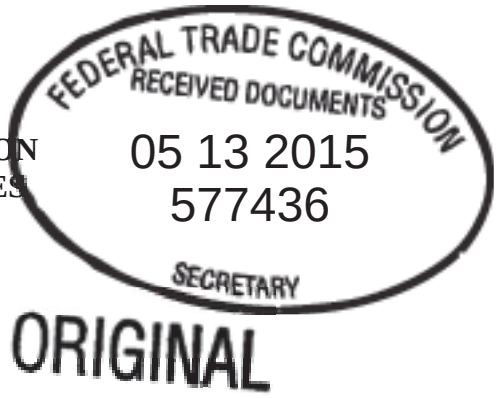

ORIGINAL

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION
OFFICE OF ADMINISTRATIVE LAW JUDGES

In the Matter of	)	**PUBLIC**
LabMD, Inc., a corporation Respondent.	)	Docket No. 9357

RESPONDENT LABMD, INC.'S
REPLY IN SUPPORT OF ITS MOTION TO DISMISS

Pursuant to 16 C.F.R. § 3.22(a), Respondent LabMD, Inc. ("LabMD") files this Reply in Support of its Motion to Dismiss dated April 24, 2015 (the "Motion").

The Federal Trade Commission ("FTC") has certainly failed to carry its burden of proof. *See* Resp't's Mot. to Dismiss (May 27, 2014); Resp't's Mot. *in Limine* to Exclude Expert Test. of James Van Dyke (Apr. 22, 2014); Resp't's Mot. *in Limine* to Exclude Expert Test. of Rick Kam (Apr. 22, 2014). But Complaint Counsel has mischaracterized Respondent's Motion, which is aimed at FTC's due process violations, and expressly elected to avoid the Motion's facts and legal arguments. As a threshold matter, Complaint Counsel's failure to address LabMD's arguments means it has conceded them, and judgment for LabMD is therefore proper. *See Hopkins v. Women's Div., Gen. Bd. Of Global Ministries*, 284 F. Supp. 2d 15, 25 (D.D.C. 2003), *aff'd*, 98 F. App'x 8 (D.C. Cir. 2004).

The uncontroverted evidence is that this case is based on a crime, the theft of the 1718 File from a LabMD computer in violation of federal and Georgia law, and a lie, that the 1718 File had "spread" across P2P networks. This crime and this lie were the government's justification for spending millions of taxpayer dollars to destroy a small, innovative cancer detection laboratory. Complaint Counsel's entire case, as demonstrated by each of its expert

reports, was predicated on the notion that the 1718 File "spread" across P2P networks, when, in reality, it had not.

FTC had a constitutionally-mandated duty to exercise basic diligence before bringing its enforcement authorities to bear against LabMD. Yet, it failed to use any of its advanced investigative tools, or to do anything else, to verify or check Tiversa's manufactured lies. Given that FTC staff knew Tiversa had a direct economic stake in agency action, this failure reflects a particularly egregious and unconscionable disregard both for LabMD's due process rights and for the government's own integrity and legitimacy.[1] In any event, Richard Wallace's uncontroverted testimony demonstrating FTC's enforcement action was predicated on fraud now compels FTC to dismiss this case. Judgment for LabMD is proper here.

STANDARD OF REVIEW

FTC owed LabMD a fair and honest process. *Maness v. Meyers*, 419 U.S. 449, 463-64 (1975) ("The Fifth Amendment applies to all proceedings [including] … administrative proceedings[.]"); *Nec Corp. v. United States*, 151 F.3d 1361, 1370 (Fed. Cir. 1998). A fair trial in a fair tribunal is a basic requirement of procedural due process, *In re Murchison*, 349 U.S. 133, 136 (1955), and this rule applies with equal force in administrative proceedings. *Gibson v. Berryhill*, 411 U.S. 564, 579 (1973).

FTC may not use false evidence provided by a deceitful informant. *Giglio v. United States*, 405 U.S. 150, 153 (1972) ("[T]he presentation of known false evidence is incompatible

[1] *See, e.g.*, Prelim. Injun. Hrg. Tr. at 77:9-15, *LabMD, Inc. v. Fed. Trade Comm'n*, No. 14-00810 (N.D. Ga. May 7, 2014) (Statement of the Hon. William S. Duffy) (stating it is a "sad comment on [the FTC], that you would wait until months before a hearing and months after you instituted an investigation on a principal claim that you are asserting, that you have not even taken any effort to interview the people that you claim had the documents that underlie the charge of a security breach" and that it "strikes me as almost being unconscionable").

with 'rudimentary demands of justice.'" (citing *Mooney v. Holohan*, 294 U.S. 103, 112 (1935))); *Morris v. Ylst*, 447 F.3d 735, 744 (9th Cir. 2006) (suspected perjury requires an investigation and this "duty to act 'is not discharged by attempting to finesse the problem by pressing ahead without a diligent and good faith attempt to resolve it'" (citation omitted)). For this reason, perjured testimony must be expunged from the administrative record. *Communist Party of the United States v. Subversive Activities Control Bd.*, 351 U.S. 115, 125 (1956).

ARGUMENT

I. FTC MISCHARACTERIZES LABMD'S MOTION TO DIVERT ATTENTION FROM FACTS WHICH IT CANNOT REFUTE.

A. LabMD's Motion Seeks Dismissal for Lack of Due Process, Making FTC's Request for *Prima Facie* Standard Inapplicable Here.

FTC distorts the present Motion by characterizing it as one for failure to establish a *prima facie* case. LabMD indeed filed such a motion on May 27, 2014, which it renewed in open court on May 5, 2015 and which it reserves the right to supplement.[2] However, the Motion here is for lack of due process arising from the egregious conduct of a federal agency, tasked with consumer protection, colluding with an economically self-interested fraudster.

To this end, Complaint Counsel has not addressed, challenged, or even explained the pages of facts cited in Respondent's Motion to Dismiss as proof that FTC has acted in violation of the law and in contravention of LabMD's due process rights. Indeed, FTC flatly admitted that it had not responded to each of these facts and "instead addresses Respondent's failure to meet the legal standard to prevail on its Motion." Compl. Counsel's Opp. to Resp't's Mot. to Dismiss

[2] "The instant Motion in no way alters or effects Respondent's pending Motion to Dismiss for Complaint Counsel's failure to establish a *prima facie* case." *See* Resp't's Mot. to Dismiss (Apr. 24, 2015) (citing Resp. Mot. to. Dismiss (May 27, 2014)).

("Opp.") at 4 (May 6, 2015) (referencing a legal standard inapplicable to LabMD's instant Motion). Complaint Counsel does not have the authority to re-invent Respondent's filing just so that it can avoid addressing uncomfortable facts in the record and its failure to respond means it has conceded the issues and judgment should be granted. *See Hopkins*, 284 F. Supp. 2d at 25; *see also Mason v. Geithner*, 811 F. Supp. 2d 128, 178 (D.D.C. 2011) ("'[I]t is well understood . . . that when a plaintiff files an opposition to a dispositive motion and addresses only certain arguments raised by the defendant, a court may treat those arguments that the plaintiff failed to address as conceded.'" (citation omitted)).

B. FTC Cites Inapplicable Sanctions Standards.

The Court should similarly ignore Complaint Counsel's misguided attempts to convert LabMD's motion into one for sanctions. Complaint Counsel's relief at the lack of a Commission Rule which models Rule 11 of the Federal Rules of Civil Procedure is telling. *See* Opp. at 9.[3] But LabMD did not file a motion for sanctions. Complaint Counsel's argument seems to be an attempted distraction because FTC has not and, indeed, cannot refute the facts demonstrating disregard for FTC's most basic due process obligations and warranting dismissal of this case.

[3] Rule 11, of course, requires an attorney to conduct pre-suit diligence of the sort FTC failed to conduct here. *Bus. Guides, Inc. v. Chromatic Communs. Enters.*, 498 U.S. 533, 542 (1991) ("The heart of Rule 11 . . . explains in detail [that a] . . . signature certifies to the court that the signer has read the document, has conducted a reasonable inquiry into the facts and the law and is satisfied that the document is well grounded in both[.]"); *In re Engle Cases*, 767 F.3d 1082, 1118 (11th Cir. 2014) (citing *Attwood v. Singletary*, 105 F.3d 610, 613 (11th Cir. 1997) ("Rule 11 requires [an attorney] to make reasonable inquiries into the veracity of information filed before the court and to advise the court of any changes.")).

II. RICHARD WALLACE GUTS FTC'S CASE.

It marks an unfortunate day in American administrative jurisprudence when a cancer detection laboratory, already driven out of business, must stand to fight against FTC even after the government has conceded that it invested more than five years of enforcement action and millions of taxpayer dollars based on the lies of a corrupt business.

Richard Wallace, a highly skilled computer analyst who worked with law enforcement and handled "special projects" for Tiversa's CEO Robert Boback, RX0517, Gormley Dep. at 83:3-4, testified:

- Tiversa lied about its system and software capabilities to FTC in order to impress them. Trial Tr. vol. 9 at 1435:16-23 (Testimony of Richard Wallace).
- Tiversa provided extensive false evidence to FTC in the administrative proceeding which FTC never investigated or corroborated. For example, contrary to documents provided by Tiversa and testimony provided by Boback, the 1718 File never spread to any IP address. It was only ever detected at the IP address belonging to LabMD in Atlanta, Georgia. Trial Tr. vol. 9 at 1444:1-4.
- Boback told Wallace to lie in his deposition. Trial Tr. vol. 9 at 1455:19-1456:3.
- Tiversa fabricated a data breach pertaining to Marine One. Trial Tr. vol. 9 at 1453:23-1454:24.
- When a company refused to do business with Tiversa, Boback made their problems appear worse by manipulating data to make it look like the file had proliferated around the Internet in order to convince the company to buy Tiversa's services. Trial Tr. vol. 9 at 1364:20-1365:8.
- Tiversa routinely made a company's "data breach appear to be much worse than it actually had been." Trial Tr. vol. 9 at 1368:14-17.
- The companies targeted by Tiversa had no way of knowing that Tiversa was lying about the extent of the data breach. Trial Tr. vol. 9 at 1377:21-1378:2.
- Tiversa manipulated data for every company it dealt with. Trial Tr. vol. 9 at 1391: 7-9.

- It was a "common practice for Tiversa to give false information concerning when and where they found certain documents to their clients." Trial Tr. vol. 9 at 1395:23-1396:1.

Yet, in the face of this fraud, and rather than protecting consumers, FTC instead continues its barrage against LabMD. Despite Wallace's testimony, detailed findings by the U.S. House of Representatives, *see* RX0543 (Letter from Rep. Darrell Issa, Chairman, U.S. H. Comm. on Oversight & Gov't Reform, to Edith Ramirez, Chairwoman, Fed. Trade Comm'n (Dec. 1, 2014)), and the plain evidence of the relevant transcripts themselves, *see, e.g.*, Mot. to Dismiss (May 27, 2014); Mot. to Dismiss (Apr. 24, 2015); Resp't's Mot. to Admit RX-543-548; Resp't's Mot. for Sanctions (Aug. 14, 2014), Complaint Counsel claims the obvious inconsistencies in Boback's testimony are mere "misunderstandings." Opp. at 3 n.4.

The record shows that Tiversa used the FTC for its own financial gain so that it could pressure prospective clients under the threat of enforcement proceedings. *See* Trial Tr. vol. 9 at 1363: 2-4 (stating that Tiversa turned over potential clients to the FTC "so that the FTC would contact them and notify them of a data breach and hopefully we would be able to sell our services to them"); *id.* at 1363:2-4 (Tiversa included prospective client names on the list to turn over to the FTC as they would "use any means necessary to let them know that an enforcement action is coming down the line and they need to hire us or face the music, so to speak"); *id.* at 1452:24-1453:20 (after Tiversa began working with the FTC, it threatened prospective customers with FTC enforcement proceedings). FTC knew this from the start. CX0679, Ex. 5 (Dissenting Statement of Comm'r J. Thomas Rosch, FTC File No. 1023099 (June 21, 2012)).

Even presented with evidence that Tiversa was profiting from its relationship with FTC, the agency relies upon testimony from Boback and refuses to rescind its reliance on Tiversa, stating that there is "no basis in the rules" for suggesting that "a witness's testimony must be

stricken from the record." Opp. at 9. Contrary to FTC's assertion, however, black-letter law requires that this Court strike all tainted evidence from the administrative record. *Communist Party*, 351 U.S. at 125. This is particularly true when FTC completely abdicated its duty to investigate or corroborate Tiversa's allegations. *United States v. Janis*, 428 U.S. 433, 455 (1976); *In re Big Ridge, Inc.*, 36 FMSHRC 1677, 1739, 2014 FMSHRC LEXIS 465 (FMSHRC June 19, 204) (Mine Safety and Health Review Commission excluded tainted evidence and found otherwise insufficient evidence to show violation of law); *United States v. Brown*, 500 F.3d 48, 56 (1st Cir. 2007) (authorities must "act with due diligence to reduce the risk of a mendacious or misguided informant").

LabMD's due process rights to a fair trial have been infringed. FTC's entire case is premised on the theft of the 1718 File, in violation of both Georgia and federal law, *see* Ga. Code Ann. §§ 16-9-90 – 16-9-109 (2014); *see also* 18 U.S.C. § 1030 (2012); Health Insurance Portability and Accountability Act of 1996, Pub. L. 104-191, 110 Stat. 1936 (codified as amended in scattered sections of 18, 26, 29 & 42 U.S.C.), which the government only obtained from a vengeful Tiversa after LabMD refused to pay them for service. Trial Tr. vol. 9 at 1365:18-1366:3 (after LabMD refused to do business with Tiversa, CEO Robert Boback said "F-- him" and sent LabMD's information "at the top of the list" to the FTC). The message that FTC continues to send, while utilizing taxpayer dollars to send it, is that the agency protects thieves and corporate bullying, not innocent businesses and consumers. It is simply untenable that FTC continues to subject LabMD to this administrative proceeding given the fraudulent basis for its case. *Gibson*, 411 U.S. at 579 (due process in administrative proceeding requires a fair trial by a fair and impartial tribunal).

FTC's reliance on fraudulent and illegal evidence, combined with its failure to correct the administrative records, its resilience in its defense of Boback and Tiversa, combined with its 100% success rate before the Commission, renders this proceeding void of due process. *Mesarosh v. United States*, 352 U.S. 1, 9 (1956) (prosecutorial misconduct violates due process); *Sorrells v. United States*, 287 U.S. 435, 459 (1932) (Roberts, J., concurring) (the ends do not justify the means); *see also Withrow v. Larkin*, 421 U.S. 35, 47 (1975); *Pillsbury Co. v. Fed. Trade Comm'n*, 354 F.2d 952, 964 (5th Cir. 1966) (Commission must maintain the appearance of impartiality).

III. FTC FAILS ITS ELECTED STANDARD.

LabMD did not file the motion Complaint Counsel answered. But FTC fails even its own elected standard because Wallace's uncontroverted testimony means FTC cannot meet its *prima facie* burden that LabMD's allegedly deficient data security "causes or is likely to cause substantial injury to consumers" as required by Section 5(n). First, FTC has not proven any actual substantial injury to consumers due to the alleged deficiencies. Second, FTC has not proven the alleged deficiencies were "likely to cause" – that is, were highly probable to cause – substantial, nonspeculative injury to consumers.[4] 15 U.S.C. § 45(n) (codifying FTC's Ltr. to

[4] Congress intended FTC's burden of proof to be very heavy and it designed Section 5(n) accordingly. *See* S. Com. Rep. 103-130, FTC Act of 1993 (Aug. 24, 1993) (stating that "[t]his section amends section 5 of the FTC Act to limit unlawful 'unfair acts or practices' to only those which cause or are likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or competition" and that "substantial injury" is "not intended to encompass merely trivial or speculative harm"). The plain meaning of the word "likely," usually defined as "having a high probability of occurring or being true," sets the evidentiary benchmark. *Morse v. Republican Party*, 517 U.S. 186, 254 (1996) ("When words in a statute are not otherwise defined, it is fundamental that they 'will be interpreted as taking their ordinary, contemporary, common meaning.'" (citations omitted) (applying Webster's New International Dictionary to ascertain such meaning)). Proving a claim or defense is highly probable means meeting the "clear and

Hon. Wendell H. Ford, Chairman, and Hon. John C. Danforth, U.S. S. Comm. on Commerce, Consumer Subcomm. (Dec. 17, 1980) [hereinafter "Unfairness Statement"], *available at* https://www.ftc.gov/public-statements/1980/12/ftc-policy-statement-unfairness) (stating that "[t]he Commission is not concerned with trivial or merely speculative harms")).

FTC's argument that it met its burden is premised almost entirely on the expert report and testimony of Raquel Hill.[5] However, Hill's expert report (written by someone who never worked for a health care provider or in the health care industry, and therefore fails the test of *S&H Riggers & Erectors v. Occupational Safety & Health Review Comm'n*, 659 F.2d 1273, 1280-83 (5th Cir. 1981) (holding that the reasonable-person standard divorced from industry standards or regulations violates due process)) is based on the underlying assumption that the 1718 File proliferated to four IP addresses outside of Atlanta, Georgia and on perjured testimony. *See* CX0740, Expert Report of Raquel Hill, at 15, 17, 18.[6]

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convincing" evidentiary standard, which is a more burdensome standard than even a clear preponderance. *Colorado v. New Mexico*, 467 U.S. 310, 316 (1984) (defining clear and convincing evidence); *see also Murphy v. Immigration & Naturalization Serv.*, 54 F.3d 605, 610 (9th Cir.1995) (the burden of proving a matter by clear and convincing evidence is "a heavier burden than the preponderance of the evidence standard"). Construing Section 5(n) according to its plain meaning, and requiring FTC to prove causation by clear and convincing evidence, is the only approach consistent with Congressional intent. *See* Ernest Gellhorn, *Trading Stamps, S&H, and the FTC's Unfairness Doctrine*, 1983 Duke L.J. 903, 906, 942 (1983) (providing legislative context for the 1994 amendment, and stating that the FTC's abuse of its Section 5 unfairness jurisdiction following *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972), led to the 1980 Federal Trade Commission Improvement Act which "prohibited application of the unfairness doctrine in several specified proceedings and curtailed its use in rulemaking for at least three years while Congress engaged in oversight hearings").

[5] *See* Opp. at 5.

[6] *See also* CX0741, Expert Report of James Van Dyke, at 2, 4, 7, 8; CX0742, Expert Report of Rick Kam, at 6, 9, 18, 19; CX0738, Rebuttal Expert Report of Clay Shields, at 3, 25.

Wallace testified that the 1718 File never spread from LabMD's workstation and "was only ever seen detected at the IP address belonging to LabMD in Atlanta, Georgia." Trial Tr. vol. 9 at 1444:1-4 (Testimony of Richard Wallace). Wallace also testified that he had fabricated the IP addresses on CX 19 which purportedly showed that the 1718 File had "spread." Trial Tr. vol. 9 at 1369-1370.

Accordingly, the predicate assumption used by Hill and all of the other FTC experts to reach their "expert" conclusions is completely false, and those reports are valueless. Complaint Counsel, as it must, has agreed that it "will not use its experts' affected calculations in the post-trial brief or findings of fact." Opp. at 4 n.4. However, since each of FTC's expert reports are premised on a basic falsehood, Complaint Counsel necessarily fails to meet its *prima facie* burden. *See* Opp. at 5-6; *see Anderson v. Liberty Lobby, Inc*., 477 U.S. 242, 250 (1986) ("[T]he trial judge must direct a verdict if . . . there can be but one reasonable conclusion as to the verdict[.]"); *Atlantic Richfield Co. v. Fed. Trade Comm'n*, 546 F.2d 646, 651 (5th Cir. 1977) (improperly obtained evidence—as well as its 'fruits'—must be excluded in an administrative hearing); *Knoll Assocs. v. Fed. Trade Comm'n*, 397 F.2d 530, 537 (7th Cir. 1968).

Furthermore, not only has there never been any evidence introduced that any consumer was injured by LabMD's data security practices (although FTC had the means readily at hand to determine if any such injury had occurred, *see* Mot. to Dismiss (Apr. 24, 2015) at 3, 15 (discussing FTC's "Consumer Sentinel" and "Internet Lab")), Wallace's testimony proves that no consumer ever *could likely* be substantially harmed since the 1718 File never left Atlanta, Georgia, Trial Tr. vol. 9 at 1444:1-4 (Testimony of Richard Wallace), never "spread" across any P2P network, *id*., and was only ever found by a uniquely skilled computer analyst who was purportedly told to hack and steal from innocent victims to "supplement" a propriety technology

that, for all its sophistication, was "not downloading . . . not catching" LabMD's file. Trial Tr. vol. 9 at 1372:5-11.

CONCLUSION

For these reasons, LabMD respectfully requests that this Court grant its Motion and dismiss the Complaint with prejudice.

Dated: May 13, 2015.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on May 13, 2015, I caused to be filed the foregoing document and an electronic copy with the Office of the Secretary:

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Secretary
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I also certify that I delivered via electronic mail and caused to be hand-delivered a copy of the foregoing document to:

The Honorable D. Michael Chappell
Chief Administrative Law Judge
Federal Trade Commission
600 Pennsylvania Ave., NW, Rm. H-110
Washington, DC 20580

I further certify that I delivered via electronic mail a copy of the foregoing document to:

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Dated: May 13, 2015 By: /s/ Patrick J. Massari

CERTIFICATE OF ELECTRONIC FILING

I certify that the electronic copy sent to the Secretary of the Commission is a true and correct copy of the paper original and that I possess a paper original of the signed document that is available for review by the parties and the adjudicator.

Dated: May 13, 2015 By: /s/ Patrick J. Massari

Notice of Electronic Service

I hereby certify that on May 13, 2015, I filed an electronic copy of the foregoing Respondent LabMD, Inc.'s Reply in Support of its Mtn. to Dismiss for Lack of Due Process, with:

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