UNITED STATES DISTRICT COURT

DISTRICT OF NEVADA

FEDERAL TRADE COMMISSION,	2:05-cv-0440-LDG-LRL
Plaintiff,	
v.	
	ORDER
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. Morever, 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. Morever, 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

26

funds. Accordingly, the court will, as an equitable matter, permit payment of defense counsel's

reasonable and documented attorneys fees on matters directly related to this specific litigation up

to March 24, 2006. The court will, therefore, grant the FTC's motion to set aside transfer of

retainer funds to that extent and order def