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**UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA**

FEDERAL TRADE COMMISSION,	2:05-cv-0440-LDG-LRL
Plaintiff,	
v.	<u>ORDER</u>
NETWORK SERVICES DEPOT, et al.,	
Defendants.	

The court has reviewed the parties’ supplemental briefs on whether and to what extent funds transferred by Charles Castro to defense counsel should be subject to consumer redress, and finds that a portion of these funds are recoverable under the theory of constructive trust. In its order denying defendants’ motion for summary judgment and granting the FTC’s, this court held that Castro and NSD violated the Federal Trade Commissions Act, and the Franchise Rule. The court held that the corporate defendants are liable for restitution, and that Castro is personally liable for such. Finally, the court ruled that the corporate defendants form a common enterprise.

Defendants argue that their counsel properly exercised its duty of inquiry and had no knowledge of tainted funds. However, despite defense counsel’s position that its evaluation of its clients’ business indicated that it was viable, and in compliance with applicable regulations, defense counsel does not dispute that they negotiated their fee arrangement after the FTC staff sent defendants a complaint naming the corporate defendants and a letter stating that the Bureau of Consumer Protection had determined that there was reason to believe defendants had violated the Act and the Franchise Rule. Moreover, defense counsel apparently did not even consult defendants’

1 initial counsel, Peter Spivack, or reviewed the documents that Spivack had exchanged with the
2 FTC during the course of the FTC investigation. Nor have defendants rebutted that counsel knew
3 that the funds were transferred from accounts that were the very subject of the FTC settlement
4 negotiations. Under these circumstances, the court cannot accept that defense counsel's fee
5 arrangements were made in good faith.

6 The court is also convinced that the funds in question are traceable to defendants' wrongful
7 conduct. The FTC's expert analyzed the relevant bank records and determined that virtually all of
8 the funds can be traced directly to the corporate defendants, which comprise a single economic
9 unity under the common enterprise theory, or to the internet kiosk scheme, of which NSM played a
10 pivotal role in advancing. Defendants have not established that that determination is flawed. For
11 these and the other reasons cited by the FTC, the court finds that the FTC has established by clear
12 and convincing evidence that the fee funds derive from corporate defendants' proceeds, that
13 defendants' acquisition of the funds was wrongful, and that the FTC is entitled to the proceeds for
14 consumer redress.

15 Based on the above determination, the court need not address at this time whether the
16 transfer was fraudulent or violated the asset freeze. The court, however, is mindful that there has
17 been some question regarding whether counsel for defendants would be entitled to payment of
18 their reasonable and documented fees from frozen assets. As the court ruled in its order of March
19 24, 2006, that determination was dependent on the portion of the Castro defendants' assets that
20 was not connected to the fraud. Moreover, in that order, the court specifically ruled that the transfer
21 of funds to counsel may be set aside for consumer redress, and that defense counsel should have
22 factored that possibility into its fee arrangement. At that point, defense counsel was on clear
23 notice that, subject to the disposition of the merits, counsel may not be entitled to compensation
24 under its fee arrangement. The court finds that, at least from that point onward, defense counsel
25 should have sought attorneys fees from the court before relying on payment from the transferred
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1 funds. Accordingly, the court will, as an equitable matter, permit payment of defense counsel's
2 reasonable and documented attorneys fees on matters directly related to this specific litigation up
3 to March 24, 2006. The court will, therefore, grant the FTC's motion to set aside transfer of
4 retainer funds to that extent and order defendants to file a documented request for fees based on
5 that calculation, with an opportunity for the FTC to respond.

6 THE COURT HEREBY ORDERS that the FTC's motion to set aside transfer of retainer
7 funds (#153) is GRANTED as set forth above.

8 THE COURT FURTHER ORDERS that within 30 days from the filing of this order
9 defendants shall file a documented request for fees in accordance with this ruling, and that the FTC
10 may file a response within 15 days thereafter. Upon disposition of that request, the court will
11 order the FTC to file a proposed final judgment on the summary judgment motions.


12 THE COURT FURTHER ORDERS that the motion to strike (#170) is denied as moot.

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14 DATED this 17 day of September, 2007.

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Lloyd D. George
United States District Judge

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