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UNITED STATES DISTRICT COURT
DISTRICT OF OREGON

FEDERAL TRADE COMMISSION,

Case No. CV 07-0533 BR

Plaintiff,

v.

PRELIMINARY REPORT OF RECEIVER
MICHAEL A. GRASSMUECK

MERCHANT PROCESSING, INC.;
VEQUITY FINANCIAL GROUP, INC.;
DIRECT MERCHANT PROCESSING,
INC.; and AARON LEE RIAN,

I. INTRODUCTION

The Federal Trade Commission (the “Commission”) filed this action against Merchant Processing, Inc. (“MPI”), Vequity Financial Group, Inc. (“Vequity”), Direct Merchant Processing, Inc. (“DMP”) and Aaron Lee Rian (“Rian”) (collectively, the “Defendants”). In the Complaint, the FTC made the various allegations, summarized below, against the Defendants and requested the appointment of a receiver to take over the business of MPI, Vequity and DMP and their affiliates and subsidiaries, as well as any other corporations or businesses under the control of any of them (the “Receivership Defendants”) during the pendency of the action to: (a) avert the likelihood of consumer injury; and (b) to preserve the possibility of effective final relief.

1 The Court appointed Michael A. Grassmueck as the temporary receiver for the
2 Receivership Defendants, to serve as the agent of the Court as an equity receiver. Ultimately, as
3 described below in Section II, the parties entered into a stipulated order appointing the Receiver
4 as a permanent receiver in this case.
5

6 The Receivership Defendants are in the business of offering for sale and selling credit
7 and debit card merchant account services and offering for lease related goods and services. MPI
8 is an Independent Sales Organization (“ISO”) in the credit and debit card processing industry.
9 ISOs act as liaisons between small business merchants who want to accept credit and debit card
10 payments and financial institutions that are members of card associations such as MasterCard
11 and Visa. ISOs solicit merchants to establish accounts (“Merchant Accounts”) with a financial
12 institution (the “Acquiring Bank”) for the purpose of depositing the proceeds of merchants’ card
13 sales. For this service, merchants pay processing fees, including a “discount rate” that is a
14 percentage of each sale that they make.
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17 The Commission generally alleges in its Complaint that: (a) to obtain Merchant
18 Accounts, the Receivership Defendants’ sales agents promise that the merchants will enjoy
19 substantial savings from the fees they pay their current processors, which merchants allegedly do
20 not ultimately enjoy (Complaint, ¶15); (b) that the Receivership Defendants offer for lease credit
21 card processing terminals with the representation that they will pay off the balances of the
22 merchants’ existing leases, which they allegedly do not pay off; and (c) that the Receivership
23 Defendants allegedly do not leave copies of the processing agreements with the merchants and
24 do not show the merchants the last four pages of the agreements, which contains fine print
25 disclosures regarding various fees charged (Complaint, ¶18).
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1 The Commission alleges that, as a result that the Defendants: (a) are committing unfair
2 or deceptive acts or practices in or affecting commerce in violation of federal law; (b) are
3 misrepresenting or omitting material facts in violation of federal law; and (c) are committing acts
4 that are unfair if it causes or is likely to cause substantial injury to consumers themselves and not
5 outweighed by countervailing benefits to consumers or to competition. (Complaint ¶25). In this
6 case, the Commission requests that the Court enter a permanent injunction to prevent future
7 violations of the FTC Act by Defendants, and that ill-gotten moneys be disgorged, refunds be
8 paid and contracts cancelled.
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11 It is not the receiver's duty to pursue the Commission's claims on the Commission's
12 behalf. Rather, generally speaking, it is the receiver's duty to take actions to prohibit the
13 Receivership Defendants from engaging in any conduct that the Commission alleges has taken
14 place in violation of federal law and to preserve the value of the assets for the receivership estate.
15

16 **II. EXECUTIVE SUMMARY**

17 As explained above, MPI is an ISO that sells credit card processing services to
18 businesses. MPI sells the credit card processing services of Global Payments ("Global") who
19 actually processes the card transactions and in whose name all of the contracts with merchants
20 are entered. MPI assumes the majority of the risk of fraud in the credit card transactions of its
21 merchants through its contractual agreement with Global and because of this, MPI obtains a
22 more favorable rate from Global and can offer a more favorable rate to its customers than an ISO
23 who does not qualify for a similar arrangement. Global holds a perfected security interest in the
24 assets of MPI to secure any funds lost through fraud. MPI maintains a risk department that
25 continuously reviews transactions to detect fraud and minimize losses to MPI.
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1 MPI also leases credit card “swipe” terminals to its customers and normally funds the
2 leases with a leasing company who then bills the customer for the lease payments. Historically,
3 funds from this activity were used to pay sales commissions to the company’s sales persons.
4

5 There is a strong and steady attrition rate in the customer base in this industry regardless
6 of the level of customer service. This attrition forces companies to maintain sales efforts to stay
7 to maintain or build on its account base.

8 **III. PROCEDURAL BACKGROUND**

9 On April 11, 2007, on application of the Federal Trade Commission (the “Commission”),
10 the Court issued its Temporary Restraining Order With Asset Freeze, Appointment of
11 Temporary Receiver, Immediate Access to Business Premises and an Order to Show Cause Why
12 a Preliminary Injunction Should Not Issue (the “Order”) on all assets of MPI, Vequity, DMP and
13 Rian.
14

15 On April 30, 2007, the Court issued its Stipulated Preliminary Injunction and Order For
16 Other Equitable Relief (the “Stipulated Order”). Pursuant to this Stipulated Order, Michael A.
17 Grassmueck was appointed the Permanent Receiver (the “Receiver”). Among the specific tasks
18 of the Receiver are as follows:
19

- 20 ▪ Assume full control of the Receivership Defendants;
- 21 ▪ Take exclusive custody, control, and possession of all assets and documents of,
22 or in the possession, custody or under the control of the Receivership
23 Defendants, wherever situated.
- 24 ▪ Take all corporate actions necessary to operate the business in the normal course;
- 25 ▪ Divert mail and sue for, collect, receive, take in possession, hold, and manage all
26 assets and documents of the Receivership Defendants and other persons or
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1 entities whose interests are now held by or under the direction, possession,
2 custody, or control of the Receivership Defendants;

- 3
4 ■ Take all steps necessary to secure the business premises of the Receivership
5 Defendants.
- 6
7 ■ Investigate, conserve, hold, and manage all receivership assets, and perform all
8 acts necessary or advisable to preserve the value of those assets in an effort to
9 prevent any irreparable loss, damage or injury to consumers or to creditors of the
10 Receivership Defendants;
- 11
12 ■ Enter into contracts and purchase insurance for the Receivership Defendants as
13 advisable or necessary.
- 14
15 ■ Prevent the inequitable distribution of assets and determine, adjust, and protect
16 the interest of consumers and creditors who have transacted business with the
17 Receivership Defendants.
- 18
19 ■ Manage and administer the business of Receivership Defendants until further
20 order of this Court;
- 21
22 ■ Chose, engage, and employ attorneys, accountants, appraisers, and other
23 independent contractors and technical specialists;
- 24
25 ■ Make payments and distributions from the receivership estate that are necessary
26 or advisable for carrying out the directions of, or exercising the authority granted
27 by, the Order.
- 28
■ Determine and implement the manner in which the Receivership Defendants will
comply with, and prevent violations of, the Order and all other applicable laws;

- 1 ▪ Institute, compromise, adjust, defend, appear in, intervene in, or become a party
2 to such actions or proceedings in state, federal or foreign courts that the Receiver
3 deems necessary and advisable to preserve or recover the assets of the
4 Receivership Defendants or that the Receiver deems necessary and advisable to
5 carry out the Receiver's mandate under the Order;
- 7 ▪ Defend, compromise, adjust or otherwise dispose of any or all actions or
8 proceedings instituted in the past or in the future against the Receiver in his role
9 as receiver, or against the Receivership Defendants;
- 11 ▪ Continue and conduct the business of the Receivership Defendants in such
12 manner, to such extent, and for such duration as the Receiver may in good faith
13 deem to be necessary and advisable to operate the business profitability and
14 lawfully;
- 16 ▪ Conduct investigations and issue subpoenas to obtain documents and records
17 pertaining to or in aid of the receivership, and conduct discovery in this action
18 on behalf of the receivership estate.
- 19 ▪ Open one or more bank accounts at a bank designated by the Receiver and
20 consented to by the FTC as a depository for funds of the Receivership
21 Defendants.
- 23 ▪ Maintain accurate records of all receipts and expenditures that he makes as
24 Receiver.
- 25 ▪ Cooperate with all reasonable requests for information or assistance from any
26 state or federal law enforcement agency.

1 **IV. OVERVIEW OF RECEIVER'S ACTIVITIES TO DATE**

2 **A. Security**

3
4 Immediately upon the Receiver's appointment in this matter, the Receiver took
5 possession of Receivership Defendant's premises, including, but not limited to the corporate
6 headquarters located at 1600 NW Compton Drive, Beaverton, Oregon 97006. The locks and
7 electronic key card access at the facility were changed within hours of the Receiver's
8 appointment and the new keys are controlled by the Receiver.

9
10 For the purpose of safeguarding computer memory devices, the Receiver's staff, along
11 with a team of forensic computer consultants, secured all computers and took steps to prevent the
12 computers from being accessed from outside the Receivership Defendants' offices.

13 **B. Staffing**

14
15 On the appointment date, the Receiver and his team initiated a review of the staff
16 positions and the current organization of the company. At the time that the Receiver took over,
17 there were approximately 63 employees working at the corporate headquarters. These
18 employees worked in the following departments: accounting, risk management, deployment,
19 customer service, inside sales and appointment setters. All employees were immediately
20 interviewed and then sent home pending the Receiver's decision on the direction of the
21 company.

22
23 Once the Receiver determined that the Receivership Defendants' had a viable business,
24 the Receiver began bringing employees back to work and hiring new employees. The first
25 department that was brought back on line full-time was customer service, which was restarted on
26 April 15, 2007. Shortly thereafter, the risk management, deployment and accounting
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1 departments were brought back in order to protect the assets of the receivership estate. These
2 employees were brought back a few days after the customer service employees.

3
4 The Receiver hired a new CEO, Jim Keller, to take over the day-to-day operations of the
5 Receivership Defendants' on May 6, 2007. Since Jim Keller has taken over operations, he has
6 brought back the appointment setters and outside sales staff.

7 **C. Professionals Employed by Receiver**

8 The Receiver has engaged the following qualified professionals to assist him and his staff
9 in furtherance of his receivership duties:
10

11 **Farleigh Witt** was employed as general counsel for the Receiver. Since the appointment
12 date, Farleigh Witt has assisted with (i) appearances and representations of the Receiver in all
13 hearings; (ii) representing the estate's interests; (iii) interviewing interested parties; (iv) working
14 extensively with the Commission and the State of Washington to coordinate the activities of the
15 Receiver with those of the various law enforcement agencies; (v) providing general advice to the
16 Receiver regarding his rights, powers and duties under the Court's Orders and general equity
17 receivership law; (vi) providing employment law advice to the Receiver in his operation of the
18 Receivership Defendants' businesses; (vii) investigating potential claims and causes of action
19 held by the Receivership Defendants; (viii) assisting the Receiver in preparation of this report;
20 (ix) assisting other professionals in connection with this matter; (x) assisting with contract
21 review, lease and real estate issues; and (xi) assisting with the enforcement of obligations owed
22 to some of the Receivership Defendants by third parties.
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25 **Buchalter Nemer** was employed as special receivership counsel based on its experience
26 as counsel in other receivership cases. Since the appointment date, Buchalter Nemer has assisted
27 the Receiver in fulfilling his duties under the Order, including but not limited to: (i) representing
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1 the estate's interests; (ii) negotiating with credit card processors on the estate's behalf; advising
2 the Receiver and general counsel regarding Commission receivership issues in the case; and (iii)
3 assisting other professionals in connection with this matter.
4

5 **Financial Forensics** was employed as forensic accountants and financial consultants to
6 the Receiver. Since the appointment date, assistance has included: (i) communications with
7 financial institutions to secure pertinent accounts; (ii) review and analysis of the Receivership
8 Defendants' physical and electronic records; (iii) interviews of employees and third parties
9 possessing data pertinent to operations of the receivership entities; (iv) massive reconstruction
10 and correction of financial records; (v) forensic analysis of Defendants' financial activities; (vi)
11 transaction and asset tracing; (vii) analysis of Receivership Defendants' financial position and
12 results; (viii) preparation of information for Receiver's report; (ix) assistance with reorganization
13 of accounting department and related functions for future operations; and (x) other accounting
14 and financial support to the Receiver and his counsel.
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17 **Moss Adams** was employed as accountants to the Receiver. Since the appointment date,
18 assistance has included: (i) assistance in analyzing and beginning preparation of necessary tax
19 returns; (ii) advice on various tax matters; and (iii) other accounting support to the Receiver and
20 his counsel.
21

22 **Jim Keller** was employed as CEO of the Receivership Defendant, MPI, by the Receiver.
23 Since the appointment date, assistance has included: (i) analyzing and implementing the proper
24 course of actions to take regarding operation of the business, including employment and contract
25 matters; (ii) preparing new contracts for merchants and implementing the use of such contracts
26 by MPI; (iii) analyzing and implementing all operational protocol and procedures for MPI's
27 continued operations; (iv) communicating with the Commission and Defendant's counsel
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1 regarding the business operations; (v) assisting the Receiver in preparation of this Report; and
2 (vi) assisting other professionals in connection with this matter.

3 **Creative Computer Solutions, Inc.** (“CCSI”) was employed as computer consultants.
4 CCSI’s task focused on assisting the Receiver in controlling and editing the Receivership
5 Defendants’ websites.

6 **Mary Dees Griffith** was employed to provide industry expertise and to assist the
7 Receiver in his search for a capable replacement as CEO of Merchant Processing, Inc.

8 **The Strawhecker Group** was employed to help the Receiver evaluate the current
9 business plan of Merchant Processing and to review the sales program and train employees. In
10 addition, the Strawhecker Group provided insight and training in the areas of: (i) customer
11 service; (ii) risk management; and (iii) underwriting.

12 **Bernstein Crisis Management** was employed by the Receiver to assist in the
13 dissemination of information related to the actions filed by the Commission against the
14 Receivership Defendants and about the changes that the Receiver was putting in place.

15 **D. Initial Investigation and Assets Identification**

16 The Receiver, with the assistance of his team of professionals, has taken possession and
17 control of known assets of the Receivership Defendants; investigated and analyzed the
18 operations of the Receivership Defendants; analyzed and evaluated the assets held by
19 Receivership Defendants; and commenced investigation into value of claims against third
20 parties.

21 The Receiver has taken physical custody and control of all known personal property,
22 assets and records other than certain files in the possession of Receiver’s attorney’s and
23 accountants. The Receiver has also downloaded the Receivership Defendants’ computer systems

1 and records and has made a mirror image of these systems. The Receiver has contacted banks
2 and other financial institutions holding funds on behalf of the Receivership Defendants and has
3 either froze such accounts or obtained turnover of those funds. The Receiver has contacted the
4 United State Postal Service to ensure that the Receiver has exclusive control over the mail for all
5 Receivership Defendants.
6

7 The assets of the Receivership Defendants have been identified based on the Receiver
8 and his team's inspection of company facilities, review of company records and interviews with
9 current and former employees. The Receiver details these assets and the steps taken to secure
10 their possession below.
11

12 It should be noted that certain equipment, vehicles and real property in the Receiver's
13 possession are encumbered by the liens of third parties. The Receiver is reviewing these assets
14 to determine whether the receivership estate has any equity interest in these assets.
15

16 **E. Asset Recovery and Preservation**

17 In accordance with the Order, the Receiver moved quickly to marshal and secure the
18 Receivership Defendants' assets. This includes an array of business equipment, computers,
19 furniture, fixtures, artwork and automobiles. In addition, the Receiver, with the assistance of his
20 team and the Commission, has located and secured real property owned by Receivership
21 Defendants.
22

23 Based on research by the Receiver and his team, the Receiver took possession of a 2006
24 Lamborghini and a 2007 BMW. The Receiver contacted the seller of the Lamborghini and
25 determined that the car was purchased one week prior to the Receiver being appointed and the
26 Receiver successfully negotiated rescission resulting in recovery of almost \$160,000 for the
27 receivership estate. The Receiver has also taken possession of the 2007 BMW and is
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1 investigating the best course of action given the existence of a large third-party lien still
2 remaining.

3 The Receiver has taken possession and control of certain real property owned by
4 Receivership Defendants. Furthermore, the Receiver is investigating other real properties and
5 assets that may have been purchased with assets of the Receivership Defendants.
6

7 **F. Existing Litigation**

8 One of the Receivership Defendants is a defendant in a lawsuit relating to the sale of real
9 property at the former corporate headquarters located on Tualatin Valley Highway. The
10 Receiver has notified the Plaintiff of the Order and stay and is currently exploring alternatives to
11 seek resolution to this litigation.
12

13 **G. Claims Against Third Parties**

14 The Receiver has commenced an investigation into potential claims against third parties.
15 The Receiver believes that the best interest of the receivership estate will be served through a
16 coordinated and controlled approach to litigation. The Receiver has not yet commenced any
17 litigation in connection with these matters.
18

19 **H. REDACTED**

20 21 **V. REDACTED**

22 23 **VI. EFFORTS BY RECEIVER TO ALTER BUSINESS PRACTICES**

24 25 **A. Initial Changes**

26 On the date of appointment, the Receiver immediately began implementing changes to
27 the business practices of the Receivership Defendants. The first step the Receiver took was to
28 remove all employees from the premises and then evaluate the employees. Those employees

1 believed to be a part of the practices alleged by the Commission were terminated. The Receiver
2 then began bringing back current employees and hire new ones and training them to ensure
3 compliance with the Order and all laws.
4

5 **B. Continued Changes**

6
7 As part of the plan to alter business practices, the Receiver determined that it was prudent
8 to halt all sales to new customers until the sales process could be reviewed. To help ensure
9 compliance with the Order, all laws, and to meet the demands of the parties on the Receivership
10 Defendants, the Receiver and his team hired the Strawhecker Group as consultants to train
11 employees in specific key areas and draft a new contract. The contract was redrafted to ensure
12 clarity in the terms between the merchant and the processor in order to eliminate many of the
13 issues that led to this action by the Commission. A copy of the contract was submitted to all
14 parties for review.
15

16 After the contract was redrafted, the Receiver and his team made the determination to
17 bring the sales force back. In order to effectuate this, the Strawhecker group was brought in to
18 train employees and review sales materials. Copies of the contract and scripts have been
19 submitted to the parties for their review.
20

21 **C. Customer Service**

22
23 Throughout the process of making changes to the business practices, customer service
24 was always the foremost one priority of the Receiver. As part of customer service, the Receiver
25 recognized the importance of ensuring that no harm was done to current and former customers
26 and the Receiver wanted to also begin addressing many of the issues that were previously
27 unresolved. In order to do so, the Receiver determined those issues that relate to receivership
28

1 claims and those issues that are part of the ongoing contractual relationship between the
2 Receivership Defendants and current merchants.

3 As part of the Receiver's commitment to resolving issues with current merchants, the
4 Receiver has begun addressing them on a case-by-case basis. One of the largest unresolved
5 issues involves lease buyouts that were promised but never fulfilled. The Receiver is evaluating
6 these claims and has paid approximately 80 lease buyouts to date, with additional pending. The
7 Receiver has also identified a number of customers no longer processing transactions with MPI
8 but who are still being charged a minimum monthly fee. The Receiver is currently reviewing
9 these merchant's accounts to determine the appropriate course of action.
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12 **VII. OVERVIEW OF RECEIVERSHIP WORK TO BE PERFORMED AND** 13 **RECOMMENDATIONS**

14 This Receivership has significant work in progress which can be broken down generally
15 into the following categories: reconstruction of records and tax accounting, improve business
16 operations, liquidation of non-performing assets and investigation and action regarding third
17 party claims.
18

19 **A. Reconstruction of Records and Tax Accounting**

20 As reviewed earlier, there are continuing efforts to complete the proper recording of
21 historical transactions. While the vast majority of corrections have been completed, some
22 ongoing work will still be required. Additionally, income tax returns need to be completed and
23 filed, and taxes paid for all years the companies have been in business.
24

25 **B. Improve Business Operations**

26 MPI has significant work to do to improve customer relations and operations. The Receiver
27 recommends the following overall steps:
28

- i. With assistance of a public relations professional, do further targeted communications with customers acknowledging shortfalls identified by customer survey and launching a program of corrective actions;
- ii. As part of reformation, rename company to assist in distinguishing new management and practices from old management and practices;
- iii. Offer existing customers new and improved contracts (subject to Global approval); and
- iv. Continue to survey customers and make changes as needed.

C. Liquidation of Non-Performing Assets

The Receiver has already unwound the purchase of an exotic automobile that was not needed for the operations of the business and recommends the liquidation of the remaining vehicles as well as the non-performing assets, including Bad Boy Racing and Bad Boy Investments. These liquidations will improve the company's cash position and reduce the drain on future earnings.

D. Investigation and Action Regarding Third-Party Claims

The Receiver has yet to conclude his standard review of activities of the company's professionals and other parties to determine if there are any claims against third parties. So far, there is no indication of a large number of claims.

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1 **VIII. CONCLUSION**

2 This Preliminary Report of Receiver reflects the Receiver’s work and conclusions as of
3 this date. As indicated above, the findings reflected in this report are based on the information
4 that has been discovered to date and are subject to clarification, expansion or change pending
5 additional work by the Receiver and his team.

6 Respectfully submitted this 6th day of July, 2007.

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Michael A. Grassmueck, Receiver