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UNITED STATES DISTRICT COURT

DISTRICT OF ARIZONA

Federal Trade Commission, Plaintiff, v. Vemma Nutrition Company, et al., Defendants.	Case No. CV-15-01578-PHX-JJT **OPPOSITION TO EMERGENCY MOTION TO COMPEL TURNOVER OF FUNDS HELD BY FORMER TEMPORARY RECEIVER**

Robb Evans & Associates LLC as the former Temporary Receiver ("Receiver") files this opposition to the Emergency Motion to Compel Turnover of Funds Held by Former Temporary Receiver ("Emergency Motion")[1] filed by defendants Vemma

[1] While styled as an "emergency motion," Vemma admittedly knew of the Receiver's position on September 18, 2015 (Exhibit 1 to Emergency Motion), yet chose to wait thirteen days before filing the instant motion. On the other hand, the Receiver and its counsel worked over the weekend of September 19 to prepare and file its First and Final Motion for Approval and Payment of Fees and Expenses of Temporary Receiver and Its Counsel ("Fee Motion") (Doc. No. 120) to avoid any claims of delay.

Nutrition Company and Vemma International Holdings, Inc. (collectively "Vemma") as follows:

I. INTRODUCTION

The Receiver was appointed as temporary receiver under the Order filed under seal dated August 21, 2015 ("Temporary Restraining Order"). Doc. No. 25. Section XII of the Temporary Restraining Order contains an extensive list of powers and duties that the Receiver was "directed and authorized to accomplish." The Receiver faithfully discharged all of its powers and duties professionally, thoroughly, efficiently and fairly despite facing a complex receivership with numerous issues that needed immediate attention.[2] The Court's order dated September 18, 2015 ("Preliminary Injunction Order") adopted certain of the key facts uncovered by the Receiver in its investigation in concluding that there is "little doubt that the FTC will ultimately succeed on the merits in demonstrating that Vemma is operating a pyramid scheme" (Preliminary Injunction Order, p. 6:20-21), including the overwhelming percentage of sales to Affiliates and Vemma's five-month backlog auditing fifteen Affiliates each month and never disciplining or suspending an Affiliate. The Court's finding that the FTC was likely to succeed on the merits in demonstrating Vemma is making material misrepresentations and omissions, as well as furnishing Vemma Affiliates with the means and instrumentalities to make material misrepresentations and omissions in violation of the FTC Act, validates the Receiver's interim decision to suspend operations on the basis that Vemma could not operate profitably **and** lawfully, as required by the Temporary Restraining Order at Section XII.C. The Court was satisfied with the Receiver's performance and diligence during this always-

[2] This opposition does not address many of the spurious claims made in the declarations of Morris Aaron (Doc. No. 130) and Brad Wayment (Doc. No. 131), to the extent they seek to challenge the fees requested in the Fee Motion, but reserves its right to file a timely reply to them if they are considered as opposition to the Fee Motion, no other opposition to the Fee Motion having yet been filed. This opposition generally discusses the inherent absurdity surrounding the complaints made by Messrs. Aaron and Wayment in Section VI, below.

challenging temporary receivership period, which lasted only four weeks, in that it appointed the Receiver as Monitor going forward.

Section XIX of the Temporary Restraining Order expressly required the Receiver to file an initial request for compensation within sixty days of the entry of that order, which the Receiver did in its Fee Motion. Section XIX of the Temporary Restraining Order further expressly provides:

> IT IS FURTHER ORDERED that the Temporary Receiver, and all persons hired by the Temporary Receiver as authorized by this Order, are entitled to reasonable compensation for the performance of duties undertaken pursuant to this Order, and for the cost of actual out-of-pocket expenses incurred by them **solely from the assets now held by or in the possession or control of, or which may be received by, the Receivership Defendants**. (emphasis added)

As set forth in Declaration of Kenton Johnson in support of the Fee Motion and the financial report attached as Exhibit 1 thereto, the Receiver took into the estate a total of $799,677.76.[3] The Receiver incurred and paid $358,293.05 in business operating expenses, primarily for payroll, employee benefits and insurance premiums. Vemma incorrectly asserts the Receiver is holding $441,384 of Vemma's funds. As explained in the Fee Motion, the only sums now held are those necessary to cover the Receiver's allowed administrative expenses and the other estimated business operating expenses incurred during the temporary receivership and itemized on the financial report attached as Exhibit 1 to the Declaration of Kenton Johnson. The Receiver already transferred $35,707.68 to Vemma on September 21, 2015 and holds $405,677.03. Of this sum,

[3] Vemma continues to assert that the Receiver "seized" its funds, apparently in an attempt to inflame and mislead the Court. This assertion simply ignores another of the Receiver's duties under the Temporary Restraining Order, which expressly directed the Receiver to take exclusive custody, control and possession of all of Vemma's assets, including all of its funds. Section XII.B.

$111,224.92 is for estimated additional operating expenses believed to have been incurred during the temporary receivership and $294,452.11 is for the fees and expenses of the Receiver and its counsel subject to Court allowance.

II. THE RECEIVER IS ENTITLED TO BE PAID FROM THE ASSETS OF THE TEMPORARY RECEIVERSHIP ESTATE

The Temporary Restraining Order established protections for the Court-appointed Receiver which may not be eviscerated by the expiration of the Temporary Restraining Order. Section XIX of the Temporary Restraining Order provided a comprehensive mechanism for the Receiver to periodically file requests for compensation for the fees and expenses incurred by the Receiver and its professionals, and to be paid from the assets of the Receivership Defendants. This language is standard language in receivership appointment orders and in accord with applicable federal receivership law, including the authorities cited in the Fee Motion, including *Securities and Exchange Commission v. Elliott*, 953 F.2d 1560, 1576 (11th Cir. 1992): "…there is an implied understanding that the Court which appointed him and whose officer he is will protect his right to be paid for his services, to be reimbursed for his proper costs and expenses." *See also*, *2 Clark on Receivers* § 637, pp. 1052-1053 (3rd ed. 1992):

> The costs and expenses of a receivership are primarily those incurred by the court in performing its duty of preserving the assets of the defendant so that those assets or their proceeds if sold will be available to meet the valid demands of the litigants and other creditors of the defendant. **The costs and expenses of preserving, administering and realizing the property or fund must be paid out of the property or fund.**
>
> The obligations and expenses which the court creates in its administration of the property are necessarily burdens on the property taken possession of, and this, irrespective of the question who may be the ultimate owner, or who may have the

> preferred lien, or who may invoke the receivership. **The appointing court pledges its good faith that all duly authorized obligations incurred during the receivership shall be paid.** (emphasis added)

The Receiver and its professionals justifiably relied on Section XIX of the Temporary Restraining Order to ensure that there is a mechanism for payment for the services rendered and the expenses incurred. A receiver is not expected to and does not work on a contingency fee basis, and contingencies such as whether the Court appoints the receiver on a permanent basis or whether the plaintiff ultimately prevails in the litigation are not factors that should be considered when addressing a receiver's motion for compensation. When there is clearly a fund available for payment of allowed fees and expenses, the fund should remain with the receiver pending the Court's determination of a timely-filed request for compensation; the receiver should not have to hope that funds will be turned over by defendants who were upset that a receiver was appointed in the first place. This is the pledge made to the receiver at the outset of the case; the pledge is not contingent upon whether the receiver becomes permanent. Without the enforceability of that pledge, competent, professional and talented receivers would simply refuse to serve, lest the Court ultimately rule against a permanent appointment or ultimately find for the defendants. It is particularly important that this pledge be maintained at the early stages of the receivership when a receiver is asked to undertake an enormous set of tasks and responsibilities "in the blind." If, in hindsight, the Court believes that the receivership was unwarranted, that is not justification for depriving the receiver of an available fund of money to pay allowed fees and expenses.

Contrary to Vemma's contention, the Receiver's fees and expenses constitute a priority administrative expense no less than any other necessary expenses incurred during the receivership period. Vemma complains that other administrative expenses were not yet paid by the Receiver during the receivership, despite the Receiver holding $111,224.92

precisely for that purpose. Apparently the only administrative creditors who Vemma believes should be at risk of non-payment are the Receiver and its professionals.

This does not deprive Vemma of their opportunity to object to the fees and expenses sought or to prevent the Court from reviewing the Fee Motion and determining the reasonableness of the fees and expenses. The Receiver is confident that all of the fees and expenses incurred were reasonable and necessary in performing the duties and responsibilities assigned to it under the Temporary Restraining Order and that a full and complete analysis of the work performed justifies the allowance and payment of all fees and expenses sought. But, regardless of how the Court ultimately rules on the Fee Motion, the Receiver's ability to be compensated cannot be compromised after the fact by an order releasing assets back to Vemma for use in the post-receivership operations of the business and before the Court determines the Fee Motion and allows its Receiver's fees and expenses to be paid.

III. THE PAYMENT PROTECTIONS AFFORDED THE RECEIVER UNDER THE TEMPORARY RESTRAINING ORDER DID NOT EXPIRE

Not all terms of the Temporary Restraining Order expired when the Court issued the Preliminary Injunction Order. Rights arising under a temporary restraining order can be enforced even after the order has expired in a variety of different circumstances. For example, it is well established that the presence of a bond prevents the validity of an expired temporary restraining order or injunction from becoming moot. *See American Can Co. v. Mansukhani*, 742 F.2d 314, 320 (7th Cir. 1984). While the Temporary Restraining Order has expired, surely Vemma would not contend that the $50,000 Temporary Receiver's bond filed with the Court by the Receiver pursuant to Section XI of the Temporary Restraining Order is no longer in effect. Similarly, Section XIX of the Temporary Restraining Order provided that the Receiver file periodic requests for payment, "with the first such request filed no more than sixty (60) days after the date of entry of this Order." Therefore, the first fee motion by the very terms of the Temporary Restraining Order properly could have been filed long after expiration of that order, which

initially lasted only 14 days. It follows that the entirety of Section XIX survived the Court's new Order, including the Receiver's right to be paid from the assets of the Receivership Defendants. *See also In Re EZ Pay Services, Inc.,* 390 B.R. 445, 454 (Bktcy. Ct. M.D. Fla. 2008) holding that a person may be held in contempt for violating a temporary restraining order even if the contempt order is sought after the temporary restraining order has expired: "[E]ven if the TRO had expired by its terms, ADP is nevertheless entitled to seek damages based on violations of the order which occurred while it remained in effect." The Receiver's payment protections set out in Section XIX did not expire.

IV. VEMMA IS NOT IRREPARABLY HARMED BECAUSE THE RECEIVER IS PREPARED TO TURN OVER AN ADDITIONAL $111, 224.92

Vemma states that the Receiver's failure to turn over funds threatens irreparable harm because many of the expenses it needs to fund are expenses the Receiver did not pay during the temporary receivership period. However, Vemma fails to advise the Court that the Receiver stated in its Fee Motion that it would turn over to Vemma $111,224.92 held for estimated operating expenses incurred during the temporary receivership provided the Court enters an order discharging and releasing the Receiver and the receivership estate from any liability for non-payment of these liabilities. If these are truly expenses that were incurred and should be paid as administrative expenses of the receivership estate, and Vemma intends on paying them directly, then the Receiver has no objection to releasing this amount to Vemma provided the Receiver is protected against subsequent claims of non-payment.

V. THE RECEIVER IS NOT ADEQUATELY PROTECTED BY THE PROSPECT OF VEMMA'S FUTURE OPERATIONS OR THE ALLEGED BOOK VALUE OF ILLIQUID ASSETS

Vemma's argument that the Receiver is adequately protected for the payment of its fees is disingenuous. It would be particularly prejudicial to the Receiver if it were required to turn over funds to enable Vemma to operate post-receivership given its bleak financial

condition. There is no meaningful dispute that Vemma was hugely unprofitable in the period immediately preceding the temporary receivership. Vemma's own consolidated income statement for the period from January 1, 2015 through June 30, 2015 evidenced a loss of approximately $1.4 million before depreciation and amortization expense. In 2014, the consolidated financial report reviewed by Vemma's outside accountants showed a loss before depreciation of approximately $2.2 million. Including the net income and losses of the European operations, the Vemma worldwide operations incurred net losses of $1.3 million in 2014 and $4.1 million for the six months ended June 30, 2015. Vemma's dire financial condition is further evidenced by Brad Wayment's own admission in his declaration in opposition to the preliminary injunction application ("Wayment PI Decl.") that a cash infusion of approximately $1.3 million was going to be made by Vemma's ownership group **on the day the receivership commenced** and that a further capital infusion was planned by the ownership group within 45 days thereafter (Wayment PI Decl., Doc. 78-2, para. 78). Wayment further testified that Vemma was working on establishing a private line of credit of $3 to $4 million dollars (Wayment PI Decl., para. 79). This demonstrates that Vemma knew it needed immediate access to a tremendous amount of cash in order to maintain its operations.

There is no explanation why the shareholders of this company, comprised solely of defendant Benson Boreyko and two members of his immediate family, should not make the $1.4 million capital infusion they were going to make on the day the receivership commenced. There is no explanation why Boreyko, **who sucked $19.7 million out of Vemma over the last 5 ½ years** (Receiver's Report, p. 14; Doc. No. 50-1), much of which was paid while the company lost huge sums of money, should not bear the risk of this enterprise going forward by infusing the requisite funds to restart operations. If there is truly "adequate protection" for the payment of the Receiver's fees and expenses based on the book value of inventory and other assets, an assertion lacking meaningful evidence,[4]

[4] The book value of assets referenced in the Emergency Motion does not constitute *{footnote continued}*

then Boreyko should be more than willing to accept such assets as adequate protection for **his capital infusion** into Vemma. It would be the height of absurdity to impose the risk of non-payment on the Court's Receiver while the owners of the company refused to adequately capitalize Vemma's post-receivership operations going forward.

In addition, Vemma's last four pages of its opposition to the FTC's preliminary injunction (Doc. No. 74) application strenuously argued that it should be permitted to file for relief under the Bankruptcy Code, including the right to file for Chapter 7 liquidation. Surely, Vemma recognized its dire financial condition. The Court's Preliminary Injunction Order has permitted operations to be restarted only by totally revamping its business model so as to cease operating as an illegal pyramid scheme. These stringent restrictions make the likelihood that Vemma's unprofitable operations can suddenly become profitable even more remote.[5] Vemma cannot be permitted to restart operations by using funds necessary to pay the legitimate administrative expenses of the receivership estate, including the fees and expenses of the Receiver and its professionals as may be approved by the Court.

VI. THE CRITICISMS SET FORTH IN THE DECLARATIONS OF AARON AND WAYMENT ARE UNSUPPORTABLE AND UNFOUNDED

As noted above, it is not the intent of this opposition to address the spurious claims raised against the Receiver in the declarations of Morris Aaron (Doc. No. 130) and Brad Wayment (Doc. No. 131). No actual opposition to the Fee Motion has yet been filed, but the Receiver will timely respond in detail and in full when an opposition is filed. However, a few points are worth noting which demonstrates why these declarations are fundamentally flawed and unfounded. First, Aaron continues to complain about the Receiver's prompt decision not to permit business operations during the temporary

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realizable value.

[5] Vemma also fails to disclose to the Court that its Australian subsidiary has recently been placed into the Australian equivalent of a Chapter 7 liquidation proceeding.

receivership, because the Receiver determined that Vemma could not continue to operate during the interim period lawfully and profitably. This was a theme he consistently raised in his first declaration and the MCA Report filed in opposition to the preliminary injunction (Doc. No. 78-7). The charge is meritless and absurd for two principal reasons. First, the Court has agreed with the Receiver in its Preliminary Injunction Order that Vemma was not operating lawfully, when it found little doubt that the FTC will ultimately succeed on the merits in demonstrating that Vemma was operating a pyramid scheme and that Vemma was making material misrepresentations and omissions, as well as furnishing Vemma Affiliates with the means and instrumentalities to make material misrepresentations and omissions, in violation of the FTC Act. Second, it is apparent that Aaron never even bothered to read the Temporary Restraining Order which **directed** the Receiver's actions, including the requirement that the Receiver determine whether Vemma could be operated profitably and lawfully, under Section XII.C, **because he criticized the Receiver for addressing this very issue**. MCA Report, Doc. No. 78-7, p. 19.

Aaron's latest declaration is similarly unsupportable. He asserts that he has determined that Vemma can operate profitably under the Preliminary Injunction Order based on a cash flow projection provided at Ex. C to the MCA Report. In fact, Aaron's analysis was based on operations that existed pre-receivership and which the Court preliminarily found to constitute an illegal pyramid scheme. **Aaron's analysis pre-dates the Preliminary Injunction Order.** Obviously, Aaron's continued reliance on a business model he created prior to the Preliminary Injunction Order only demonstrates that he is an "expert" paid to say anything to support Vemma's side of the story. The cash flow projections he prepared based on Vemma's now-discredited pyramid scheme cannot be used to plausibly argue that the Receiver will be adequately protected by Vemma's ongoing business operations. The Court has constrained Vemma's operations in fundamental ways which must necessarily call the entire operation's continued viability into question.

Further, Wayment's latest declaration attacking the Receiver's decision not to make various payments ignores the fact that it took the Receiver until September 4, 2015 to receive any substantial funds whatsoever, which was a full two weeks into the temporary receivership period which only lasted four weeks. BMO Harris Bank did not turn over $633,913.57 (out of a total of $799,677.76 collected) until September 4. The Receiver could not make timely payment of many administrative expenses **because it lacked any funds to do so**.

VII. CONCLUSION

For the reasons set forth herein, and such other and further evidence and argument as may be presented at or before any hearing on the Emergency Motion, it is respectfully requested that the Court deny the Emergency Motion in its entirety; or alternatively direct the Receiver to turn over the sum of only $111,224.92 to Vemma for the payment of actual business operating expenses incurred during the temporary receivership provided the Court

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enters an order discharging and releasing the Receiver and the receivership estate from any liability for such expenses.

DATED: October 2, 2015

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CERTIFICATE OF SERVICE

I hereby certify that on October 2, 2015, I electronically transmitted the attached document to the Clerk's office using the CM/ECF System for filing and transmittal of a Notice of Electronic Filing to the following CM/ECF registrants:

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