beyond its pro-rata share,

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¹ Even accepting its proffered standard, TK Global might face significant challenges in recovering on its breach of contract and assignment claims. For example, TK Global will have to overcome the fact that its contract claims depend entirely on asserting MCB's rights pursuant to an assignment agreement that was

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

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

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

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

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

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

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

3 LMS PI Order § IX(A) (emphasis added). Although the FTC served a copy of the
4 Order on MCB on August 19, 2009, see Ex. 2 (Murphy), Att. A at 12-45, on October
5 2, 2009, MCB purported to assign for collection to TK Global the Bank’s “right,
6 title, and interest in and to any and all claims that Bank has or may have against
7 LOSS MITIGATION SERVICES, INC. (“LMS”) for fees, chargebacks, and any
8 other amounts due to Bank . . . pursuant to that Merchant Agreement dated July 7,
9 2009 between bank and LMS. See Assignment Agreement. This assignment of
10 claims violates the plain language of the LMS PI Order and is therefore invalid.
11 In re Carpiq, 213 B.R. 744, 748 (W.D. Mo. 1997) (agreement made in violation of a
12 court’s order is void ab initio³). TK Global thus has no standing to assert a contract
13 claim pursuant to the Merchant Processing Agreement and cannot show that it has
14 sufficient interest to satisfy the first part of the test under Rule 24(a)(2).

15 “The kind of ‘interest’ contemplated by Rule 24(a)(2) refers not to any interest
16 the applicant can put forward, but only a legally protectable one. FTC v. First
17 Capital Consumer M’ship Servs., 19206 F.R.D. at 362 (internal quotations
18 omitted). To be sufficient, the interest must be “significantly protectable, direct, and
19 immediate, as opposed to one which is remote or contingent.” TK Global has no
20 direct contractual relationship with any defendant in this case; its asserted claims are
21 once-removed, based entirely on the invalid Assignment Agreement between TK
22 Global and MCB. Such derivative claims are not sufficient to give rise to an interest
23 under Rule 24(a)(2). Accordingly, TK Global cannot intervene as of right.

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

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

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

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

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

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

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

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1 Ex. C (Pisano), Att. B at 56. In response, Defendant Shafer acknowledged that he
2 was not complying with the requirements referenced in Mr. Dunn's email. He
3 asserted instead that LMS was on a "to be compliance" in which "[m]y attorneys
4 are aggressively trying to become FULLY compliant"; and "[m]y attorneys
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17 ⁴ Email correspondence between Mr. Shafer and Mr. Dunn and his
18 colleagues suggest that TK Global operates business with LMS interchangeably
19 through "Meritus Payment Solutions" and "Primus Payment Solutions." In
20 correspondence, Mr. Dunn listed his title as Director of Risk Management,
21 alternately, for Primus Payment Solutions and Meritus Payment Solutions.
22 Ex. C (Pisano), Att. B at 56 (Primus), Att. E at 80 (Meritus). Emails also reflect
23 that Mr. Dunn maintained email accounts with addresses at both
24 merituspayment.com and primuspayment.com. See id., Att. B at 56
25 (primuspayment.com), Att. E at 80 (merituspayment.com). Additionally, in
26 emails sent from Mr. Dunn's primuspayment.com account he addressed issues
27 related to LMS's reserve accounts. See id., Att. B at 55-56, and in emails sent from
28 his merituspayment account, he addressed similar issues, copying his colleagues on
their accounts at primuspayment.com. See id., Att. E at 80.

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

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

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

14 Even if TK Global could show that it had a valid interest, it could not
15 demonstrate that its purported interest would be impaired by the disposition of this
16 matter absent intervention, or that its interest

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

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

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

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

23 As the parties advised the Court in their Joint Report and Discovery Plan
24 Pursuant to Federal Rule of Civil

1 they are the source of additional questions, objections, briefs, arguments, motions
2 and the like.” FTC v. First Capital Consumer M’ship Servs., 1208 F.R.D. at 366
3 (internal quotation omitted). This is yet another reason why “[i]ntervention can
4 impose substantial costs on the parties and the judiciary.” FTC v. Med Resorts
5 Intern., Inc, 199 F.R.D. 601, 607 (N.D. Ill. 2001) (citing Solid Waste Agency of N.
6 Cook County v. U.S. Army Corps of Eng’rs, 101 F.3d 503, 507-08 (7th Cir. 1996).
7 Accordingly, permissive intervention is not warranted.

8 III. TK GLOBAL SHOULD NOT BE GRANTED RELIEF FROM THE
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1 Through its request for leave to sue LMS and Dean Shafer, TK Global asks the
2 Court to permit it to initiate an action asserting purported legal claims to the same
3 property that is at issue in this proceeding. Although TK Global does not specify the
4 forum in which it proposes to file such actions, it is likely that they would have to be
5 filed in state court, given that TK Global does not appear to have diversity of
6 citizenship with any of the defendants, or any other basis to proceed in federal court.
7 Such actions would require a state court impermissibly to assert jurisdiction over
8 property already under the jurisdiction of this Court. These kinds of duplicative
9 proceedings long have been disfavored by courts. See, e.g., Penn Gen. Casualty Co.
10 v. Pennsylvania, 294 U.S. at 195 (“[t]o avoid unseemly and disastrous conflicts in
11 the administration of our dual judicial system, and to protect the judicial processes of
12 the court first assuming jurisdiction, the propriety of 557.58-6., s4 Tw i.4 Tts.

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

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1 CONCLUSION

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

4 Dated: November 20, 2009

Respectfully submitted,

5 Willard K. Tom
6 General Counsel

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27 Attorneys for Plaintiff FTC
28

CERTIFICATE OF SERVICE

I, Mark Glassman, certify as follows:

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

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

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Defendant Pro Se

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

Dated: November 20, 2009

/s/ Mark L. Glassman
Mark L. Glassman