

1 MARK S. HEGEDUS, DC Bar No. 435525
2 (admitted *pro hac vice*)
3 Federal Trade Commission
4 600 Pennsylvania Avenue NW
5 Washington, DC 20580
6 (202) 326-2115 (tel)
7 (202) 326-2477 (fax)
8 mhegedus@ftc.gov

9 MILES D. FREEMAN, CA Bar No. 299302
10 (Local Counsel)
11 Federal Trade Commission
12 10990 Wilshire Boulevard, Suite 400
13 Los Angeles, CA 90024
14 (310) 824-4332 (tel)
15 (310) 824-4380 (fax)
16 mfreemen@ftc.gov

17 ATTORNEYS FOR APPELLANT
18 FEDERAL TRADE COMMISSION

19 UNITED STATES DISTRICT COURT
20 CENTRAL DISTRICT OF CALIFORNIA

21 FEDERAL TRADE)
22 COMMISSION,)
23 Appellant,)
24 v.)
25 DENNIS EDWARD LAKE,)
26 Appellee.)

Case No. 8:22-cv-00388-CJC
Bankr. No. 8:17-bk-14478-SC
Adv. No. 8:18-ap-01035-SC
Chapter 7

**OPENING BRIEF OF APPELLANT
FEDERAL TRADE COMMISSION**

27
28

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

STATEMENT REGARDING ORAL ARGUMENT

The Federal Trade Commission believes that oral argument would be helpful to address the bankruptcy court’s novel and incorrect understanding of legal and factual issues that have otherwise been settled in this Court, and in light of the FTC’s request that this Court rule on fully briefed issues that the Bankruptcy Court did not reach.

TABLE OF CONTENTS

1

2

3 Table Of Authoritiesiv

4 Introduction 1

5 Questions Presented 2

6

7 Statement Of The Case 3

8 A. Lake Participated in a Fraudulent Mortgage Assistance Relief

9 Scheme 3

10 B. Lake’s Scheme Violated the Federal Trade Commission Act, the

11 Mortgage Assistance Relief Services Rule, and the Telemarketing

12 Sales Rule 5

13 C. The FTC Brings a Civil Action Against Lake, and the U.S.

14 Indicts Him. 8

15 D. Rather Than Paying the Judgment Against Him, Lake Files for

16 Bankruptcy..... 10

17 Summary of Argument 13

18 Standard of Review 13

19 Argument..... 16

20 I. The Bankruptcy Court Erred in Dismissing the Complaint 17

21 A. The Adversary Complaint States a Claim that Lake’s Debt

22 Satisfies the Elements of the Fraud Exception..... 19

23 1. The Adversary Complaint alleges that Lake engaged in

24 “misrepresentation, fraudulent omission or deceptive

25 conduct.” 20

26 2. The Adversary Complaint alleges that Lake had

27 “knowledge” that his statements and conduct were

28 “false or deceptive” and that he had “intent to deceive.” 22

3. The Adversary Complaint alleges that consumers

justifiably relied on Lake’s representations or conduct..... 26

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

4. The Adversary Complaint alleges that consumers were harmed as a result of Lake’s representations or conduct.....28

B. The Bankruptcy Court Erred in Reading the Enforcement Judgment as a Conclusive Determination that Lake’s Debt Was Not for Money Obtained by Fraud.....29

II. The Bankruptcy Court Misapplied Principles of Issue Preclusion in Denying the FTC’s Motion for Summary Judgment on the Issue of Justifiable Reliance.34

A. This Court’s Findings Holding Lake Liable for MARS Rule and TSR Violations Preclude Relitigation of Justifiable Reliance.36

B. This Court’s Findings Holding Lake Liable for Monetary Relief Independently Preclude Relitigation of Justifiable Reliance.42

III. The Court Should Rule that Issue Preclusion Applies to All Elements of the Fraud Exception.....48

A. Misrepresentation, Fraudulent Omission, or Other Deceptive Conduct.....49

B. Knowledge of Fraud and Intent to Deceive51

C. Harm53

Conclusion55

Certificate of Compliance

Certificate of Service

TABLE OF AUTHORITIES

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

CASES

Advanta Nat’l Bank v. Kong (In re Kong),
239 B.R. 815 (B.A.P. 9th Cir. 1999).....23

Affiliated Ute Citizens v. United States,
406 U.S. 128 (1972).....47

Aldabe v. Aldabe,
616 F.2d 1089 (9th Cir. 1980)17

AMG Capital Management, LLC v. FTC,
141 S. Ct. 1341 (2021).....19

Anastas v. Am. Sav. Bank (In re Anastas),
94 F.3d 1280 (9th Cir. 1996).....22

Apte v. Japra (In re Apte),
96 F.3d 1319 (9th Cir. 1996)..... 39, 40, 41, 47, 49

Arm v. A. Lindsay Morrison, M.D., Inc. (In re Arm),
175 B.R. 349 (9th Cir. B.A.P. 1994).....20
87 F.3d 1046 (9th Cir. 1996).....20

Bank of Cordell v. Sturgeon (In re Sturgeon),
496 B.R. 215 (B.A.P. 10th Cir. 2013)..... 20, 49

Barnes v. Roberts (In re Roberts),
538 B.R. 1 (Bankr. C.D. Cal. 2015)..... 20, 27, 46

Chesterfield v. Buck (In re Buck),
75 B.R. 417 (N.D. Cal. 1987) 20, 49

Citibank (S.D.), N.A. v. Eashai (In re Eashai),
87 F.3d 1082 (9th Cir. 1996).....26

Clark v. Bear Stearns & Co., Inc.,
966 F.2d 1318 (9th Cir. 1992)36

Cohen v. de la Cruz,
523 U.S. 213 (1998)..... 19, 28, 53

Deitz v. Ford (In re Deitz),
760 F.3d 1038 (9th Cir. 2014) 15, 20

Dodd v. Hood River County,
59 F.3d 852 (9th Cir. 1995).....38

1 *Doyle v. Raley’s Inc.*,
 158 F.3d 1012 (9th Cir. 1988)17

2

3 *Field v. Mans*,
 516 U.S. 59 (1995)..... 23, 26, 27, 28, 43, 45, 46

4 *Frankfort Digital Servs. v. Kistler (In re Reynoso)*,
 477 F.3d 1117 (9th Cir. 2007).....53

5

6 *FTC v. Abeyta (In re Abeyta)*,
 387 B.R. 846 (Bankr. D.N.M. 2008) 19, 30, 47

7

8 *FTC v. Cyberspace.com, LLC*,
 453 F.3d 1196 (9th Cir. 2006) 40, 44

9

10 *FTC v. Figgie International, Inc.*,
 994 F.2d 595 (9th Cir. 1993)..... 11, 43, 44, 45

11

12 *FTC v. Freecom Communications, Inc.*,
 401 F.3d 1192 (10th Cir. 2005)44

13

14 *FTC v. Gugliuzza*,
 527 B.R. 370 (C.D. Cal 2015) 43, 47

15

16 *FTC v. Ivy Capital, Inc.*,
 No. 2:11-cv-283, 2022 WL 706507 (D. Nev. Mar. 9, 2022).....19

17

18 *FTC v. Kitco of Nevada, Inc.*,
 612 F. Supp. 1282 (D. Minn. 1985).....46

19

20 *FTC v. Lake*,
 181 F. Supp. 3d 692 (C.D. Cal. 2016) *passim*

21

22 *FTC v. Pantron I Corp.*,
 33 F.3d 1088 (9th Cir. 1994)..... 33, 42, 45, 46

23

24 *FTC v. Security Rare Coin & Bullion*,
 931 F.2d 1312 (8th Cir. 1991)46

25

26 *FTC v. Stefanichik*,
 559 F.3d 924 (9th Cir. 2002)..... 33, 42

27

28 *Getsch v. Johnson & Johnson, Fin. Corp. (In re Gertsch)*,
 237 B.R. 160 (B.A.P. 9th Cir. 1999)..... 23, 51

Ghomeshi v. Sabban (In re Sabban),
 384 B.R. 1 (B.A.P. 9th Cir. 2008)..... 28, 53, 54
 600 F.3d 1219 (9th Cir. 2010)28

1 *Grogan v. Garner*,
 498 U.S. 279 (1991).....35

2 *Hal Roach Studios, Inc. v. Richard Feiner & Co., Inc.*,
 3 896 F.2d 1542 (9th Cir. 1989)18

4 *Harmon v. Kobrin (In re Harmon)*,
 5 250 F.3d 1240 (9th Cir. 2016) 36, 49

6 *Harper v. Va. Dept. of Taxation*,
 509 U.S. 86 (1993).....19

7 *Household Credit Servs., Inc. v. Ettell (In re Ettell)*,
 8 188 F.3d 1141 (9th Cir. 1999)23

9 *In re Dickerson*,
 10 372 B.R. 827 (Bankr. N.D. Miss. 2007)52

11 *In re E.R. Fegert, Inc.*,
 887 F.2d 955 (9th Cir. 1989).....48

12 *In re Houtman*,
 13 568 F.2d 651 (9th Cir. 1978).....23

14 *In re Kirsh*,
 973 F.2d 1454 (9th Cir. 1992)46

15 *Itano Farms, Inc. v. Currey (In re Currey)*,
 16 154 B.R. 977 (Bankr. D. Idaho 1993).....52

17 *Matter of Pizza of Hawaii, Inc.*,
 18 761 F.2d 1374 (9th Cir.1985) 16, 48

19 *Muegler v. Bening*,
 20 413 F.3d 980 (9th Cir. 2005).....19

21 *Pac. Boring, Inc. v. Staheli Trenchless Consultants, Inc.*,
 138 F. Supp. 3d 1156 (W.D. Wash. 2015).....38

22 *Reyn’s Pasta Bella, LLC v. Visa USA, Inc.*,
 23 442 F.3d 741 (9th Cir. 2006).....35

24 *Robi v. Five Platters, Inc.*,
 838 F.2d 318 (9th Cir. 1998).....16

25 *Taylor v Sturgell*,
 26 553 U.S. 880 (2008).....38

27 *Turtle Rock Meadows Homeowners Ass’n v Slyman (In re Slyman)*,
 28 234 F.3d 1081 (9th Cir. 2000) 10, 19, 20, 53

1 *U.S. Dep’t of Educ. V. Wallace (In re Wallace),*
 2 259 B.R. 170 (C.D. Cal. 2000)16
 3 *United States v. Green,*
 4 592 F.3d 1057 (9th Cir. 2010)52
STATUTES
 5 11 U.S.C. § 523(a)(2)(A) 1, 2, 3, 10, 19
 6 15 U.S.C. § 45(a)8
 7 15 U.S.C. § 53(b)42
 8 15 U.S.C. § 57a8
 9 15 U.S.C. § 6102(c)8
 10 Pub. L. 111-203, Section 1097, 124 Stat. 1376 (Jul. 21,
 11 2010).....8
 12 Pub. L. 111-24, § 511, 123 Stat. 1734, (May 22, 2009)8
 13 Pub. L. 111-8, Section 626, 123 Stat. 524 (Mar. 11, 2009).....8
RULES
 14 Fed. R. Bankr. P. 7012(b)17
 15 Fed. R. Civ. P. 12(b)17
 16 Fed. R. Civ. P. 12(c).....17
REGULATIONS
 17 12 C.F.R. § 1015.36
 18 12 C.F.R. § 1015.46
 19 12 C.F.R. § 1015.55
 20 12 C.F.R. § 1015.6 7, 30, 51
 21 16 C.F.R. § 310.37, 51
 22 16 C.F.R. § 310.46
 23 Mortgage Assistance Relief Services Rule, Statement of
 24 Basis & Purpose, 75 Fed. Reg. 75092 (Dec. 1, 2010) 5, 7, 24
 25 Telemarketing Sales Rule, Statement of Basis & Purpose,
 26 60 Fed. Reg. 43842 (Aug. 23, 1995).....7, 24
 27
 28

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TREATISES

Restatement (Second) of Torts § 526 (Am. L. Inst. 1965)23
Restatement (Second) of Torts § 551 (Am. L. Inst. 1976)49

INTRODUCTION

1
2 Dennis Edward Lake harmed consumers by knowingly participating in a
3 fraudulent mortgage relief services scheme and was ordered by this Court in a prior
4 Federal Trade Commission enforcement action to repay \$2,349,885 in ill-gotten
5 gains. He later pleaded guilty to criminal charges of conspiracy to commit mail
6 fraud largely on the same facts as the civil case. Instead of paying the judgment
7 against him, Lake filed for bankruptcy and sought to have the debt discharged. The
8 FTC initiated an Adversary Proceeding opposing discharge of Lake's \$2,349,855
9 debt under the fraud exception of the Bankruptcy Code. The FTC showed that
10 Lake's debt is "for money ... obtained by... false pretenses, a false representation,
11 or actual fraud" (11 U.S.C. § 523(a)(2)(A)), and that the civil and criminal
12 judgments conclusively established and precluded relitigation of the fraud
13 exception. The Bankruptcy Court rejected the FTC's motion for summary
14 judgment on issue preclusion and then dismissed the Adversary Complaint
15 entirely, effectively allowing Lake to escape monetary liability for his
16 malfeasance. The FTC now appeals those decisions.

17
18
19
20
21
22
23 This Court should reverse. Its rulings in the prior FTC enforcement action
24 plainly established that Lake's debt—the judgment against him—falls within the
25 fraud exception of the Bankruptcy Code. Indeed, Lake pleaded guilty to criminal
26 fraud charges based on the very same facts. In denying the FTC's motion for
27
28

1 summary judgment, the Bankruptcy Court misapplied governing law on issue
2 preclusion. Furthermore, although the FTC’s Adversary Complaint set forth each
3 element of the fraud exception, the Bankruptcy Court entirely ignored those
4 allegations and its obligation to accept them as true when adjudicating Lake’s
5 motion to dismiss, instead dismissing the Adversary Complaint entirely and
6 effectively allowing Lake to walk away scot-free. This Court should reverse those
7 decisions, and should exercise its discretion to rule on the elements of the fraud
8 exception the Bankruptcy Court did not reach. This Court’s findings in the prior
9 FTC enforcement action preclude relitigation in the Adversary Proceeding of all
10 five elements of the Bankruptcy Code’s fraud exception.
11
12
13
14

15 **QUESTIONS PRESENTED**

16 1. Whether the Bankruptcy Court erred in dismissing the FTC’s
17 Adversary Complaint to except the monetary judgment from discharge under the
18 Bankruptcy Code’s fraud exception to discharge of debt, 11 U.S.C. § 523(a)(2)(A).
19

20 2. Whether the Bankruptcy Court erred in denying summary judgment
21 on the issue of justifiable reliance where this Court’s findings in the prior FTC
22 enforcement action against Lake involved the same issues and facts, thus
23 precluding relitigation in the Adversary Proceeding of the justifiable reliance
24 element of the fraud exception.
25
26
27
28

1 after the affiliate marketers paid him from money they had collected from their
2 clients. *Id.* In 2014, Lake contracted with HOPE Services, an affiliate company run
3 by Brian Pacios and others (collectively the “HOPE Defendants”). *Id.* (HOPE
4 Services later changed its name to HAMP Services. FTCER227.)
5

6 Lake and the HOPE Defendants carried out their scheme in three phases. In
7 phase one, the HOPE Defendants would mail advertisements for mortgage
8 modification services and make unsolicited phone calls to distressed homeowners.
9 *Id.* at 697. The marketing materials falsely represented that HOPE was a non-profit
10 affiliated with the U.S. Government that could help consumers successfully obtain
11 mortgage modifications. *Id.* Consumers who expressed interest were asked to
12 provide some initial documentation, after which the HOPE Defendants told them
13 that they were preliminarily approved for a loan modification. *Id.*
14
15
16
17

18 In phase two, the HOPE Defendants told consumers that they needed to
19 make three monthly “trial mortgage payments,” through the HOPE Defendants, to
20 the lenders’ trust accounts. In reality, the accounts were not the lenders’ trust
21 accounts at all, but belonged to the HOPE Defendants themselves. *Id.* After the
22 first payment, the HOPE Defendants would hand the consumers off to Lake, *id.*,
23 paying him \$800 per account from the initial trial mortgage payment. *Id.* at 702.
24
25

26 In phase three, Lake and his Advocacy Department would contact the
27 consumers, assure them that the modification process was underway (even though
28

1 consumers might be receiving foreclosure notices), and ask additional questions
2 before starting to “advocate” on consumers’ behalf. *Id.* at 697. Lake knew that the
3 HOPE Defendants were not holding consumers’ payments in trust accounts, yet he
4 never disclosed that to consumers. *Id.* at 700. Instead, Lake continued interacting
5 with consumers, prompting them to make the second and third “trial” mortgage
6 payments. *Id.* Lake and the HOPE Defendants never sent these payments to the
7 mortgage holders; instead, they simply kept the money, which caused harm to at
8 least 432 consumers totaling \$2,349,885. *Id.* at 702-03; FTCER199-200.
9
10
11

12 **B. Lake’s Scheme Violated the Federal Trade Commission Act, the**
13 **Mortgage Assistance Relief Services Rule, and the Telemarketing**
14 **Sales Rule.**

15 The Mortgage Assistance Relief Services Rule (“MARS Rule”) prohibits
16 MARS providers from requesting or receiving payment of any fee or other
17 consideration until a consumer has executed a written agreement with the
18 consumer’s loan holder or servicer modifying the mortgage terms. 12 C.F.R.
19 § 1015.5(a) (“advance-fee” prohibition). Such advance fees are red flags for
20 fraudulent conduct, such as deceptive promises to negotiate mortgage relief.
21 MARS Rule, Statement of Basis & Purpose, 75 Fed. Reg. 75092, 75119-75120
22 (Dec. 1, 2010). By requiring up-front payment long before any ultimate relief
23 (which they never secured anyway), Lake and the HOPE Defendants violated that
24 rule.
25
26
27
28

1 The MARS Rule also prohibits any MARS provider from misrepresenting,
2 expressly or by implication, any material aspect of any MARS, including the
3 likelihood of obtaining a loan modification, affiliation with the U.S. Government,
4 and the terms and conditions of any refunds. 12 C.F.R. § 1015.3(b). Nor may a
5 MARS provider tell the consumer to refrain from contact or communicate with
6 their lender or loan servicer. *Id.* at § 1015.3(a). The MARS Rule further requires
7 certain mandatory disclosures including: (1) that the provider is not associated with
8 any government and that the services are not approved by any government or
9 lender; 12 C.F.R. § 1015.4(a)(1); (2) that the consumer may stop doing business
10 with the MARS provider or reject an offer for mortgage assistance without having
11 to pay for the services, 12 C.F.R. § 1015.4(b)(1); and (3) that a consumer may lose
12 their home or damage their credit if they stop paying their mortgage, 12 C.F.R.
13 § 1015.4(c). Lake and the HOPE Defendants violated all of those prohibitions and
14 requirements.
15
16
17
18
19

20 The Telemarketing Sales Rule (“TSR”) prohibits sellers/telemarketers from
21 requesting or receiving payment of any fee or consideration in advance of
22 obtaining a loan or other extension of credit when they have guaranteed or
23 represented a high likelihood of success. 16 C.F.R. § 310.4(a)(4). Like the MARS
24 Rule, the TSR’s advance-fee prohibition aims to protect consumers from
25 sellers/telemarketers who make false promises of success. TSR, Statement of Basis
26
27
28

1 & Purpose, 60 Fed. Reg. 43842, 43854 (Aug. 23, 1995). It also prohibits sellers
2 and telemarketers from “making a false or misleading statement to induce any
3 person to pay for goods or services,” 16 C.F.R. § 310.3(a)(4), and from
4 misrepresenting any material aspect of the seller’s refund policies, 16 C.F.R.
5 § 310.3(a)(2)(iv). Lake and the HOPE Defendants violated all of those
6 prohibitions.
7
8

9 The MARS Rule and the TSR each prohibits any person from providing
10 substantial assistance or support to any MARS provider or to a seller/telemarketer
11 when that person knows or consciously avoids knowing that the provider (MARS
12 Rule) or seller/telemarketer (TSR) is engaged in any act or practice that violates
13 these rules. 12 C.F.R. § 1015.6; 16 C.F.R. § 310.3(b). The FTC promulgated the
14 MARS Rule prohibition on substantial assistance because “[m]any MARS
15 providers rely on, or work in conjunction with, other entities to advertise their
16 services and operate their businesses.” MARS Rule, Statement of Basis & Purpose,
17 75 Fed Reg. at 75123. It specifically identified “back-end handling of consumer
18 files” as one of the “critical support functions” that constitutes “substantial
19 assistance.” *Id.* As a back-end provider of support for MARS, Lake was covered
20 by and violated those provisions.
21
22
23
24
25
26
27
28

1 Violations of the MARS Rule and TSR also constitute unfair or deceptive
2 acts or practices in or affecting commerce in violation of the Section 5(a) of the
3 FTC Act, 15 U.S.C. § 45(a).²
4

5 **C. The FTC Brings a Civil Action Against Lake, and the U.S. Indicts**
6 **Him.**

7 In April 2015, the FTC brought a civil enforcement action against Lake and
8 the HOPE Defendants for violating the FTC Act, the MARS Rule, and the TSR.
9
10 *FTC v. Lake*, SACV 15-00585-CJC (C.D. Cal.) (“Enforcement Action”). The FTC
11 charged Lake with assisting and facilitating a deceptive mortgage relief services
12 scheme and deceptive telemarketing by knowingly providing substantial assistance
13 to the fraud. *Lake*, 181 F. Supp. 3d at 697.
14

15 In February 2016, this Court granted the FTC’s motion for summary
16 judgment holding Lake liable for his participation in the scheme. *Id.* at 704. (The
17 HOPE Defendants had admitted liability and settled the case against them by that
18 point. *Id.* at 697.) The Court held that Lake had substantially assisted the HOPE
19 Defendants in violating the MARS Rule and the TSR. *Id.* at 700-01. In particular,
20
21
22

23
24 ² See 2009 Omnibus Appropriations Act, Pub. L. 111-8, Section 626, 123 Stat.
25 524, 678 (Mar. 11, 2009), as clarified by the Credit Card Accountability
26 Responsibility and Disclosure Act of 2009, Pub. L. 111-24, § 511, 123 Stat. 1734,
27 1763-64 (May 22, 2009), and amended by the Dodd-Frank Wall Street Reform and
28 Consumer Protection Act, Pub. L. 111-203, Section 1097, 124 Stat. 1376, 2102-03
(Jul. 21, 2010); 15 U.S.C. § 6102(c), 15 U.S.C. § 57a(d)(3).

1 the Court found that Lake knew the HOPE Defendants were not sending the trial
2 mortgage payments to lenders, as consumers were led to believe, and that Lake
3 concealed the truth from them. *Id.* at 701. According to the Court:
4

5 Fraud was the HOPE Defendants’ business model, and Lake knew it.
6 Nonetheless he continued contracting with them, continued to assist
7 them in procuring payments from clients, ... and continued to refuse
8 to inform customers about the location and use of their trial payments.

9 *Id.* Further, the Court found that Lake’s back-end services were “crucial” in
10 causing consumers to continue to make those payments. *Id.* at 702.

11 In March 2016, this Court entered judgment against Lake for \$2,349,885,³
12 which represented consumers’ total payments, and permanent injunctive relief to
13 protect consumers from Lake’s repeated involvement in fraudulent mortgage relief
14 services schemes. *FTC v. Lake*, No. SACV 15-00585-CJC, Amended Final
15 Judgment, ECF No. 132 (C.D. Cal. Mar. 22, 2016).
16
17

18 In December 2017, the United States indicted Lake and others for
19 conspiracy to commit mail fraud and other crimes, based on the same facts at issue
20 in the FTC’s Enforcement Action. FTCER225 (“Criminal Action”). In May 2019,
21 Lake pleaded guilty, admitting his intent and the operative facts. FTCER258-259;
22
23
24

25
26 ³ This Court initially set the amount at \$2,104,031.56, *Lake*, 181 F. Supp. 3d at
27 703, but later increased it to \$2,349,855. *FTC v. Lake*, No. SACV 15-00585-CJC,
28 Minute Order Amending Final Judgment, ECF No. 131 (C.D. Cal. Mar. 22, 2016).

1 FTCER283-299. In January 2020, the District Court (Judge Guilford) found Lake
2 guilty based on his plea admissions and convicted him. FTCER302.

3
4 **D. Rather Than Paying the Judgment Against Him, Lake Files for
5 Bankruptcy.**

6 Lake did not repay his ill-gotten gains. Instead, in November 2017, Lake
7 filed a Chapter 7 petition seeking discharge of his judgment debt. The FTC filed an
8 Adversary Complaint under 11 U.S.C. § 523 in February 2019, FTCER001, which
9 it later amended, FTCER020. Lake filed an Answer generally denying the
10 allegations. FTCER041.

11
12 In July 2020, the FTC moved for summary judgment and sought an order
13 declaring that the \$2,349,885 Enforcement Judgment was excepted from discharge
14 under 11 U.S.C. § 523(a)(2)(A) as “debt ... for money ... obtained ... by false
15 pretenses, a false representation or actual fraud.” FTCER044. The FTC showed
16 that the fully litigated facts determined in the Enforcement Judgment met the five
17 elements of the fraud exception to discharge: (1) misrepresentation, fraudulent
18 omission or deceptive conduct by the debtor; (2) knowledge of the falsity or
19
20
21
22
23
24
25
26
27
28

See Turtle Rock Meadows Homeowners Ass’n v Slyman (In re Slyman), 234 F.3d
1081, 1085 (9th Cir. 2000); FTCER060-067. As the FTC showed, those elements

1 were further ratified by Lake's guilty plea, which established that he acted with the
2 intent to defraud. FTCER064. Lake thus could not relitigate the facts in the
3 Adversary Proceeding, and the FTC was entitled to summary judgment as a matter
4 of law.
5

6 In the first of the three judgments under review, the Bankruptcy Court
7 denied the FTC's motion for summary judgment. FTCER068. The court held that
8 the Enforcement Judgment did not establish justifiable reliance on Lake's
9 misrepresentations, thus defeating application of the fraud exception to discharge.
10 In the court's view, because the FTC did not have to show justifiable reliance to
11 prove Lake's MARS Rule and TSR violations, there were no findings on justifiable
12 reliance to be given preclusive effect in the Adversary Proceeding. FTCER075-
13 078.
14
15
16

17 The FTC demonstrated that, under *FTC v. Figgie International, Inc.*, 994
18 F.2d 595 (9th Cir. 1993), it had established a presumption of the requisite degree of
19 reliance by proving "that the defendant made material misrepresentations, that they
20 were widely disseminated, and that consumers purchased the defendant's product."
21 *Id.* at 605-06. The Bankruptcy Court rejected that showing, stating that the FTC
22 had not demonstrated that the degree of reliance recognized in *Figgie* satisfies the
23 fraud exception's requirement of "justifiable reliance" nor that the presumption
24
25
26
27
28

1 “equates to proof by a preponderance of the evidence of justifiable reliance.”

2 FTCER082 (underscoring in original).⁴

3
4 The Bankruptcy Court declined to rule on the other four elements of the
5 fraud exception. FTCER085. The court said that its order “is without prejudice to
6 the FTC to file a motion for partial summary judgment based on issue preclusion
7 with respect to issues other than justifiable reliance.” *Id.*

9 After discovery, Lake moved to dismiss the Adversary Complaint. His chief
10 argument was an attack on the legal bases for the underlying judgment.

11
12 FTCER086. The FTC filed a motion for partial summary judgment, FTCER184,
13 arguing on independent grounds that (1) the evidence in the Adversary Proceeding
14 showed no disputed issues of material fact on the five elements of the fraud
15 exception, FTCER207-215; and (2) the Enforcement Judgment and the Criminal
16 Action precluded relitigation of those elements, FTCER216-223.

17
18
19 In the second order on review, the Bankruptcy Court granted Lake’s motion
20 to dismiss. FTCER373. The Bankruptcy Court held that the Enforcement Judgment
21 was a “debt ‘for’ violating FTC regulations, not a debt ‘for’ obtaining money by
22

23
24
25

⁴ The Bankruptcy Court also said that the Criminal Action was not preclusive on
26 the issue of justifiable reliance because reliance is not an element of an offense
27 under the mail fraud statute. FTCER083-084. The FTC had not argued that the
28 Criminal Action precluded relitigation of justifiable reliance in the Adversary
Proceeding.

1 false pretenses, a false representation or actual fraud.” FTCER377. Repeating its
2 earlier conclusions on reliance, the Bankruptcy Court also stated that the
3 Enforcement Judgment did not render any findings that Lake’s debt was obtained
4 by “false pretenses, a false representation or actual fraud.” FTCER379.

5
6 In the third order on review, the Bankruptcy Court denied the FTC’s motion
7 for partial summary judgment as moot given the court’s dismissal of the Adversary
8 Complaint. FTCER381.
9

10 **SUMMARY OF ARGUMENT**

11
12 Lake knowingly participated in a fraudulent scheme that swindled
13 distressed homeowners of \$2,349,855 and was ordered by this Court to repay these
14 ill-gotten gains. Instead of paying as ordered, he declared bankruptcy. The debt
15 plainly falls within the fraud exception of the Bankruptcy Code, but the
16 Bankruptcy Court approved discharge of the debt anyway. The decision was
17 riddled with error, and this Court should not only reverse, but direct the entry of
18 summary judgment to the Commission on remand.
19
20

21
22 1. The Commission’s Adversary Complaint alleged every element of the
23 fraud exception to discharge in bankruptcy. Instead of accepting those allegations
24 as true, as the law requires, the Bankruptcy Court dismissed the Adversary
25 Complaint on the theory that the Enforcement Judgment had conclusively
26 determined that Lake’s debt was *not* for money obtained by fraud. That was a gross
27
28

1 misreading of this Court’s ruling. The Enforcement Judgment leaves no room for
2 doubt that Lake’s debt for violating the MARS Rule and TSR is a debt for money
3 obtained by “false pretenses, a false representation or actual fraud.” The Court
4 determined explicitly that “[f]raud was the HOPE Defendants’ business model, and
5 Lake knew it.” That understanding permeates the Court’s understanding
6 throughout the Enforcement Judgment, including its findings that Lake violated the
7 MARS Rule and TSR and its imposition of a \$2,349,885 monetary judgment.
8
9

10 2. The Bankruptcy Court erred in denying the FTC’s motion for summary
11 judgment. The question of justifiable consumer reliance was fully litigated and
12 decided in the FTC’s favor in the underlying proceeding before this Court, but the
13 Bankruptcy Court held that the Enforcement Judgment did not preclude relitigation
14 of that question. The ruling was wrong for two independent reasons.
15
16

17 First, the Bankruptcy Court wrongly insisted that preclusion could apply
18 only if the words “justifiable reliance” appear in the Enforcement Judgment. Under
19 the law, however, where an earlier court necessarily decided an issue, issue
20 preclusion applies even in the absence of an express finding. The Bankruptcy
21 Court overlooked the core finding of the Enforcement Judgment that Lake failed
22 to disclose to consumers the fraudulent nature of the HOPE Defendants’ services,
23 including the fact that their trial mortgage payments were not being held in trust
24 for their lenders. The Bankruptcy Court also wrongly determined that preclusion
25
26
27
28

1 prior case presents a mixed question of law and fact in which the legal issues
2 predominate” and is also reviewed *de novo*. *Robi v. Five Platters, Inc.*, 838 F.2d
3 318, 321 (9th Cir. 1998). A bankruptcy court’s rulings on summary judgment are
4 reviewed *de novo*, *U.S. Dep’t of Educ. V. Wallace (In re Wallace)*, 259 B.R. 170,
5 178 (C.D. Cal. 2000), and a district court sitting as an appellate court has the
6 authority to consider any issue presented by the record, even if not addressed by
7 the bankruptcy court. *Matter of Pizza of Hawaii, Inc.*, 761 F.2d 1374, 1379 (9th
8 Cir.1985).

12 ARGUMENT

13 Three orders of the Bankruptcy Court are now before this Court on appeal:
14 the order denying the FTC’s motion for summary judgment (FTCER068), the
15 order dismissing the FTC’s Adversary Complaint (FTCER373), and the order
16 denying as moot the FTC’s motion for partial summary judgment (FTCER381). At
17 the outset, the dismissal order was erroneous and should be reversed. In addition,
18 the Bankruptcy Court erroneously denied summary judgment on the justifiable
19 reliance element of the fraud exception. Finally, this Court should exercise its
20 discretion and rule on the remaining elements of the fraud exception to discharge
21 of debt, because the necessary issues were already decided in earlier litigation.
22 Rulings in the FTC’s favor on all three orders would allow the Court to instruct the
23 Bankruptcy Court to enter judgment in the FTC’s favor.
24
25
26
27
28

1 **I. THE BANKRUPTCY COURT ERRED IN DISMISSING THE COMPLAINT.**

2 In the first ruling under review, the Bankruptcy Court granted Lake’s
3 motion for judgment on the pleadings, which Lake had styled as a “motion to
4 dismiss.”⁵ Rather than accept the Adversary Complaint’s allegations as true, as it
5 was obligated to do, the Bankruptcy Court ruled on its own initiative that a “person
6 can violate the [MARS Rule and TSR] without obtaining money by false pretenses,
7 a false representation or actual fraud.” FTCER377.⁶ That ruling ignored the
8 Adversary Complaint’s allegations that *in this case* Lake’s violations of the MARS
9 Rule and TSR *did involve* fraud and that his debt was obtained by false pretenses, a
10 false representation or actual fraud.
11
12
13

14 Under Fed. R. Bankr. P. 7012(b) and Fed. R. Civ. P. 12(c), the Bankruptcy
15 Court was required to construe the Adversary Complaint’s allegations as true and
16 in the light most favorable to the FTC, much like a 12(b)(6) motion. *Doyle v.*
17 *Raley’s Inc.*, 158 F.3d 1012, 1014 (9th Cir. 1988). And like a Rule 12(b)(6)
18 motion, judgment on the pleadings is proper only “when the moving party clearly
19
20
21

22 ⁵ Lake filed the motion long after he had answered the Adversary Complaint.
23 Given that posture, Lake’s motion could not be construed as a motion to dismiss
24 for failure to state a claim under Fed. R. Bankr. P. 7012(b) and Fed. R. Civ. P.
25 12(b)(6). Rather, Lake’s motion should have been construed as a motion for
26 judgment on the pleadings pursuant to Fed. R. Civ. P. 12(c). *See Aldabe v. Aldabe*,
616 F.2d 1089, 1093 (9th Cir. 1980).

27 ⁶ The Bankruptcy Court did not address Lake’s arguments in his motion
28 (FTCER088-110) or the FTC’s arguments in opposition (FTCER346-357).

1 establishes on the face of the pleadings that no material issue of fact remains to be
2 resolved and that it is entitled to judgment as a matter of law.” *Hal Roach Studios,*
3 *Inc. v. Richard Feiner & Co., Inc.*, 896 F.2d 1542, 1550 (9th Cir. 1989). In
4 concluding that the “Adversary Complaint fails to state a claim upon which relief
5 can be granted,” FTCER380, the Bankruptcy Court erred by failing to assume the
6 truth of the complaint’s allegations and construe them in the FTC’s favor.
7
8

9 The Bankruptcy Court erred further in holding that the Enforcement
10 Judgment was not a “judicial determination by the District Court that Mr. Lake
11 obtained \$2,349,885.00 through false pretenses, a false representation or actual
12 fraud.” FTCER379. In reaching that determination, the Bankruptcy Court misread
13 the Enforcement Judgment, which plainly held that Lake’s violations involved
14 fraudulent conduct.
15
16
17
18
19
20
21
22
23
24
25
26
27
28

1 **A. The Adversary Complaint States a Claim that Lake’s Debt**
2 **Satisfies the Elements of the Fraud Exception.**

3 The Adversary Complaint plausibly alleges that Lake’s debt is not
4 dischargeable under Section 523(a)(2)(A) of the Bankruptcy Code.⁷ Under Section
5 523(a)(2)(A), a debt is not dischargeable if it was “for money ... obtained ... by
6 false pretenses, a false representation, or actual fraud.” 11 U.S.C. § 523(a)(2)(A).
7 “[T]he overriding purpose of [the fraud exception] is to protect victims of fraud”
8 by ensuring that those who commit fraud are not excused from paying redress.
9
10 *Muegler v. Bening*, 413 F.3d 980, 983 (9th Cir. 2005) (citing *Cohen v. de la Cruz*,
11 523 U.S. 213, 222-23 (1998)). The exception also “ensure[s] that the relief
12 intended for honest debtors does not go to dishonest debtors.” *In re Slyman*, 234
13 F.3d at 1085. As we will show here, Lake is the very sort of dishonest debtor who
14 should not be permitted to escape liability to his victims.
15
16
17
18
19

20 ⁷ It is well settled that the FTC has standing to object to dischargeability under
21 § 523(a)(2)(A) for judgment debts arising from consumer protection cases under
22 the FTC Act. *See, e.g., FTC v. Abeyta (In re Abeyta)*, 387 B.R. 846, 850 (Bankr.
23 D.N.M. 2008) (citing cases). Although the Supreme Court recently held that
24 Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), does not authorize equitable
25 monetary relief, *see AMG Capital Management, LLC v. FTC*, 141 S. Ct. 1341
26 (2021), that ruling does not affect the Enforcement Judgment the FTC seeks to
27 except from discharge. The Enforcement Judgment was based on then-controlling
28 precedent, and Lake did not appeal. *See Harper v. Va. Dept. of Taxation*, 509 U.S.
86, 97 (1993); *FTC v. Ivy Capital, Inc.*, No. 2:11-cv-283, 2022 WL 706507, at *2-
*3 (D. Nev. Mar. 9, 2022).

1 The fraud exception applies where five elements are met: (1) the debtor
2 engaged in “misrepresentation, fraudulent omission or deceptive conduct”; (2) the
3 debtor had “knowledge of the falsity or deceptiveness of his statement or conduct”;
4 (3) the debtor had an “intent to deceive”; (4) the creditor justifiably relied on the
5 representations or conduct; and (5) the creditor was damaged as a result of the
6 debtor’s representations or conduct. *Id.* The Adversary Complaint plausibly
7
8 pleaded all five elements.
9

10
11 **1. The Adversary Complaint alleges that Lake engaged in**
12 **“misrepresentation, fraudulent omission or deceptive**
13 **conduct.”**

14 To satisfy the first element of the fraud exception, a creditor must
15 demonstrate “misrepresentation, fraudulent omission or deceptive conduct by the
16 debtor.” *Slyman*, 234 F.3d at 1085; *Deitz*, 760 F.3d at 1050. A debtor is liable
17 under § 523(a)(2)(A) for fraud committed by others where “he acts in concert with
18 others in a scheme.” *Barnes v. Roberts (In re Roberts)*, 538 B.R. 1, 10 (Bankr.
19 C.D. Cal. 2015) (citing *Arm v. A. Lindsay Morrison, M.D., Inc. (In re Arm)*, 175
20 B.R. 349, 352-53 (9th Cir. B.A.P. 1994), *aff’d*, 87 F.3d 1046 (9th Cir. 1996)). That
21 is because a debtor who is a “knowing and active participant in [a] scheme to
22 defraud” meets the deceptive conduct element. *See Chesterfield v. Buck (In re*
23 *Buck)*, 75 B.R. 417, 420-21 (N.D. Cal. 1987); *Bank of Cordell v. Sturgeon (In re*
24 *Sturgeon)*, 496 B.R. 215, 223-24 n.15 (B.A.P. 10th Cir. 2013) (same, citing cases).
25
26
27
28

1 The Adversary Complaint alleges that Lake purposefully associated himself
2 with the HOPE Defendants in carrying out the three-phase deceptive MARS
3 scheme described at pages 3-5 above. FTCER025 ¶ 23.
4

5 The HOPE Defendants first sent mailers and placed robocalls to
6 homeowners facing foreclosure, falsely claiming to be affiliated with the
7 Government and thus highly successful at obtaining mortgage modifications.
8 FTCER025-026 ¶¶ 24-27. When victims responded, the HOPE Defendants then
9 reiterated the false claim of affiliation with the U.S. Government and falsely
10 informed the consumers that their applications for loan modifications had been
11 approved on favorable terms. FTCER026 ¶ 28. The HOPE Defendants discouraged
12 consumers from speaking to anyone, such as an attorney or their lender, who could
13 reveal the fraudulent nature of the HOPE Defendants' services. FTCER026 ¶ 29.
14 They falsely told consumers that after making three initial trial mortgage payments
15 the loan modification would become final. FTCER026 ¶ 30 The HOPE Defendants
16 also falsely told consumers that their money would remain in trust accounts and
17 hid from consumers that the accounts were created under fictitious business names
18 registered to the HOPE Defendants. FTCER026-027 ¶¶ 31-32.
19
20
21
22
23
24

25 The fraud continued once Lake and his Advocacy Department became
26 involved and substantially assisted, supported and perpetuated the scheme. Lake
27 instructed consumers to continue making payments into the bogus trust accounts,
28

1 and helped the HOPE Defendants deflect consumer inquiries about their money.
2 FTCER027-028 ¶¶ 35, 37. Lake made false statements and concealed facts from
3 consumers, including the fact (known to Lake) that the HOPE Defendants were not
4 forwarding the trial mortgage payments to lenders. FTCER028 ¶ 38. Lake
5 instructed his staff to tell consumers to speak with the HOPE Defendants about
6 their payments, and when the HOPE Defendants ignored their calls or failed to
7 deliver promised refunds, Lake falsely claimed he did not have additional contact
8 information. FTCER028 ¶¶ 38-39. Lake’s assistance to the HOPE Defendants’
9 deceptive scheme enabled them to take consumers’ second and third trial mortgage
10 payments, thus increasing the harm to consumers. FTCER028 ¶ 40.

11
12 The foregoing allegations of the Adversary Complaint state claims that the
13 HOPE Defendants’ scheme was fraudulent through and through; that Lake actively
14 participated and furthered the scheme, including through fraudulent conduct of his
15 own; and therefore that Lake engaged in fraudulent conduct.

16
17
18
19
20 **2. The Adversary Complaint alleges that Lake had**
21 **“knowledge” that his statements and conduct were “false**
22 **or deceptive” and that he had “intent to deceive.”**

23 The second and third elements of the fraud exception—knowledge of the
24 fraud and intent to deceive—typically converge because findings concerning the
25 debtor’s knowledge of misrepresentation often show the requisite intent. *See*
26 *Anastas v. Am. Sav. Bank (In re Anastas)*, 94 F.3d 1280, 1286 (9th Cir. 1996);
27
28

1 accord *Household Credit Servs., Inc. v. Ettell (In re Ettell)*, 188 F.3d 1141, 1145
2 n.4 (9th Cir. 1999). Further, under common law fraud principles governing the
3 interpretation of § 523(a)(2)(A),⁸ these elements can be satisfied by showing that
4 the debtor had actual knowledge of the falsity of a representation or “reckless
5 disregard for its truth.” See *Getsch v. Johnson & Johnson, Fin. Corp. (In re*
6 *Getsch)*, 237 B.R. 160, 167 (B.A.P. 9th Cir. 1999) (citing *In re Houtman*, 568
7 F.2d 651, 656 (9th Cir. 1978)). Moreover, the debtor’s knowledge and intent may
8 be shown by circumstantial evidence and inferred from the debtor’s course of
9 conduct. *Id.* at 167-68. “Reckless disregard for the truth” and “conscious avoidance
10 of knowledge” are different terms of art with the same meaning. Both satisfy the
11 common law definition of fraudulent misrepresentation. See *Advanta Nat’l Bank v.*
12 *Kong (In re Kong)*, 239 B.R. 815, 826-27 (B.A.P. 9th Cir. 1999) (citing
13 Restatement (Second) of Torts § 526). The Adversary Complaint’s allegations
14 satisfy the knowledge and intent requirements under these standards.
15
16
17
18
19

20 The Adversary Complaint alleges that Lake knew that the HOPE
21 Defendants were violating the MARS Rule and TSR and that they were soliciting
22 advance fees, which consumers were submitting. FTCER029 ¶¶ 41-42. Under the
23
24

25
26 _____
27 ⁸ Courts interpret the terms in § 523(a)(2)(A), including “actual fraud,” in
28 accordance with common law definitions set forth in the Restatement (Second) of
Torts. *Field v. Mans*, 516 U.S. 59, 69 (1995).

1 MARS Rule and TSR, advance fees are red flags for fraud and *per se* deceptive. 75
2 Fed. Reg. at 75119-75120; 60 Fed. Reg. at 43854. Further, a steady stream of
3 consumer calls and emails show that Lake knew the HOPE Defendants were
4 making material misrepresentations to consumers, FTCER029 ¶ 43, including that
5 consumers were approved for loan modifications even before Lake had done
6 anything at all to obtain such modifications. FTCER029 ¶ 44. Lake directly
7 confided twice—to a good friend and to the second-in-command at the Advocacy
8 Department—that he believed the HOPE Defendants were lying to consumers. *Id.*
9 Lake also knew that the HOPE Defendants were not holding consumers' trial
10 mortgage payments in trust but rather were pocketing the money, yet he
11 perpetuated the false claim that the funds were held in trust. FTCER029 ¶ 45.

12 Lake also consciously avoided information confirming that the HOPE
13 Defendants were violating the law, even though from experience he knew that their
14 operations were likely fraudulent. FTCER024-025 ¶¶ 19-22. From his years
15 working with MARS providers that law enforcement had shut down, he was aware
16 of the high likelihood of fraud associated with practices such as soliciting advance
17 fees from consumers. *Id.* Accordingly, he sought to put a buffer between himself
18 and consumers by collaborating with affiliates who would market MARS to
19 distressed consumers while he provided back-end services. FTCER024 ¶¶ 20-21.
20 Nevertheless, he admitted that his business practice was to conduct no due
21
22
23
24
25
26
27
28

1 diligence into how his affiliates operated, such as asking for references or
2 searching the internet for information about them to assure himself that they were
3 not acting fraudulently. FTCER030 ¶ 47. Nor did he ask affiliates how they
4 marketed MARS to consumers or when they requested and received consumer
5 fees. *Id.* Even after he had associated with an affiliate, he continued to consciously
6 avoid knowledge of the affiliate’s practices regarding advance payments, and he
7 admitted to never asking consumers or affiliates about advance fees. FTCER030
8 ¶ 48.

9
10
11
12 Indeed, with respect to the HOPE Defendants, Lake had notice of their
13 fraudulent plans from the outset, yet took no genuine steps to mitigate the
14 dishonesty. When he saw their prototype “approval form,” he suggested a different
15 form that was more “honest and compliant” because it did not falsely tell
16 consumers that a government agency had approved the consumers’ loan
17 modifications. FTCER031 ¶¶ 51-52. Nevertheless, he admitted that he never
18 investigated what form the consumers actually received. FTCER031 ¶ 52. Lake’s
19 conscious avoidance continued throughout his work with the HOPE Defendants,
20 despite his receipt of information that indicated fraud. FTCER031 ¶ 53. Even after
21 he received two subpoenas from the State of Washington about his MARS work
22 and after the Advocacy Department was named as a defendant in a HOPE client’s
23 lawsuit alleging fraud, Lake admitted that he never asked the HOPE Defendants
24
25
26
27
28

1 whether he could see their marketing materials, never asked them what they told
2 consumers or where consumers' payments went, and never verified that the HOPE
3 Defendants sent refunds to consumers. *Id.*

4
5 Those allegations support the claim that Lake had knowledge and reckless
6 disregard for the truth about the HOPE Defendants' fraudulent scheme, as well as
7 an intent to deceive, thus satisfying the second and third elements of the fraud
8 exception.
9

10
11 **3. The Adversary Complaint alleges that consumers
12 justifiably relied on Lake's representations or conduct.**

13 To satisfy Section 523(a)(2)(A), the FTC needed to show that consumers
14 justifiably relied on Lake and the HOPE Defendants' false misrepresentations. *See*
15 *Field v. Mans*, 516 U.S. at 74. As the Ninth Circuit has explained, justifiable
16 reliance "turns on a person's knowledge under the particular circumstances."
17 *Citibank (S.D.), N.A. v. Eashai (In re Eashai)*, 87 F.3d 1082, 1090 (9th Cir. 1996).
18 "Justification is a matter of the qualities and characteristics of the particular
19 plaintiffs, and the circumstances of the particular case, rather than application of a
20 community standard of conduct to all cases." *Field*, 516 U.S. at 71. Reliance on a
21 misrepresentation is "justifiable" even if other, accurate information is available
22 unless a consumer "would at once recognize at first glance that the statement was
23 false." *Id.* at 71-72 (cleaned up). Consumers are "entitled to rely upon
24 representations" corresponding to their ordinary understanding, and to establish
25
26
27
28

1 that their reliance on representations was “justifiable,” the FTC need not prove that
2 they went out of their way to conduct “some kind of investigation or examination”
3 to discover the falsity of the representations. *Id.* at 72 (cleaned up). Reliance is
4 justifiable so long as the deceit was not apparent. *In re Roberts*, 538 B.R. at 10.
5

6 The Adversary Complaint plausibly alleges that consumers justifiably relied
7 on misrepresentations committed by Lake and in which he participated. The HOPE
8 Defendants lured consumers through the false pretenses of affiliation with the U.S.
9 Government and preliminary modification approval. FTCER025-026 ¶¶ 25-29.
10

11 Given those representations, consumers had every reason to make trial mortgage
12 payments in the hopes of obtaining relief. Locking in the initial reliance, the
13 HOPE Defendants then affirmatively tried to prevent consumers from learning the
14 truth, such as discouraging them from speaking to anyone who might reveal the
15 fraudulent nature of the services. FTCER026 ¶ 29.
16
17
18

19 Lake worked hand-in-glove with the HOPE Defendants in the deceit. Once
20 the HOPE Defendants handed off a consumer to Lake, he did not tell them that the
21 HOPE Defendants were lying about the fate of the trial mortgage payments and
22 that consumers were not already approved for loan modifications, even though he
23 knew those things were false. FTCER028 ¶ 38, FTCER029 ¶ 44. Instead, Lake did
24 his part to ensure that consumers would not learn the truth about the HOPE
25 Defendants’ services and that they would continue to make the trial mortgage
26
27
28

1 payments. To increase consumers' reliance on him and prevent them from learning
2 the truth, he instructed them to communicate only with him, not with their lenders,
3 and to continue to make the payments. FTCER027 ¶ 35.

4
5 The Adversary Complaint alleges that Lake's false representations and
6 deceptive omissions, as well as those of the HOPE Defendants, were material to
7 consumers' decisions to begin and continue making the trial mortgage payments.
8 FTCER034 ¶ 65, FTCER038 ¶ 82. And Lake's active concealment of the truth
9 ensured that consumers were unaware of and could not discover the fraud. The
10 allegations in the Adversary Complaint amply support a case of justifiable
11 consumer reliance on the fraudulent conduct. *See Field*, 516 U.S. at 71-72.

12
13
14
15 **4. The Adversary Complaint alleges that consumers were**
16 **harmed as a result of Lake's representations or conduct.**

17 In the Enforcement Judgment, this Court determined consumers were
18 defrauded of \$2,349,885, and that Lake was jointly and severally liable for that
19 amount given his direct participation in the scheme. Section 523(a)(2)(A) excepts
20 from discharge "any debt" for money or property obtained by fraud. *Cohen v. De*
21 *La Cruz*, 523 U.S. at 223. The debtor, here Lake, need not "obtain" the money or
22 property directly from the victim. *Ghomeshi v. Sabban (In re Sabban)*, 384 B.R. 1,
23 6-7 (B.A.P. 9th Cir. 2008), *aff'd in part*, 600 F.3d 1219 (9th Cir. 2010). The
24 Adversary Complaint alleges that Lake provided the critical third phase of the
25 HOPE Defendants' fraudulent scheme and indeed amplified the consumer losses
26
27
28

1 because Lake’s activities caused consumers to make their second and third trial
2 mortgage payments, doubling or tripling the initial harm. FTCER025 ¶ 24,
3 FTCER027 ¶ 34, FTCER035 ¶ 66, FTCER038 ¶ 83.
4

5 * * *

6 The Adversary Complaint plausibly alleges each of the five elements of the
7 fraud exception and that Lake’s debt is for money obtained by false pretenses, false
8 representation, or actual fraud. FTCER035 ¶ 67, FTCER038 ¶ 83. In dismissing
9 the Complaint, the Bankruptcy Court ignored these allegations rather than
10 accepting them as true, as it should have done. What is more, the court relied on an
11 erroneous legal theory when dismissing the complaint, as described below.
12
13
14

15 **B. The Bankruptcy Court Erred in Reading the Enforcement**
16 **Judgment as a Conclusive Determination that Lake’s Debt Was**
17 **Not for Money Obtained by Fraud.**

18 Rather than examining the Adversary Complaint’s allegations to determine
19 if they stated a claim under the fraud exception, the Bankruptcy Court considered a
20 different issue: whether a “person can violate the [MARS Rule and TSR] without
21 obtaining money by false pretenses, a false representation or actual fraud.”
22 FTCER377. And the Bankruptcy Court concluded that “to be able to render the
23 FTC Judgment,” this Court “did not have to make” and thus did not make a finding
24 that Lake’s debt was obtained by fraud. FTCER379. The Bankruptcy Court then
25 held that Lake’s debt was not for money obtained by fraud. FTCER380. In effect,
26
27
28

1 it applied a form of issue preclusion against the FTC. That approach was error,
2 because the Enforcement Judgment is replete with findings of fraud.

3
4 The Bankruptcy Court was incorrect in concluding that because Lake's
5 judgment debt stemmed from his violations of FTC rules, the Bankruptcy Court
6 needed "to determine whether the FTC Judgment is a debt for money ... obtained
7 by false pretenses, a false representation or actual fraud." FTCER375. As this
8 Court's earlier findings make clear, Lake violated the MARS Rule and the TSR by
9 obtaining money through fraudulent conduct. To the extent the Bankruptcy Court
10 was distinguishing between a debt attributable to FTC enforcement proceedings
11 and one attributable to a suit brought directly by Lake's victims, the distinction is
12 not legally relevant because the FTC has standing to recover money obtained from
13 consumers by fraud. *See In re Abeyta*, 387 B.R. at 850 (citing cases).

14
15
16
17 In the Enforcement Judgment, this Court noted that there are "three
18 elements to a violation of the MARS 'substantial assistance' rule: (1) an
19 underlying violation of the MARS rule by a MARS provider; (2) substantial
20 assistance or support by a person to that provider; and (3) knowledge or conscious
21 avoidance, on the part of the person, of the underlying violation." *Lake*, 181 F.
22 Supp. 3d at 699 (quoting 12 C.F.R. § 1015.6). On the first element, the Court held
23 that Lake had offered no evidence to contradict the FTC's showing that the HOPE
24 Defendants violated the MARS rule by: (1) illegally accepting advance fees; (2)
25
26
27
28

1 making material misrepresentations about matters such as the government
2 affiliation, the terms of loan modifications, and the nature of the trial mortgage
3 payments; and (3) failing to make mandatory disclosures, such as that they were
4 not affiliated with the U.S. Government. *Id.*

6 On the second element, this Court easily found that Lake provided
7 substantial assistance, noting that he played “an integral part in the HOPE
8 Defendants’ scheme, because his ‘advocacy’ on the back end meant clients
9 continued to make ‘trial payments’ to the HOPE Defendants in the hope that they
10 were actually getting something for their money.” *Id.* at 700. Contrary to the
11 Bankruptcy Court’s mistaken view, this Court found that Lake himself acted
12 fraudulently: he “substantially assist[ed] the HOPE Defendants by concealing the
13 fact that the clients’ advance fees were *not* being held in trust for the clients’
14 banks, as the HOPE Defendants had represented.” *Id.*

19 On the third element, this Court held that Lake knew that the HOPE
20 Defendants received advance fees, that Lake himself was paid from these advance
21 fees, and that he would not even begin working on a loan modification until he was
22 paid. *Id.* at 700. The Court found that Lake looked the other way even though he
23 knew the HOPE Defendants “were le[ading] people to believe [that their]
24 payments were going directly to the bank” [*i.e.*, the lenders]. *Id.* He also
25 “steadfastly refused to ‘have [a] conversation with consumers about the location of
26
27
28

1 the trial payments, some portion of which were actually sitting in Lake’s own bank
2 account.” *Id.*

3
4 Turning to Lake’s substantial assistance for the HOPE Defendants’ TSR
5 violations, this Court noted that “the substantial assistance provision in the TSR
6 has three elements: (1) there must be an underlying violation of the TSR; (2) the
7 person must provide substantial assistance or support to the seller or telemarketer
8 violating the TSR; and (3) the person must know or consciously avoid knowing
9 that the seller or telemarketer is violating the TSR.” *Id.* at 700-701. Again, the
10 fraudulent nature of Lake’s and the HOPE Defendants’ conduct is clear.
11

12
13 On the first element, the Court held that Lake had offered no evidence
14 contradicting the FTC’s showing that the “HOPE Defendants violated the TSR in
15 at least three ways: by accepting fees while telemarketing after making a false
16 statement, by making material misrepresentations while telemarketing, and by
17 particularly misrepresenting material aspects of their refund policies while
18 telemarketing.” *Id.* at 701. Among other things, the HOPE Defendants “falsely
19 represented to consumers that their payments would be held in trust for their
20 lenders ... and then subsequently took advance fees from those consumers;” “made
21 material misrepresentations about the MARS services they sold;” and
22 “misrepresented their refund policy, telling consumers that their payments would
23 all be refunded if a modification fell through.” *Id.*
24
25
26
27
28

1 On the second element, the Court held that Lake provided substantial
2 assistance for the HOPE Defendants' TSR violations for the same reasons that the
3 Court had concluded he provided substantial assistance for their MARS Rule
4 violations. *Id.* On the third element, summing up Lake's knowledge or and
5 participation, the Court observed that "[f]raud was the HOPE Defendants' business
6 model, and Lake knew it. Nonetheless he continued contracting with them,
7 continued to assist them in procuring payments from clients, ... and continued to
8 refuse to inform customers about the location and use of their trial payments." *Id.*

9 The fraudulent nature of Lake's MARS Rule and TSR violations is evident
10 as well in this Court's decision to make Lake jointly and severally liable for the
11 full \$2,349,885 of harm stemming from the fraudulent scheme. For Lake to be held
12 personally liable for the whole scheme, the FTC had to show, among other things,
13 that he and the HOPE Defendants engaged in fraudulent conduct and that Lake was
14 aware of or recklessly indifferent to that fraud. *See FTC v. Pantron I Corp.*, 33
15 F.3d 1088, 1102 (9th Cir. 1994); *FTC v. Stefanchik*, 559 F.3d 924, 931 (9th Cir.
16 2002). As this Court said, "[f]raud was the HOPE Defendants' business model, and
17 Lake knew it." *Lake*, 181 F. Supp. 3d at 701. The Court characterized "Lake's
18 involvement on the back-end [as] crucial to keeping customers in the scheme long
19 enough to extract additional payments." *Id.* at 702. The Court specifically held that
20 consumers suffered harm from Lake's actions. *Id.* By "persuad[ing] consumers to
21
22
23
24
25
26
27
28

1 stick around while he ‘advocated’ for them with their lenders, their harm
2 continued.” *Id.*

3
4 The Bankruptcy Court thus grossly misread the Enforcement Judgment as
5 not having addressed fraudulent conduct. In fact, the Enforcement Judgment is
6 saturated with determinations that Lake’s MARS Rule and TSR violations
7
8 involved fraudulent conduct and that fraudulent conduct justified the Court’s
9 imposition of the monetary judgment. The Enforcement Judgment leaves no room
10 for doubt that Lake’s debt for violating the MARS Rule and TSR is a debt for
11 money obtained by “false pretenses, a false representation or actual fraud.” The
12 Bankruptcy Court’s contrary reading and its dismissal of the FTC’s Adversary
13 Complaint based on that reading were errors that should be reversed.
14
15

16 **II. THE BANKRUPTCY COURT MISAPPLIED PRINCIPLES OF ISSUE**
17 **PRECLUSION IN DENYING THE FTC’S MOTION FOR SUMMARY JUDGMENT**
18 **ON THE ISSUE OF JUSTIFIABLE RELIANCE.**

19 The FTC sought summary judgment that Lake’s debt was not dischargeable
20 by virtue of the fraud exception and showed that all elements of the exception had
21 been litigated and resolved in the FTC’s favor in the Enforcement Judgment.
22
23 FTCER216-223. The Bankruptcy Court did not address four of the five factors of
24 the fraud exception, but denied the motion in a mistaken belief that the underlying
25 case did not decide whether consumers justifiably relied on Lake’s
26 misrepresentations. FTCER077-079.
27
28

1 The question of justifiable consumer reliance was fully litigated and
2 decided in the FTC's favor in the underlying proceeding before this Court, and
3 Lake should have been precluded from relitigating it. Collateral estoppel (*i.e.*, issue
4 preclusion) applies in bankruptcy court proceedings to prevent relitigation of
5 nonbankruptcy court findings relevant to dischargeability. *Grogan v. Garner*, 498
6 U.S. 279, 284 n.11 (1991). Relitigation of an issue is precluded where "(1) the
7 issue necessarily decided at the previous proceeding is identical to the one which is
8 sought to be relitigated; (2) the first proceeding ended with a final judgment on the
9 merits; and (3) and the party against whom collateral estoppel is asserted was a
10 party or in privity with a party in the first proceeding." *Reyn's Pasta Bella, LLC v.*
11 *Visa USA, Inc.*, 442 F.3d 741, 746 (9th Cir. 2006) (cleaned up).

12 There is no question that elements 2 and 3 are satisfied because the
13 Enforcement Judgment ended with a judgment on the merits and Lake was a party
14 to that proceeding. The only remaining matter is whether the reliance issue in the
15 original proceeding encompassed the one in the Adversary Proceeding. Two
16 independent bases support the conclusion that it did. First, in holding Lake liable
17 for violation of the MARS Rule and the TSR, this Court found that Lake's
18 fraudulent conduct was integral and material to inducing consumers to continue to
19 make trial mortgage payments. Second, in holding Lake liable for monetary relief,
20 the Court found that consumers had "reasonably relied" on Lake's
21
22
23
24
25
26
27
28

1 misrepresentations, a finding that by definition independently satisfies the
2 “justifiable reliance” element of the fraud exception.

3
4 **A. This Court’s Findings Holding Lake Liable for MARS Rule and
5 TSR Violations Preclude Relitigation of Justifiable Reliance.**

6 The Enforcement Judgment’s findings satisfied the reliance element of the
7 fraud exception to discharge. The Bankruptcy Court’s holding to the contrary,
8 based on the absence of the words “justifiable reliance” or “reliance” in the
9 Enforcement Judgement (FTCER075, FTCER078), was error and should be
10 reversed.
11

12 To begin, “[w]hen the issue for which preclusion is sought is the only
13 rational one the factfinder could have found, then that issue is considered
14 foreclosed, even if no explicit finding of that issue has been made.” *Clark v. Bear*
15 *Stearns & Co., Inc.*, 966 F.2d 1318, 1321 (9th Cir. 1992). In other words, if “the
16 court in the prior proceeding necessarily decided the issue,” issue preclusion
17 applies even in the absence of an express finding. *Harmon v. Kobrin (In re*
18 *Harmon)*, 250 F.3d 1240, 1248 (9th Cir. 2016). Thus, even though this Court made
19 no specific mention of “justifiable reliance,” the absence of those words does not
20 mean that the court did not establish justifiable reliance.
21
22
23
24

25 As noted above, unless the falsity of a statement is obvious, a consumer is
26 justified in relying on it. *See* pages 26-27 *supra*. The Enforcement Judgment
27 established that the HOPE Defendants’ statements were not obviously false and
28

1 that consumers justifiably relied on them. Most salient, this Court found that the
2 HOPE Defendants had falsely told consumers that their trial mortgage payments
3 were being held in trust for their lenders. *Lake*, 181 F. Supp. 3d at 699, 701. Lake
4 knew that this representation was false, *id.* at 701, but he “conceal[ed]” the truth,”
5 *id.* at 700, and “refuse[d] to inform customers about the location and use of their
6 trial payments,” *id.* at 701. This Court found that consumers relied on these false
7 representations when they continued to make the trial mortgage payments,
8 increasing the harm they suffered. *Id.* at 702. The only rational interpretation of
9 those findings is a determination that consumers justifiably relied on Lake’s
10 misrepresentations.
11
12
13
14

15 The Bankruptcy Court articulated several reasons for concluding that the
16 Enforcement Judgment had not established justifiable reliance. They all fail on
17 examination.
18

19 First, the Bankruptcy Court focused on whether the MARS Rule and TSR,
20 on the one hand, and the fraud exception of the Bankruptcy Code, on the other, are
21 “the same rule of law”; concluding that they are not, the court held that the
22 “justifiable reliance element of fraud was not necessarily determined by the
23 District Court.” FTCER078. That conclusion rests on a fundamentally mistaken
24 understanding of the “identical issues” requirement of issue preclusion. “[U]nder
25 collateral estoppel, once a court has decided an issue of fact or law necessary to its
26
27
28

1 judgment, that decision may preclude relitigation of the issue in suit *on a different*
2 *cause of action* involving a party to the first case.” *Dodd v. Hood River County*, 59
3 F.3d 852, 863 (9th Cir. 1995) (emphasis added). Factual findings in a prior
4 proceeding may be given preclusive effect in a subsequent proceeding “even if the
5 issue recurs in the context of a different claim.” *Taylor v Sturgell*, 553 U.S. 880,
6 892 (2008); *see also Pac. Boring, Inc. v. Staheli Trenchless Consultants, Inc.*, 138
7 F. Supp. 3d 1156, 1163 (W.D. Wash. 2015) (claims need not be identical so long
8 as issues are). Thus, even though the MARS Rule and TSR are not the same rules
9 of law as the fraud exception, the factual findings necessary to hold Lake liable in
10 the Enforcement Judgment could and did suffice to preclude relitigation of
11 justifiable reliance in the Adversary Proceeding.

12
13
14
15
16 Next, the Bankruptcy Court stated that because Lake was held liable under
17 the substantial assistance provisions of the MARS Rule and TSR and because the
18 “threshold for what constitutes substantial assistance is low,” the FTC failed to
19 show that “‘substantial assistance’ and ‘material omission’ (where there is a duty
20 to disclose) are one and the same thing.” FTCER076. The Bankruptcy Court said
21 that it “can envision nondisclosures that, while satisfying the low threshold for
22 ‘substantial assistance,’ nevertheless do not rise to the level of a material omission
23 for purposes of determining fraud.” *Id.* And here, in the Bankruptcy Court’s view,
24
25
26
27
28

1 “[f]indings regarding the materiality of omissions and the duty to disclose were not
2 necessary—nor does it appear they were made.” *Id.*

3
4 The Bankruptcy Court’s concern seemed to be that a hypothetical non-
5 material nondisclosure that does little to support a fraudulent scheme could still
6 constitute substantial assistance. That concern is misplaced here. This Court noted
7 the importance of “back-end” services provided by Lake, which served as “critical
8 support” to MARS providers, and it contrasted those services with ones that do not
9 further offending practices. *Lake*, 181 F. Supp. 3d at 699. Far from being “not
10 related to the [HOPE Defendants’] offending practices” (FTCER077), Lake’s
11 support “played an integral part in the HOPE Defendants’ scheme.” *Lake*, 181 F.
12 Supp. 3d at 700. Lake’s “‘advocacy’ on the back end meant that clients continued
13 to make ‘trial payments’ to the HOPE Defendants.” *Id.*

14
15
16
17 With respect to the materiality of the failures to disclose, the Bankruptcy
18 Court wrongly concluded that this Court had not found the nondisclosures to be
19 material. Addressing the Ninth Circuit’s decision in *Apte v. Japra (In re Apte)*, 96
20 F.3d 1319 (9th Cir. 1996), the Bankruptcy Court observed that “(1) fraudulent
21 nondisclosure can be the basis for an action for exception to discharge under 11
22 U.S.C. § 523(a)(2)(A), and (2) materiality of the nondisclosure rather than reliance
23 is the decisive element on causation.” FTCER075 (citing *Apte*, 96 F.3d at 1323).
24
25 While the Bankruptcy Court recognized that this Court had found that the HOPE
26
27
28

1 Defendants failed to make mandatory disclosures, it erroneously concluded that hat
2 this Court had not identified the specific nondisclosures or whether they were
3 material. *Id.*

4
5 The Bankruptcy Court’s reasoning overlooks this Court’s core finding
6 about Lake’s nondisclosure—his failure to disclose to consumers the fraudulent
7 nature of the HOPE Defendants’ services, including the fact that their trial
8 mortgage payments were not being held in trust for their lenders. *Lake*, 181 F.
9 Supp. 3d at 701. Lake’s nondisclosure was material to consumers because it
10 “involve[d] information that [was] important to consumers and, hence, likely to
11 affect [consumers’] choice of, or conduct regarding, goods or services.” *FTC v.*
12 *Cyberspace.com, LLC*, 453 F.3d 1196, 1201 (9th Cir. 2006) (cleaned up).

13
14 Consumers made trial mortgage payments because they “hope[d] they were
15 actually getting something for their money.” *Lake*, 181 F. Supp. 3d at 700.

16
17 Thus, contrary to the Bankruptcy Court’s view (FTCER075-078), this case
18 is on all fours with *Apte*, 96 F.3d at 1323-24. There, the defendant failed to
19 disclose to his sublessee the master lessor’s refusal to consent to a condition
20 demanded by the sublessee. Thinking the condition satisfied, the sublessee signed
21 the sublease, started paying rent, and made improvements to the leased property.
22 After the defendant lost the master lease and filed for bankruptcy, the sublessee
23 sought to have his costs declared nondischargeable under the fraud exception. The
24
25
26
27
28

1 Ninth Circuit held that the sublessee had shown justifiable reliance, explaining that
2 the defendant's failure to disclose the master lessor's rejection of the sublease
3 condition was material to the sublessee's decisions and that the defendant had a
4 duty to disclose the truth. *Id.* at 1323-24. A party to a transaction has a duty to
5 disclose "facts basic to the transaction," the Ninth Circuit held, and this duty
6 extends to the other party who is "ignorant of materials fact which he does not
7 have an opportunity to discover." *Id.* at 1324.

8
9
10 Here, just as in *Apte*, Lake knew that consumers made trial mortgage
11 payments "in the hope that they were actually getting something for their money."
12 *Lake*, 181 F. Supp. 3d at 700. Nevertheless, he failed to disclose the fact that the
13 payments were not going to lenders' trust accounts and affirmatively kept
14 consumers in the dark about the truth. *Id.* at 701. These findings readily establish
15 that Lake's nondisclosure was material, that he had a duty to disclosure the truth
16 about the payments, and that his victims justifiably relied on the false promise that
17 their payments were being held in trust.

18
19
20
21 In sum, the Bankruptcy Court was simply wrong when it denied summary
22 judgment on justifiable reliance. This Court's findings in support of holding Lake
23 liable for MARS Rule and TSR violations preclude relitigation of justifiable
24 reliance in the Adversary Proceeding.
25
26
27
28

1
2 **B. This Court’s Findings Holding Lake Liable for Monetary Relief**
3 **Independently Preclude Relitigation of Justifiable Reliance.**

4 Contrary to what the Bankruptcy Court concluded (FTCER080-081), this
5 Court’s findings pertinent to holding Lake liable for monetary relief independently
6 preclude relitigation of justifiable reliance. Under then applicable law, Lake and
7 the HOPE Defendants could be liable for equitable monetary relief under Section
8 13(b) of the FTC Act, 15 U.S.C. § 53(b), only if the FTC showed that they
9 “engaged in misrepresentations or omissions of a kind usually relied on by
10 reasonably prudent persons and that consumer injury resulted.” *Pantron I Corp.*,
11 33 F.3d at 1102.⁹ Further, Lake could be held personally liable if he “(1)
12 participated directly in the deceptive acts or had authority to control them and (2)
13 he had knowledge of the misrepresentations, was recklessly indifferent to the truth
14 or falsity of the misrepresentations, or was aware of a high probability of fraud
15 along with any intentional avoidance of the truth.” *Stefanchik*, 559 F.3d at 931.
16 Applying these standards, this Court held Lake personally liable for the \$2,349,885
17 Enforcement Judgment. *Lake*, 181 F. Supp. 3d at 701-02. In so doing, this Court
18
19
20
21
22
23

24
25
26

27 ⁹ The Supreme Court later held that monetary remedies are not available under
28 Section 13(b), but that holding does not apply retroactively to cases, like this one,
 that were closed by the time of decision. *See n.7 supra*.

1 necessarily found that consumers had justifiably relied on Lake's and the HOPE
2 Defendants' misrepresentations.

3 Under Section 13(b), reasonable reliance is presumed if the evidence shows
4 that the defendant made and widely disseminated material misrepresentations and
5 that consumers purchases goods or services as a result. *See Figgie*, 994 F.2d at
6 605-06; *see also FTC v. Gugliuzza*, 527 B.R. 370, 377 (C.D. Cal 2015). The
7 "reasonable reliance" necessary for this Court's imposition of equitable monetary
8 relief under Section 13(b) *a fortiori* satisfies the "justifiable reliance" requirement
9 of Section 523(a)(2)(A), *Gugliuzza*, 527 B.R. at 377, because reasonable reliance is
10 a more demanding standard than justifiable reliance. *Field*, 516 U.S. at 72-74.

11 There is no question that this Court's findings established reasonable
12 reliance. Lake's and the HOPE Defendants' misrepresentations were widely
13 disseminated, robbing over 400 consumers of \$2,349,885. Consumers seeking
14 mortgage relief were distressed homeowners and reasonably relied on
15 misrepresentations that the HOPE Defendants were affiliated with the U.S.
16 Government, that consumers had already been approved for government-affiliated
17 loan modifications, and that consumers' trial mortgage payments would be held in
18 trust to be paid to lenders. *Lake*, 181 F. Supp. 3d at 699, 701. These
19 misrepresentations were material because they induced these distressed
20 homeowners to make those payments. *Id.* at 699, 701; *Cyberspace.com*, 453 F.3d
21
22
23
24
25
26
27
28

1 at 1201. And “Lake’s involvement on the back end was critical to keeping
2 consumers in the scheme long enough to extract additional payments.” *Lake*, 181
3 F. Supp. 3d at 702.

4
5 The Bankruptcy Court nevertheless concluded that this Court had made no
6 findings on reliance and that the FTC did not even need to show reliance to obtain
7 monetary relief under Section 13(b). FTCER079-082. That conclusion rests on an
8 errant understanding of the Ninth Circuit’s decision in *Figgie*.

9
10 First, the Bankruptcy Court wrongly described *Figgie* as having concluded
11 that “individual reliance on misrepresentations is not an element of an FTC cause
12 of action for an injunction or consumer redress ... under FTC Act Section 13.”
13 FTCER081. *Figgie* held nothing of the sort. The Ninth Circuit explained that under
14 Section 13 “proof of individual reliance *by each purchasing consumer* is not
15 needed,” *Figgie*, 994 F.2d at 605 (emphasis added), meaning that the FTC need not
16 bring each defrauded consumer to court (some cases involve multiple thousands of
17 victims) to testify to their individual conduct. That phrase does not suggest,
18 however, that there is *no* reliance requirement. To the contrary, on the very same
19 page of the opinion, the Ninth Circuit recognized that reliance *is* required. *Id.*; *see*
20 *also FTC v. Freecom Communications, Inc.*, 401 F.3d 1192, 1205 (10th Cir. 2005)
21 (“proof of consumer reliance” is necessary under Section 13). The Ninth Circuit
22 explained that with respect to proof, “[a] presumption of actual reliance arises once
23
24
25
26
27
28

1 the Commission has proved that the defendant made material misrepresentations,
2 that they were widely disseminated, and that consumers purchase the defendant's
3 products." *Id.* at 605-06.

4
5 Next, the Bankruptcy Court focused on the statement in *Figgie* that a
6 "presumption of *actual reliance* arises once the Commission has proved that the
7 defendant made material misrepresentations, that they were widely disseminated,
8 and that consumers purchased the defendant's product." FTCER081 (quoting
9 *Figgie*, 994 F.2d at 605) (emphasis added). It observed that "there are strong
10 reasons to suppose that 'actual reliance' is a lesser and more diluted version of
11 'justifiable reliance.'" *Id.* Citing *Field v. Mans*, 516 U.S. at 72-73, the Bankruptcy
12 Court concluded that "actual reliance" under the FTC Act did not satisfy
13 "justifiable reliance" under § 523(a)(2)(A). FTCER082.

14
15
16
17 The Bankruptcy Court's conclusion misreads both *Figgie* and *Field*.

18
19 While *Figgie* used the term "actual reliance," the reliance standard it
20 adopted was, in fact, equivalent to what *Field* termed "reasonable reliance." When
21 *Figgie* was decided, in order to obtain equitable monetary relief, the FTC had to
22 show that the defendant "engaged in misrepresentations or omissions of a kind
23 usually relied on by reasonably prudent persons." *Pantron I*, 33 F.3d at 1102.
24 Further, a presumption of reasonable reliance arose when such representations
25 "were widely disseminated, and ... the injured consumers actually purchased the
26
27
28

1 defendants' products." *FTC v. Security Rare Coin & Bullion*, 931 F.2d 1312, 1316
2 (8th Cir. 1991); *see also FTC v. Kitco of Nevada, Inc.*, 612 F. Supp. 1282, 1293 (D.
3 Minn. 1985). *Figgie* explicitly relied on these standards as the context for what it
4 termed "actual reliance."¹⁰

6 Further, "reasonable reliance" under the FTC Act more than satisfies the
7 fraud exception's requirement of "justifiable reliance." In *Field*, the Supreme
8 Court concluded that § 523(a)(2)(A)'s reference to "justifiable reliance" required
9 more than "mere reliance in fact," but less than conduct "conform[ing] to the
10 standard of the reasonable [person]." *Field*, 516 U.S. at 70-71. That "reasonable
11 person standard" is what the Ninth Circuit has required under the FTC Act. *See*
12 *Pantron I*, 33 F.3d at 1102 ("misrepresentations or omissions of a kind usually
13 relied on by reasonably prudent persons"). "Reasonable reliance" under the FTC
14
15
16
17
18
19

20 ¹⁰ That *Figgie* was not referencing the same "actual reliance" described in *Field*
21 *v. Mans* is apparent from the Supreme Court's analysis in that case. The "actual
22 reliance" described in *Field* was "falsity [that] would be patent to [a person] if
23 [they] had utilized [their] opportunity to make a cursory examination or
24 investigation." *Id.* at 71 (cleaned up); *see also id.* at 73 n.11. With that kind of
25 reliance, "a person cannot justifiably rely on a representation if he or she knows it
26 is false or its falsity is obvious." *In re Roberts*, 538 B.R. at 11 (citing *In re Kirsh*,
27 973 F.2d 1454, 1459 (9th Cir. 1992)). For example, had the HOPE Defendants
28 represented that Elon Musk would pay off consumers' mortgages if consumers first
made the three trial mortgage payments, the falsity of such a representation would
be obvious. That is not the kind of "actual reliance" *Figgie* was referring to.

1 Act thus exceeds “justifiable reliance.” *Gugliuzza*, 527 B.R. at 327; *In re Abeyta*,
2 387 B.R. at 855.

3
4 The Bankruptcy Court also erroneously questioned whether justifiable
5 reliance under Section 523(a)(2)(A) may even be established by a presumption.
6 FTCER082. The Ninth Circuit, however, has held that it can. In *Apte*, the Court of
7 Appeals explained that reliance or causation could be presumed where there is a
8 failure to disclose material facts that an investor would have considered important
9 in making a decision. 96 F.3d at 1323. It rested that conclusion on the Supreme
10 Court’s decision in a securities fraud case that presented similar issues of
11 widespread reliance on misinformation. *See Affiliated Ute Citizens v. United*
12 *States*, 406 U.S. 128, 153-54 (1972). The Ninth Circuit stated that the “reasoning
13 of these securities cases applies equally to fraud cases in the bankruptcy context”
14 and held that “nondisclosure of a material fact in the face of a duty to disclose has
15 been held to establish the requisite reliance and causation for actual fraud under the
16 Bankruptcy Code.” *In re Apte*, 96 F.3d at 1323 (cleaned up).

17
18
19
20
21
22 Contrary to the Bankruptcy Court’s suggestion, no negative implications for
23 this case flow from *FTC v. Gugliuzza*, 527 B.R. at 377. FTCER078-079. As the
24 Bankruptcy Court correctly observed, *Gugliuzza* found that the representations of
25 the defendant there “were of a kind usually *relied* upon by reasonable and prudent
26 people.” FTCER079 (quoting *Gugliuzza*, 527 B.R. at 377). But in holding Lake
27
28

1 personally liable for monetary relief, this Court necessarily found that consumers
2 reasonably relied on Lake’s and the HOPE Defendants’ misrepresentations.

3
4 **III. THE COURT SHOULD RULE THAT ISSUE PRECLUSION APPLIES TO ALL**
5 **ELEMENTS OF THE FRAUD EXCEPTION.**

6 After dismissing the FTC’s Adversary Complaint (FTCER373), the
7 Bankruptcy Court denied as moot (FTCER381) the FTC’s motion for partial
8 summary judgment arguing for issue preclusion on the four elements of the fraud
9 exception other than justifiable reliance (FTCER184). If this Court revives the
10 Adversary Complaint, the FTC respectfully requests that it rule on issue preclusion
11 for all five elements of the fraud exception (set forth above at page 20). While the
12 Bankruptcy Court did not rule on whether the Enforcement Judgment precludes
13 relitigation of the elements other than justifiable reliance, those issues were fully
14 briefed to the Bankruptcy Court. *See* FTCER187 (FTC Motion), FTCER308 (Lake
15 Opposition), and FTCER358 (FTC Reply). A district court reviewing a bankruptcy
16 court ruling may consider issues not ruled on below where such issues were “raised
17 sufficiently for the trial court to rule on it.” *In re E.R. Fegert, Inc.*, 887 F.2d 955,
18 957 (9th Cir. 1989). “[I]ntermediate appellate courts may consider any issue
19 supported by the record,” even where the trial court did not rule on the issue.
20 *Matter of Pizza of Hawaii*, 761 F.2d at 1379.

21
22
23
24
25
26 As the court that issued those findings in the Enforcement Judgment, this
27 Court is well positioned to rule now on all elements of the fraud exception. If this
28

1 Court rules in the FTC’s favor on any elements, those elements will not require
2 relitigation on remand. And by resolving all the preclusion issues now, the Court
3 can simply instruct the Bankruptcy Court to enter summary judgment in the FTC’s
4 favor, thus serving judicial efficiency.
5

6 **A. Misrepresentation, Fraudulent Omission, or Other Deceptive**
7 **Conduct.**

8 The Enforcement Judgment conclusively decided the first element of the
9 fraud exception: misrepresentation, fraudulent omission, or deceptive conduct.
10 Being a “knowing and active participant” in a fraudulent scheme is deceptive
11 conduct. *In re Buck*, 75 B.R. at 420-21; *In re Sturgeon*, 496 B.R. at 223-24. So is
12 failing to disclose material facts when there is a duty to do so. *In re Apte*, 96 F.3d
13 at 1324 (citing Restatement (Second) of Torts § 551 (1976)). In finding that Lake
14 violated the MARS and TSR substantial assistance rules, this court necessarily
15 found that: (1) the HOPE Defendants and Lake engaged in both misrepresentations
16 and failure to disclose information they were required to disclose; and (2) Lake
17 was a knowing and active participant in the HOPE Defendant’s scheme. The Court
18 thus “necessarily decided the issue,” even if it did not expressly say so. *In re*
19 *Harmon*, 250 F.3d at 1248.
20
21
22
23
24

25 With respect to misrepresentation and failures to disclose, this Court found
26 that the HOPE Defendants “failed to make mandatory disclosures, ...
27 impermissibly represented to consumers that they were affiliated with the
28

1 government and that consumers' payments were being held in trust for their
2 lenders, ...[and] illegally requested and accepted advance fees," which constitute
3 underlying violations of the MARS Rule. *Lake*, 181 F. Supp. 3d at 699. The Court
4 also found underlying violations of the TSR, where the HOPE Defendants: (1)
5 "falsely represented to consumers that their payments would be held in trust for
6 their lenders...and then subsequently took advance fees from those consumers,"
7
8 (2) "made material misrepresentations about the MARS services they sold," and
9
10 (3) "misrepresented their refund policy, telling consumers that their payments
11 would all be refunded if a modification fell through." *Id.* at 701.
12

13 With respect to knowledge, this Court found that the record "easily
14 established" that Lake violated the MARS Rule and TSR substantial assistance
15 standard by knowingly and actively participating in the HOPE Defendants'
16 scheme. *Id.* at 699-701. "Lake played an integral part" in that scheme, because his
17 "advocacy" efforts kept consumers on the hook for payments. *Id.* at 700, 701.
18 Beyond Lake's culpability for the HOPE Defendants' deception, the Court
19 emphasized that Lake also engaged directly in misrepresentations and fraudulent
20 omissions himself, including through concealment of material facts. *Id.* at 700,
21 702. Thus, Lake's knowing and active participation in the fraudulent scheme
22 satisfies the misrepresentation, fraudulent omission, or other deceptive conduct
23 element of the fraud exception.
24
25
26
27
28

1 Moreover, in the Criminal Action, Lake pleaded guilty to engaging in a
2 criminal conspiracy to defraud consumers through the same deceptive conduct at
3 issue here. FTCER264 ¶ 8, FTCER267 ¶ 14. These findings would satisfy the first
4 element of the fraud exception on their own.
5

6 **B. Knowledge of Fraud and Intent to Deceive.**

7 Findings in the Enforcement Judgment and Criminal Action also resolve the
8 second and third elements of the fraud exception—knowledge of the fraud and
9 intent to deceive. Both knowledge and intent under the fraud exception can be
10 satisfied by showing “actual knowledge of the falsity of a statement, or “reckless
11 disregard for its truth.” *In re Gertsch*, 237 B.R. at 167-68. “Intent to deceive can be
12 inferred from the totality of circumstances, including reckless disregard for the
13 truth.” *Id.*
14
15

16 This Court’s Enforcement Judgment satisfies the knowledge and intent
17 elements by ruling that Lake violated the substantial assistance provision of the
18 MARS Rule and TSR. As noted above, an element of substantial assistance under
19 both the MARS Rule and the TSR is that the person “knows or consciously avoids
20 knowing” of the underlying violations. 12 C.F.R. § 1015.6; 16 C.F.R. § 310.3(b).
21 This standard is the same as the “actual knowledge ... or reckless disregard for the
22 truth” standard under the fraud exception. *See In re Gertsch*, 237 B.R. at 167.
23 Thus, this Court’s prior finding that Lake violated both MARS and the TSR
24
25
26
27
28

1 precludes Lake from relitigating knowledge and intent. As the Enforcement
2 Judgment underscored, Lake's conduct "easily met" the "knowledge or conscious
3 avoidance" element under both the MARS Rule and the TSR. *Lake*, 181 F. Supp.
4 3d at 700-01. This Court put it bluntly: "it is beyond dispute that Lake knew or
5 consciously avoided knowing that the HOPE Defendants were violating the TSR."
6
7 *Id.* at 701. "Fraud was the HOPE Defendants' business model, and Lake knew it."
8
9 *Id.*

10 The findings in the Criminal Action are also preclusive as to the knowledge
11 and intent elements of the Bankruptcy Code's fraud exception. When a debtor
12 pleads guilty to criminal fraud involving the same facts at issue in a bankruptcy
13 proceeding where the fraud exception is invoked, the debtor is precluded from
14 relitigating the issue of intent. *Itano Farms, Inc. v. Currey (In re Currey)*, 154 B.R.
15 977, 980-81 (Bankr. D. Idaho 1993); *In re Dickerson*, 372 B.R. 827, 833-34
16 (Bankr. N.D. Miss. 2007). Lake was convicted of knowingly and intentionally
17 engaging in the conspiracy to commit mail fraud for the same events at issue here.
18
19 FTCER264 ¶ 8. As with the elements of the fraud exception, a conviction of
20 conspiracy to commit mail fraud requires a showing of intent. *See United States v.*
21 *Green*, 592 F.3d 1057, 1067 (9th Cir. 2010). Lake's criminal conviction therefore
22 necessarily entails the requisite knowledge and intent.
23
24
25
26
27
28

1 Lake admitted to joining the HOPE Defendant’s conspiracy “*knowing* of its
2 object and *intending* to help accomplish it.” FTCER267 ¶ 14 (emphasis added). He
3 also admitted in the plea that he “knew the victims of the scheme were vulnerable
4 and particularly susceptible to the scheme’s false statements because of the
5 victims’ financial condition.” FTCER269 ¶ 14. The Criminal Action “necessarily
6 decided” the issues of knowledge and intent. *Frankfort Digital Servs. v. Kistler (In*
7 *re Reynoso)*, 477 F.3d 1117, 1122 (9th Cir. 2007).

10 **C. Harm.**

11 Finally, the Enforcement Judgment precludes relitigation of the issue of
12 harm resulting from a debtor’s conduct. *Slyman*, 234 F.3d at 1085. As noted above,
13 the fraud exception excludes from discharge “any liability arising from a debtor’s
14 fraudulent acquisition of money,” whether or not the debtor obtained the money
15 directly from his victims. *Cohen*, 523 U.S. at 221 (1998); *In re Sabban*, 384 B.R. at
16 6-7. The FTC here seeks to preclude discharge of Lake’s debt, which represents the
17 harm he caused as determined in the Enforcement Judgment.

18 This Court found Lake jointly and severally liable for \$2,349,885 for his
19 deceptive scheme. *Lake*, 181 F. Supp. 3d at 702-3. That amount reflects the “full
20 amount” swindled from consumers by the scheme. *Id.* at 703. The Court was
21 unable to apportion the harm between the HOPE Defendants and Lake because “it
22 is impossible to say how much Lake actually harmed each individual.” *Id.* at 702.
23
24
25
26
27
28

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

In many cases the harm he inflicted was “certainly much more” than the fee he received directly. *Id.* at 702. By “persuad[ing] consumers to stick around while he ‘advocated’ for them with their lenders,” the harm against these consumers continued to add up. *Id.* He therefore remains liable for the entire harm under the FTC Act and the fraud exception. *In re Sabban*, 384 B.R. at 6-7.

CONCLUSION

The Bankruptcy Court’s dismissal of the Adversary Complaint and its denial of the FTC’s two motions for summary judgment should be reversed. This Court should also rule that the Enforcement Judgment precludes relitigation of all of the elements of the fraud exception in the Adversary Proceeding and instruct the Bankruptcy Court to enter summary judgment in the FTC’s favor.

Respectfully submitted,

ANISHA S. DASGUPTA
General Counsel

JOEL MARCUS
Deputy General Counsel

May 16, 2022

/s/ Mark S. Hegedus
MARK S. HEGEDUS
MARGARET HORN
Attorneys

FEDERAL TRADE COMMISSION
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Of Counsel:

MICHAEL P. MORA
*Attorney, Bureau of Consumer
Protection*

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

CERTIFICATE OF COMPLIANCE

I certify that the foregoing brief complies with the form and length specifications of Federal Rule of Bankruptcy Procedure 8015. Excluding the sections specified in that rule, the brief contains 12,502 words.

/s/ Mark S. Hegedus
MARK S. HEGEDUS
Attorney

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

CERTIFICATE OF SERVICE

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Pursuant to F.R.Civ.P. 5 and L.R. 5-3.1, I served or caused to be served OPENING BRIEF OF APPELLANT FEDERAL TRADE COMMISSION to the following person as follows:

- Dennis Edward Lake, dennylake@aol.com (via email sent on May 16, 2022).
- Dennis Edward Lake, 352 E. 19th Street, Costa Mesa, CA 92627 (new address) (via overnight express for delivery on May 18, 2022).

DATED: May 16, 2022

Respectfully submitted,

/s/ Mark S. Hegedus

MARK S. HEGEDUS
Attorney for Appellant Federal Trade
Commission