ALDEN F. ABBOTT
General Counsel

SARAH SCHROEDER, Cal. Bar No. 221528
ROBERTA TONELLI, Cal. Bar No. 278738
EVAN ROSE, Cal. Bar No. 253478
Federal Trade Commission
901 Market Street, Suite 570
San Francisco, CA 94103
sschroeder@ftc.gov, rtonelli@ftc.gov, erose@ftc.gov
Tel: (415) 848-5100; Fax: (415) 848-5184

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

FTC'S REPLY IN SUPPORT OF MOTION TO STRIKE DEFENDANTS' LACHES, ESTOPPEL, AND OFFSET AFFIRMATIVE DEFENSES

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

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

I. Introduction

On August 29, 2018, Defendants filed an Answer to the FTC's Complaint ("Answer") that asserted eight affirmative defenses. (Dkt. 162). On September 18, 2018, the Federal Trade Commission ("FTC") filed a narrowly tailored Motion to Strike Defendants' Laches, Estoppel, and Offset Affirmative Defenses ("Motion") (Dkt. 169).[1] On October 2, 2018, Defendants filed an Opposition to the FTC's Motion to Strike ("Opp.") (Dkt. 175). However, Defendants' Opposition ignores controlling caselaw, cites a bevy of non-binding or distinguishable cases, and does not cure the fatal flaws with their affirmative defenses. For the reasons described below, the FTC respectfully requests the Court strike Defendants' sixth, seventh, and eighth affirmative defenses.

II. Courts Routinely Grant Motions to Strike in the Interest of Judicial Economy and to Prevent Prejudice to a Party

Defendants argue that the Court should not dismiss their defenses at this stage in the litigation because the Court has not reviewed evidence relating to the defenses. Opp. at 5, 10, 12 (distinguishing numerous cases cited by the FTC because they had a different procedural posture than this matter). According to Defendants' logic, even if their defenses cannot possibly succeed, the Court should allow Defendants to go on a fishing expedition, and then reject their legally deficient defenses closer to trial. This waste of money and resources on legally deficient defenses is exactly "the evils that Rule 12(f) is intended to avoid . . ." *Smith v. Wal-Mart Stores*, No. C 06-2069-SBA, 2006 U.S. Dist. LEXIS 72225, at *11-12 (N.D. Cal. Sept. 20, 2006) (Judge Saundra Brown Armstrong). As this Court has stated, "the function of a Rule 12(f) motion to strike is to avoid the expenditure of time and money that must arise from litigating spurious issues by dispensing with those issues prior to trial." *Id.* at *4-5 (*citing Sidney-Vinstein v. A.H. Robins Co.*, 697 F.2d 880, 885 (9th Cir. 1983)). Eliminating insufficient defenses early, especially those that could not possibly succeed under any facts pleaded, is an exercise of the

[1] The Defendants are American Financial Benefits Center, Ameritech Financial, Financial Education Benefits Center, and Brandon Frere (collectively "Defendants").

district court's inherent power to expedite the administration of justice and prevent abuse of its process.

As described in the FTC's Motion and further detailed below, Defendants' affirmative defenses cannot succeed under any circumstances and the FTC will suffer prejudice if they are allowed to stand. Defendants' laches, estoppel, and offset defenses are not applicable against the FTC under the circumstances of this case. As a practical matter, entertaining discovery on these insufficient defenses will prejudice the FTC by unnecessarily consuming valuable time and resources. Motion at 2. For example, Defendants have already sought "internal policies, discussions, and documents" regarding the FTC's deliberative process. Declaration of Kelly Ortiz ("Ortiz Decl.") Att. A-2 (letter from Defendants' counsel to the FTC). Although the FTC has already produced more than 5,400 documents to Defendants, responded to numerous requests for information, and produced an FTC investigator for a full day deposition, Defendants still demand more. Ortiz Decl. ¶ 5. Defendants also falsely state that the "FTC has refused to produce documents about its *secret* investigation . . . " Opp. at 4 (emphasis in original). The FTC has produced to Defendants all relevant and non-privileged documents relating to its routine non-public investigation of Defendants.

Unless the Court strikes Defendants' legally deficient defenses, this case will likely be delayed while the FTC continues to expend significant resources on Defendants' thinly veiled attempt to distract the FTC and Court from the real issue in this case – Defendants' illegal conduct.

III. Defendants Do Not Plead Facts Sufficient to Support Plausible Laches and Estoppel Defenses

Defendants' laches and estoppel defenses cannot survive a motion to strike because they are not supported by sufficient facts to make them plausible. Courts in this district generally apply the heightened pleading standard of the Supreme Court cases *Twombly* and *Iqbal* to affirmative defenses. *See Fishman v. Tiger Natural Gas Inc.*, No. C-17-05351-WHA, 2018 U.S. Dist. LEXIS 159425, at *7-8 (N.D. Cal. Sept. 18, 2018) (Judge William Alsup); *Dion v. Fulton Friedman & Gullace LLP*, No. 11-2727-SC, 2012 U.S. Dist. LEXIS 5116, at *4-6 (N.D. Cal.

Jan. 17, 2012) (Judge Samuel Conti); *Barnes v. AT&T Pension Benefit Plan*, 718 F. Supp. 2d 1167, 1171-1172 (N.D. Cal. 2010) (Judge Marilyn Hall Patel) ("[a]pplying the standard for heightened pleading to affirmative defenses serves a valid purpose in requiring at least some valid factual basis for pleading an affirmative defense").[2] Thus, "a party pleading an affirmative defense must state 'enough supporting facts to nudge a legal claim across the line separating plausibility from mere possibility.'" *Fishman*, 2018 U.S. Dist. LEXIS at *8 (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). Defendants must also plead each element of the defense. *Id.* (striking laches defense because it did not "point plaintiffs to specific elements, the alleged applicable statue, nor to any specific conduct or allegation that could plausibly entitle [them] to relief.").

Defendants focus on the specificity of their claims, arguing that the length of their Answer secures their affirmative defenses a place in this case. Opp. at 3 ("the level of specificity is at least as great as that pled in" another FTC matter). However, the real issue is not the amount of detail in an Answer, but whether the facts alleged present a plausible defense. Defendants could submit a 10-page Answer detailing in great specificity their perceived mistreatment by the government, but that does not automatically mean that their defense is sufficiently supported by facts.

Similarly, Defendants state that they do not "have the burden to prove their defenses now" and that the "FTC seems to believe that Defendants must have a trial-ready case during the pleading stage." Opp. at 4, 12. Again, the focus is not on the amount of evidence Defendants submit in support of their defenses, but whether Defendants present plausible facts and applicable law supporting their defenses. *Barnes*, 718 F. Supp. 2d at 1172 ("'Under the *Iqbal* standard, the burden is on the defendant to proffer sufficient facts and law to support an affirmative defense.'" (citation omitted)).

[2] The case Defendants rely on for their pleading standard does not address the applicability of the *Twombly/Iqbal* standard to affirmative defenses. Opp. at 2, 4 (citing *Simmons v. Navajo City., Ariz.*, 609 F.3d 1011, 1023 (9th Cir. 2010)).

Here, Defendants fail to plead plausible facts supporting each element of their laches and estoppel defenses. Answer at 20-21. First, Defendants ignore key elements of their defenses. They plead no facts indicating egregious misconduct by the FTC, nor do they indicate how the FTC caused them serious injury. Motion at 4. They also fail to show that estopping this litigation will not harm the public's interest. In fact, Defendants' estoppel defense in so vague that it is unclear what type of estoppel they are asserting. *Smith*, 2006 U.S. Dist. LEXIS at *25 (striking estoppel defense and noting, "the defense of estoppel alone could refer to any of several legal doctrines"). Second, some of the facts that purportedly support their defenses are facially insufficient. For example, Defendants argue that their laches defense provides "fair notice of delay on the part of the FTC." Opp. at 3. Defendants rely heavily on a supposed four-month delay between receiving a draft complaint and the complaint being filed. This so-called "delay," however, occurred at Defendant's own request, and is not the basis for a plausible laches defense against the FTC. *See Infra*, Section V.B.

IV. Prevailing Opinion in the Ninth Circuit Is that Laches Is Unavailable as a Defense in a Government Action

A string of Ninth Circuit precedent, relying on the Supreme Court decision *United States v. Summerlin*, 310 U.S. 414, 415 (1940), states that the defense of laches categorically does not apply to the government in a civil suit to enforce public rights.[3] Because a laches defense is not available under these circumstances, courts have stricken laches defenses in prior FTC matters. Mot. at 4-5 (citing three FTC cases); *see also FTC v. Moneymaker*, No. 2:11-CV-461 JCM, 2011 U.S. Dist. LEXIS 83913, at *5-6 (D. Nev. July 28, 2011) ("the equitable doctrine of laches . . . is not viable if asserted against the government in this context"); *United States v. Global Mortg.*,

[3] *See United States v. Menator*, 925 F.2d 333, 335 (9th Cir. 1991) (citing *Summerlin*) ("The government is not subject to the defense of laches when enforcing its rights"); *Chevron USA, Inc. v. United States*, 705 F.2d 1487, 1491 (9th Cir. 1983) (citing *Summerlin*) ("The government is not bound by . . . laches in enforcing its rights"); *SEC v. Sands*, 902 F. Supp. 1149, 1167 (C.D. Cal. 1995) ("It is well established that laches is not an affirmative defense against the United States"); *United States v. Nevada Power Co.*, No. CV-S-87-861 (RDF), 1990 WL 149660, at *31-32 (D. Nev. June 1, 1990) ("it is 'settled beyond controversy' that the United States is not subject to laches when asserting public rights") (citations omitted).

No. SACV 07-1275 DOC, 2008 U.S. Dist. LEXIS 102897, at *7 (C.D. Cal. May 15, 2008) (in matter where the Department of Justice pursued a lawsuit on behalf of the Federal Trade Commission, court held that "it is well settled that the United States is not . . . subject to the defense of laches in enforcing its rights." (citing *Summerlin*)).

The Defendants rely on *Clearfield Trust, Co. v. United States* to argue "there simpy is no 'general rule' that laches is not a recognized defense against the government." Opp. at. 7; 318 U.S. 363 (1943). However, *Clearfield* and a handful of other cases "attempted to carve out exceptions to the general rule by allowing laches against the United States in specific cases," such as contract disputes. *FDIC v. Hursley*, 22 F.3d 1472, 1490 (10th Cir. 1994). These narrow exceptions are not present here, where the FTC brings this action to enforce a public right.

To overcome *Summerlin* and its progeny, which Defendants ignore entirely, Defendants cite to Judge Gilliam's order in *FTC v. DirecTV, Inc*., No. 15-cv-01129-HSG, 2015 U.S. Dist. LEXIS 170370 (N.D. Cal. Dec. 21, 2015).[4] Opp. at 6. *DirecTV* is distinguishable from this matter because *DirecTV* alleged specific affirmative misconduct by the FTC that "plausibly could support" the defense, and detailed how those alleged acts prejudiced the company. Due to this unusual fact pattern, Judge Gilliam declined to strike the affirmative defense, but stated that "DirecTV very likely will have to prove affirmative misconduct to prevail on its laches defense." *Id.* at *8. Here, Defendants have not alleged facts sufficient to show affirmative misconduct or prejudice. Motion at 3-4.

As the Supreme Court, Ninth Circuit, and numerous courts in this circuit have held, laches does not apply when the government is enforcing public rights. For that reason, the FTC respectfully requests that the Court strike Defendants' laches defense. If the Court concludes in theory that laches may be asserted, it still should strike Defendants' laches defense because Defendants do not plausibly allege that the FTC engaged in affirmative misconduct or explain how they suffered prejudice by continuing to operate while the FTC completed its investigation.

[4] Defendants mistakenly attribute this order to Judge Griffith.

V. Defendants Can Assert an Estoppel Defense Only Under Extraordinary Circumstances, None of Which Are Present Here

Defendants can assert an estoppel defense against the government only under extraordinary circumstances showing "affirmative misconduct beyond mere negligence" by the government, such as a "deliberate lie" or "pattern of false promises." *Global Mortg.*, 2008 U.S. Dist. LEXIS at *10 (citing Ninth Circuit cases). "A mere failure to inform or assist does not justify application of equitable estoppel." *Lavin v. Marsh*, 644 F.2d 1378, 1384 (9th Cir. 1981). In addition to affirmative misconduct, Defendants have to plead facts sufficient to show prejudice to themselves, and no harm to the public if the Court estops the case. *Jaa v. I.N.S.*, 779 F.2d 569, 572 (9th Cir. 1986) ("even affirmative misconduct will not estop the government unless 'the government's wrongful conduct threatened to work a serious injustice and . . . the public's interest would not be unduly damaged by the imposition of estoppel.'") (citing *Worley v. Harris*, 666 F.2d 417, 421 (9th Cir. 1982)). As described below, Defendants fail to meet this stringent standard.

A. Estoppel by Silence Is Inapplicable Against the Government

The crux of Defendants' estoppel argument is that the FTC "sat silently" and did not respond to their unsolicited letter.[5] Answer at 22. Defendants fail to cite to any authority that supports their estoppel by silence defense. This is unsurprising, given the absurdity of the defense. Silence is not affirmative misconduct, especially where there is no duty to act. Motion at 5-6. Such a defense would paralyze law enforcement agencies. Practically speaking, Defendants are suggesting that if a company asks the FTC if it is complying with the law, the FTC must immediately give it guidance and disclose any non-public investigation, or the agency is barred from suing the company. That unrealistic standard is a sweeping abrogation of agency

[5] Even if the FTC was required to respond to Defendants' unsolicited letter, the letter contained material inaccuracies. For example, Defendants submitted an altered mailer to the FTC that included different information than the mailers Defendants actually sent to consumers. Defendants' letter also omitted the important fact that most of Defendants' profit came from monthly fees they collected for "financial education" memberships unrelated to consumers' student loans. Perhaps for this reason, Defendants did not plead another required element of estoppel – that the FTC knew all the facts. Motion at 3.

authority, prosecutorial discretion, and disclosure rules. It also would result in a huge, probably impossible, drain on agency resources. It would play out in reality as a gigantic loophole to the FTC Act. Defendant's estoppel by silence defense is ludicrous and legally insufficient, and should be stricken.

B. Delay Is Not Grounds for Estoppel Against the Government

Defendants also allege that the FTC's "claims are barred in part or in whole by the doctrine of estoppel because [the FTC] delayed bringing any action" for over a year. Answer at 22. Specifically, they allege the FTC engaged in "gross delay" by sending Defendants a draft complaint and then "wait[ing] over four months to file its Complaint in this action." *Id*. Even if Defendants' allegation of gross delay were plausible, it is not grounds for an estoppel defense. Motion at 3, citing *Jaa*, 779 F.2d at 572 (58-month delay not grounds for estoppel); *see also FTC v. Neovi, Inc*., No. 06-1952, 2010 U.S. Dist. LEXIS 101583, at *9-11 (S.D. Cal. Sept. 27, 2010) (no grounds for estoppel where the FTC raised a new challenge to defendants' marketing practices after a years-long investigation and after the court had issued a final order).

Defendants' allegation of delay is particularly jaw dropping because they asked the FTC to hold the Complaint. As detailed in the FTC's Opposition to Defendants' Motion to Dismiss the Complaint, (Dkt. 130 at 9), the Commission waited to vote on the Complaint so the Defendants could meet with the Commissioners and engage in settlement negotiations with staff. Because Defendants have not pleaded a plausible estoppel defense based on delay, the Court should strike this defense.

C. A Law Enforcement Agency Filing a Routine Lawsuit Is Not Grounds for Estoppel

Defendants' vague allegation that the FTC "engaged in an indiscriminate industry 'sweep'" is also legally insufficient to support an estoppel defense.[6] Answer at 22. Filing

[6] The FTC cases that Defendants imply were part of an illegitimate "sweep" have resulted in court orders in favor of the FTC or in court-approved settlements. Opp. at 14; *See*, e.g, *FTC v. Alliance Document Prep.*, No. 17-7048 (C.D. Cal. Sept. 24, 2018) (final order awarding FTC $10.2 million); *FTC v. A1 DOCPREP*, No. 17-07044 (C.D. Cal. May 7, 2018) (final order

lawsuits against companies and individuals that violate the law is not affirmative misconduct; it is the FTC's congressionally mandated mission. *See* 15 U.S.C. § 45(a). Furthermore, "vague allegations about a strategic decision by the Government are insufficient to rise to the level required to justify the disfavored remedy of estopping the government." *Global Mortg.*, 2008 U.S. Dist. LEXIS at *11 (striking estoppel defense). The Court should strike Defendants' legally insufficient estoppel defense to prevent prejudice to the FTC and preserve judicial resources.

VI. "Consumer Benefit" Is Not an Affirmative Defense to FTC Act Violations

The law does not support Defendants' argument that they are entitled to offset the FTC's injury figure by consumer benefits. Opp. at 11-13. First, the prevailing Ninth Circuit law sets forth the standard for monetary relief in FTC cases – gross revenue minus refunds. Motion at 6-8. Defendants ignore Ninth Circuit law that clearly prohibits offsets for alleged consumer benefits. *See FTC v. Dantuma*, Case No. 17-15600, 2018 U.S. App. LEXIS 24893, at *4 (9th Cir. Aug. 31, 2018) ("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." (citations omitted)). Defendants fail to discuss *Dantuma*, and instead cite opinions from other circuits that predate *Dantuma*, because they have no response to the Ninth Circuit's pronouncement.

In addition to ignoring Ninth Circuit precedent, Defendants attempt to distinguish cases in the FTC's Motion by claiming that a reduction in student loan payments differs from other products and services.[7] Opp. at 12-13. However, the law makes no such distinction. Defendants also claim that *FTC v. Kuykendall* "supports an offset defense here." 371 F.3d 745, 766 (10th Cir. 2004); Opp. at 12-13. The full quote from *Kuykendall* shows otherwise:

---

awarding FTC $9.1 million); *FTC v. M&T Fin. Grp.*, No. 17-06855 (C.D. Cal. June 8, 2018) (final order awarding FTC $11.6 million).

[7] Assuming consumers received a legitimate loan modification, the U.S. Department of Education granted consumers the reduction in their loan payments, not the Defendants. Defendants have made no payments towards consumers' student loans.

> The defendants maintain that the district court should also offset gross receipts by the value of the magazines the consumers received. Other courts have addressed this issue in the context of unfair and deceptive trade practices. In *Figgie*, a case involving unwanted heat detectors, the court analogized its case to that of a dishonest jeweler who represented that the rhinestones he sold were diamonds and held that a customer's recover should not be limited "to the difference between what they paid and a fair price for rhinestones" because if the customers had known the truth, they might not have bought any rhinestones at all. 994 F.2d at 606. Thus, "the fraud in the selling, not the value of the thing sold, is what entitles consumers . . . to full refunds." *Id.; see also McGregor*, 206 F.3d at 1388-89 (applying this principle in contempt proceedings).
>
> We follow the above analysis and conclude that the district court need not offset the value of any product the defrauded consumers received.

Id. (emphasis added). The *Kuykendall* court did note, as is undisputed here, that Defendants could present evidence showing that consumers received refunds and the existence of satisfied consumers who were not deceived. *Id.* at 766-67. Another case Defendants cited, *FTC v. BlueHippo Funding, LLC*, relies on *Kuykendall* and focuses on consumer refunds. 762 F.3d 238, 244-45 (2d Cir. 2014);[8] Opp. at 13. Neither case permits the type of "consumer benefit" offset that Defendants seek here.

Contrary to Defendants' assertion, the Court can consider evidence that rebuts the FTC's injury calculation, such as consumer refunds or the percentage of deceived consumers. This information is part of Defendants' denial of the FTC's claims. Thus, Defendants will suffer no

[8] In *BlueHippo*, the Defendant "proffered [f]our categories of proposed offsets: (i) consumers who ordered merchandise other than computers; (ii) cash refunds; (iii) payments to settle state enforcement actions; and (iv) consumers residing in states where no fees were charge[d]." *FTC v. BlueHippo Funding, LLC*, No. 08 Civ. 1819-PAC, 2016 U.S. Dist. LEXIS 52594, at *2-3 (S.D.N.Y. April 19, 2016).

prejudice if the Court strikes their offsets affirmative defense. However, the FTC will suffer prejudice if it has to waste resources debating the alleged benefits Defendants provided to deceived consumers, an issue the Ninth Circuit has held is irrelevant in FTC matters involving misleading sales tactics.[9] Consumer benefit is simply not an affirmative defense to deception, and the Court should strike this defense.

VII. Legally Insufficient Defenses Should Be Denied With Prejudice

Defendants request that if the Court strike any of Defendants' affirmative defenses that it "do so without prejudice and grant leave to amend the Answer." Opp. at 15. However, permitting Defendants to re-plead legally insufficient defenses will simply result in another round of unnecessary briefing. Because Defendants' laches, estoppel, and offset defenses cannot succeed under the circumstances of this case or are inappropriate as a matter of law, the Court should dismiss them with prejudice. *Global Mortg.*, 2008 U.S. Dist. LEXIS at *13 (striking laches defense with prejudice). If Defendants want to amend their Answer, the Court should require them to file a motion seeking leave to amend that "include[s] a proposed pleading (and a redlined copy)" and "clearly explain[s] why the foregoing problems are overcome by the proposed pleading." *Fishman*, 2018 U.S. Dist. LEXIS at *22.

VIII. Conclusion

Defendants' laches, estoppel, and offset defenses, if allowed to remain in this case, will serve only to needlessly prolong the discovery process and waste time and resources of the Court and the parties. The Court should use its inherent power to strike these defenses and streamline the ultimate resolution of this case.

[9] Unlike here, there was "no discernable prejudice to Plaintiff" in a case where the court declined to strike an offset defense. *See, e.g., FTC v. BF Labs Inc.*, No. 4:14-CV-00815-BCW, 2015 U.S. Dist. LEXIS 184242, at *8-9 (W.D. Mo. Aug. 28. 2015); Opp. at 12.

Respectfully submitted,

ALDEN F. ABBOTT
General Counsel

Dated: October 9, 2018

/s/ Sarah Schroeder
Sarah Schroeder
Roberta Tonelli
Evan Rose
Attorneys for Plaintiff

FEDERAL TRADE COMMISSION