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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
OAKLAND DIVISION

FEDERAL TRADE COMMISSION,

Plaintiff,

vs.

AMERICAN FINANCIAL BENEFITS CENTER, a corporation, also d/b/a AFB and AF STUDENT SERVICES;

AMERITECH FINANCIAL, a corporation;

FINANCIAL EDUCATION BENEFITS CENTER, a corporation; and

BRANDON DEMOND FRERE, individually and as an officer of AMERICAN FINANCIAL BENEFITS CENTER, AMERITECH FINANCIAL, and FINANCIAL EDUCATION BENEFITS CENTER,

Defendants.

Case No. 18-cv-00806-SBA

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF FEDERAL TRADE COMMISSION'S MOTION TO STRIKE DEFENDANTS' LACHES, ESTOPPEL, AND OFFSET AFFIRMATIVE DEFENSES

Hearing: November 14, 2018
Time: 1:00 p.m.
Location: Courtroom 210
1301 Clay Street, 2nd Floor
Oakland, CA 94612
Judge: Hon. Saundra Brown Armstrong

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NOTICE OF MOTION TO STRIKE THREE AFFIRMATIVE DEFENSES

Pursuant to Civil Local Rule 7-2 and Federal Rule of Civil Procedure 12(f), the Federal Trade Commission ("FTC") moves to strike three of American Financial Benefits Center, Ameritech Financial, Financial Education Benefits Center, and Brandon Frere's (collectively, "Defendants") asserted affirmative defenses as legally insufficient and prejudicial. The FTC submits this motion following communications between counsel for all parties.

I. Introduction

On February 7, 2018, the FTC filed a Complaint for Injunctive and Other Equitable Relief (Dkt. 1) ("Complaint") against Defendants for violations of the Federal Trade Commission Act ("FTC Act") and the Telemarketing Sales Rule ("TSR"). Specifically, evidence shows that Defendants (1) misrepresented that consumers qualified for federal programs that would permanently reduce their student loan payment or lead to total loan forgiveness; (2) misrepresented that consumers' funds were going towards their student loan payments; and (3) charged consumers advance fees, in violation of the TSR. Defendants have collected millions of dollars from consumers, none of which has gone towards consumers' student loan payments. FTC's Motion for Preliminary Injunction, at 3 (Dkt. 22).

Defendants raised a variety of affirmative defense in their Answer to the FTC's Complaint (Dkt. 162) ("Answer"). The FTC is mindful that motions to strike are disfavored, and seeks to strike only three of Defendants' affirmative defenses – laches, estoppel, and offsets. Although many of Defendants' remaining affirmative defenses are also legally insufficient, the FTC is focusing on practical issues that will streamline this litigation. For example, Defendants plan to use the improper defenses of laches and estoppel to conduct overly broad and burdensome discovery on the FTC, which may create wasteful discovery disputes that require court intervention. Striking these affirmative defenses now will preserve resources and allow the parties to focus on the relevant issues in this case. Accordingly, the FTC respectfully requests that the Court strike Defendants' affirmative defenses of laches and estoppel, as well as Defendants' improper defense that any monetary judgment should be offset by alleged benefits to consumer victims.

II. This Court Should Strike Insufficient Defenses to Prevent Wasteful Litigation

Under Fed. R. Civ. P. 12(f), it is appropriate to strike "an insufficient defense, or any redundant, immaterial, impertinent, or scandalous matter." The function of a motion to strike is avoidance of "the expenditure of time and money that must arise from litigating spurious issues by dispensing with those issues prior to trial." *Fantasy, Inc. v. Fogerty*, 984 F.2d 1524, 1527 (9th Cir. 1993), *rev'd on other grounds*, 510 U.S. 517 (1994) (citation omitted). As a "sensible matter," courts should strike "a defense that might confuse the issues in the case and would not, under the facts alleged, constitute a valid defense to the action." *FDIC v. Main Hurdman*, 655 F. Supp. 259, 263 (E.D. Cal. 1987) (citation omitted).

There are sound policy reasons to strike legally insufficient affirmative defenses aimed at the government. An agency charged with enforcement of an important regulatory scheme in the public interest, such as the FTC, should not be thwarted or distracted by conclusory and improbable allegations. This is not an abstract concern in this case. Defendants have already used their nebulous allegation of FTC misconduct, now formally asserted as their laches and estoppel defenses, as a pretense to seek broad, burdensome, and prejudicial discovery from the FTC. *See, e.g.*, Declaration of Kelly Ortiz ("Ortiz Decl.") Exhibit A (Defendants' Request for Production of Documents 4, 5, 6, and 22 (seeking evidence from FTC investigations unrelated to the Defendants)). The Court should dispose of Defendants' legally insufficient and poorly pleaded defenses so they do not distract from the real issues in this case.

III. Defendants' Laches and Estoppel Defenses Are Not Adequately Pled

As an initial matter, Defendants have not met the minimum pleading requirement for their laches and estoppel defenses, as required by Fed. R. Civ. P. 8. Affirmative defenses must be pled with sufficient particularity to notify the plaintiff of what conduct is alleged to give rise to the defense. *Main Hurdman*, 655 F. Supp. at 262. As described below, Defendants ignore essential elements of their laches and estoppel defenses. On this basis alone, the Court should strike these defenses.

A. Defendants Do Not Provide Fair Notice of the Facts Allegedly Supporting their Laches Defense

Defendants have provided no factual basis for the defense of laches. To prove laches, the defendant must prove (1) an unreasonable delay by the plaintiff and (2) prejudice to itself. *Evergreen Safety Council v. RSA Network Inc.*, 697 F.3d 1221, 1226 (9th Cir. 2012). Defendants here meet neither prong. First, Defendants do not explain how the FTC waiting four months to file its Complaint, during which time the FTC met with counsel for the Defendants on multiple occasions to discuss whether the FTC should bring the instant action, constitutes unreasonable delay. Second, Defendants also do not specify how the claimed "unreasonable delay" caused them prejudice. Instead, they simply state that the FTC "only decided to sue Defendants after gross delay, prejudice to Defendants, and in response to the Defendants' suit for declaratory judgment." Answer at 21. Defendants' barebones pleading and conclusory statements do not provide the FTC with fair notice of their defense, particularly the prejudice Defendants allegedly suffered while continuing to operate during negotiations with the FTC.

B. Defendants Fail to Plead Numerous Elements Required for an Estoppel Defense

Defendants also fail to plead adequately their estoppel defense. "To prove equitable estoppel, Defendants must show that: (1) the FTC knew the facts; (2) the FTC intended that its conduct be acted on, or acted so that Defendants had a right to believe it is so intended; (3) Defendants were ignorant of the true facts; and (4) Defendants relied on the FTC's conduct to their injury." *FTC v. EDebitPay, LLC*, Case No. CV-07-4880, 2011 U.S. Dist. LEXIS 15750, at *29-30 (C.D. Cal. Feb. 3, 2011) (citing *Watkins v. U.S. Army*, 875 F.2d 699, 707 (9th Cir. 1989)). A party seeking to raise an estoppel defense against the government also must establish three additional elements: (1) affirmative misconduct beyond mere negligence, (2) the government's wrongful act will cause a serious injustice, and (3) the public's interest will not suffer undue damage by imposition of the liability. *Id.* at *30 (citing *United States v. Bell*, 602 F.3d 1074, 1082 (9th Cir. 2010)). Unexplained delay does not constitute affirmative misconduct. *Jaa v. I.N.S.*, 779 F.2d 569, 572 (9th Cir. 1986) (citing *I.N.S. v. Miranda*, 459 U.S. 14, 18-19 (1982)).

Defendants do not satisfy the four elements required to assert an estoppel defense against a non-government plaintiff, let alone the additional three elements required in bringing such an affirmative defense against the government. It's not clear from Defendants' Answer what (1) facts the FTC knew, (2) what conduct of the FTC's the Defendants are referencing, (3) what facts Defendants were previously ignorant of, or (4) how Defendants relied on the FTC's conduct to their injury. The FTC is left to only guess at the gaping holes in Defendants' pleading. Moreover, Defendants fail to (1) articulate any affirmative misconduct by the FTC, beyond their legally insufficient claim of unexplained delay; (2) explain how the FTC's alleged wrongful act caused the Defendants serious injury, and (3) describe how the public's interest will not suffer by estopping this litigation. Because Defendants' Answer does not allege all the elements of estoppel, the Court should strike this affirmative defense. *FTC v. Medicor LLC*, Case No. CV-01-1896, 2001 U.S. Dist. LEXIS 26774, at *11 (C.D. Cal. June 27, 2001) (striking affirmative defense because "Defendants have not alleged the essential elements of estoppel").

In sum, the Court should strike Defendants' sixth and seventh affirmative defenses because they are insufficiently pleaded and do not provide fair notice of their allegations.

IV. Defendants' Alleged Affirmative Defenses Are Insufficient as a Matter of Law

A. Laches Is Inapplicable Against the Government

As a general rule, laches is not a recognized defense against the government in a civil suit to enforce a public right or protect a public interest. *United States v. Summerlin*, 310 U.S. 414, 416 (1940). As the Supreme Court has explained, "The reason underlying the principle . . . is 'to be found in the great public policy of preserving the public rights, revenues, and property from injury and loss, by the negligence of public officers.'" *Costello v. U.S.*, 365 U.S. 265, 281 (1961) (citation omitted). Courts have repeatedly upheld the well-established rule in FTC matters. *See, e.g.*, *FTC v. Image Sales & Consultants, Inc.*, Case No. CV-131, 1997 U.S. Dist. LEXIS 18902, at *3-4 (N.D. Id. November 17, 1997) ("[T]he defense of 'laches' is unavailable when the government is seeking to enforce a public right or protect a public interest."); *FTC v. N. Am. Mktg. & Assocs., LLC*, Case No. CV-12-0914, 2012 U.S. Dist. LEXIS 150102, at *5 (D. Ariz. Oct. 18, 2012); *FTC v. Debt Solutions, Inc.*, Case No. 2:06-cv-00298JLR (W.D. Wash.

Aug. 7, 2006) (Order) (laches defense "unavailable to a party seeking to avoid a governmental entity's exercise of statutory power").[1]

The Court should not permit Defendants to use their laches defense (or any other defense) as a means to undertake a fishing expedition. Permitting this wholly unsupported defense to go forward would unnecessarily complicate this case and waste time, money, and resources. Accordingly, the Court should strike the Defendants' sixth affirmative defense.

B. "Estoppel by Silence" Is Inapplicable Against the Government When There Is No Duty to Act

Defendants have not properly pleaded their estoppel defense and, in any event, it is insufficient as a matter of law. The general principle governing the applicability of estoppel to the federal government is that "the United States is neither bound nor estopped by acts of its officers or agents in entering into an arrangement or agreement to do or cause to be done what the law does not sanction or permit." *United States v. City and County of San Francisco*, 310 U.S. 16, 32 (1940). Applying this general principle, courts have routinely disallowed the application of the estoppel doctrine against the Securities and Exchange Commission, which, like the FTC, is mandated by Congress to enforce federal law. *See, e.g., SEC v. Morgan, Lewis & Bockius*, 209 F.2d 44, 49 (3rd Cir. 1953) ("[T]he [C]ommission may not waive the requirements of an act of Congress nor may the doctrine of estoppel be invoked against the Commission.").

District courts in this circuit have held that the estoppel defense may not be asserted against sovereigns who act to protect the public welfare, such as the FTC. *FTC v. Medlab, Inc.*, Case No. CV-08-0822-SI (N.D. Cal. July 22, 2008) (Order Granting in Part and Denying in Part Plaintiff's Motion to Strike Defendants' Affirmative Defenses ("Illston Order")) at *1 (striking defendants' estoppel defense);[2] *Debt Solutions*, Case No. C06-298JLR ("As to the equitable defenses of estoppel, waiver, unclean hands, and laches, the FTC correctly notes that equitable

[1] This unpublished opinion is attached as Exhibit B to Ortiz Decl., filed concurrently with this motion.

[2] This unpublished opinion is attached as Exhibit C to Ortiz Decl.

defenses are unavailable to a party seeking to avoid a governmental entity's exercise of statutory power."); *United States v. Stringfellow*, 661 F. Supp. 1053, 1062 (C.D. Cal. 1987) ("Since the plaintiffs . . . are acting to protect the public interest, the equitable defenses raised by the defendants cannot be used to preclude liability . . . ."). This action, brought to enforce the FTC Act and the TSR, is clearly an action to protect the public welfare. If estoppel were imposed against the FTC, it would preclude the equitable relief the FTC is seeking, thereby hurting the public's interest in stopping deceptive business practices.

Furthermore, Defendants' basis for their estoppel defense – the FTC's lack of response to their unsolicited letter – is legally insufficient. Defendants center their defense around the FTC's "refus[al] to respond to a letter sent by corporate Defendants on December 30, 2016 to the Chairwoman of Plaintiff, Edith Ramirez . . . ." Answer at 21. However, the FTC had no duty to respond to Defendants' letter, one of millions of pieces of correspondence the agency receives every year. Clark Decl. ¶ 3 (Dkt. 106). Courts have rejected Defendants' "estoppel by silence" argument, holding that mere inaction cannot support a claim of estoppel because it does not rise to the level of affirmative misconduct. *Dickow v. United States*, 654 F.3d 144, 152 (1st Cir. 2011) ("The argument of estoppel by silence on the part of the busy IRS is . . . simply a non-starter."); *FTC v. Algoma Lumber Co.*, 291 U.S. 67, 80 (1934) ("silence . . . will not operate as an estoppel against the community at large"). Permitting Defendants' estoppel by silence defense to stand, and thus subjecting the FTC to overly broad discovery, would set a dangerous precedent for all government agencies. Accordingly, the Court should strike the Defendants' seventh affirmative defense.

C. Monetary Relief in this Case Is Not Subject to Offsets for Alleged Benefits Received by Consumers

In their Answer, Defendants seek offsets for various "benefits" received by deceived consumers. Answer at 22. It is well settled that for violations of the FTC Act, consumer loss is calculated by the amount of money paid by the consumers, less any refunds made. *FTC v. Commerce Planet, Inc.*, 815 F.3d 593, 603 (9th Cir. 2016); *FTC v. Publishers Bus. Servs., Inc.*, 540 F. App'x 555, 558 (9th Cir. 2013), *cert. denied*, 134 S. Ct. 2724 (2014); *FTC v. Kuykendall*,

371 F.3d 745, 766 (10th Cir. 2004) (holding no need to offset gross receipts "by the value of the [product] the consumers received"). Deviating from this standard would prejudice the FTC by unnecessarily increasing the costs of this litigation, including potentially forcing the FTC to hire an expert to rebut Defendants' calculations of alleged consumer benefit.

The Ninth Circuit has specifically rejected the notion that defendants in FTC cases are entitled to offset the alleged value of a product when determining the amount of consumer injury. *Publishers Bus. Servs.*, 540 F. App'x at 557-558. As the Ninth Circuit stated in *Publishers Business Services*, "Courts have previously rejected the contention 'that restitution is available only when the goods purchased are essentially worthless.' . . . This is particularly true where the injury to consumers arises out of misrepresentations made in the sales process, which lead to a 'tainted purchasing decision.'" *Id.* (citing *FTC v. Figgie Int'l*, 994 F.2d 595, 606 (9th Cir. 1993) ("The fraud in the selling, not in the value of the thing sold, is what entitles consumers . . . to full refunds.")). Based on this reasoning, the Ninth Circuit remanded the case and instructed the district court to apply the proper restitution calculation.

On remand, the district court made "no deductions from the first-time orders based on so-called 'satisfied' consumers" and awarded the FTC over $23 million. *FTC v. Publishers Bus. Servs.*, Case No. CV-00620, 2017 U.S. Dist. LEXIS 14720, at *21, 23 (D. Nev. Feb. 1, 2017), *aff'd FTC v. Dantuma*, Case No. 17-15600, 2018 U.S. App. LEXIS 24893, at *5 (9th Cir. Aug. 31, 2018). In August 2018, the Ninth Circuit affirmed the district court's decision stating, "We have previously held that there is 'no authority' for the proposition that equitable monetary awards in the consumer protection context should be reduced by amounts paid by customers who were 'satisfied' or obtained a benefit from the defendant's services." *FTC v. Dantuma*, 2018 U.S. App. LEXIS at *5 (citing *FTC v. Gill*, 265 F.3d 944, 958 (9th Cir. 2001), and *CFPB v. Gordon*, 819 F.3d 1179, 1196 (9th Cir. 2016)).

Similarly, Judge Illston struck an offset defense in another FTC case and later based her monetary judgment on the defendants' gross revenue. In *Medlab*, the defendants attempted to assert the following defense: "Any monetary relief is subject to offsets by the benefits received by consumers, costs associated with the sale of services, and/or refunds paid to consumers."

Answer to Complaint for Injunctive and Other Equitable Relief, at *5.[3] Judge Illston rejected the defendants' argument and granted the FTC's motion to strike Defendants' affirmative defense that any monetary judgment should be offset by benefits to consumer victims. Illston Order at *1. Judge Illston later granted the FTC's motion for summary judgment, holding that the "correct measure of equitable relief" was "defendants' gross sales, minus the amount already refunded to customers." *FTC v. Medlab, Inc.*, 615 F. Supp. 2d 1068, at *33 (N.D. Cal. 2009).

To the extent Defendants claim that consumers were not deceived and received the promised service, they are simply restating their denials to sections of the Complaint, not asserting an affirmative defense. Affirmative defenses are distinct from "negative" defenses to liability. *See* Fed. R. Civ. P. 8(b), (c). Affirmative defenses are not a means to mitigate remedy, but rather, preclude liability even if the plaintiff has proven its prima facie case. *Main Hurdman*, 655 F. Supp. at 262. Here, Defendants can still argue that they did not deceive consumers. However, the Court should strike Defendants' eighth affirmative defense and apply the standard calculation for monetary relief in FTC matters.

V. Conclusion

For the foregoing reasons, Defendants' sixth, seventh, and eighth affirmative defenses are legally insufficient. In order to save time and money, and to focus the parties on meritorious issues, the Court should strike, under Fed. R. Civ. P.12(f), each of these purported defenses.

Respectfully submitted,

ALDEN F. ABBOTT
General Counsel

Dated: September 18, 2018

/s/ Sarah Schroeder
Sarah Schroeder
Roberta Tonelli
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FEDERAL TRADE COMMISSION

[3] This document is attached as Exhibit D to Ortiz Decl.