IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

Federal Trade Commission, Plaintiff, v. Electronic Payment Solutions of America Incorporated, et al., Defendants.	No. CV-17-02535-PHX-SMM **ORDER**

Before the Court are three motions filed by the parties: (1) Defendants Electronic Payment Systems, LLC and Electronic Payment Transfer, LLC's (collectively, "EPS") Motion to Dismiss Plaintiff Federal Trade Commission's (the "FTC") Claim for Monetary Relief (Doc. 153); (2) EPS's Motion to Amend its Amended Answer, Crossclaims, and Third-Party Claims (Doc. 170); and (3) Defendants John Dorsey ("Dorsey") and Thomas McCann's ("McCann") Motion for Judgment on the Pleadings (Doc. 173).[1] The motions are ripe for review. The Court will consider each motion in turn.

I. BACKGROUND

In 2013, the FTC brought suit against Money Now Funding ("MNF"), a telemarketing scheme that sold worthless business opportunities to consumers as a cover to launder money via fraudulent credit card transactions. (Doc. 85 at 3.) Credit card processing involves numerous entities including, on one side, the consumer and the

[1] The various parties requested oral argument on two of the pending motions. (Docs. 153, 173.) The Court denies the parties' requests because the issues have been fully briefed and oral argument will not aid the Court's decision. See Fed. R. Civ. P. 78(b) (court may decide motions without oral hearings); LRCiv 7.2(f) (same).

consumer's bank, and on the other, the merchant and the merchant's bank. (Id. at 4-5.) In between the consumer and the merchant are the credit card networks and other third parties such as independent sales organizations ("ISOs"). (Id. at 5.) ISOs solicit merchants seeking to open merchant accounts and refer them to the ISOs' acquiring bank, which is the bank that has access to the credit card networks. (Id.) In the credit card industry, merchant accounts are established to settle payment of credit card transactions. (Id.) The practice of processing credit card transactions through another company's merchant account is called "credit card laundering" and is illegal under the Telemarketing Sales Rules ("TSR"), 16 C.F.R. Part 310. (Id. at 4.)

To facilitate the MNF scheme, MNF principals created fictitious entities and processed individual's credit card charges through merchant accounts associated with these entities, rather than through a merchant account associated with MNF. (Id.) The MNF scheme resulted in a total injury to consumers of approximately $7,300,000.00. (Id.) In 2015, the FTC settled with many of the MNF defendants, the Court granted summary judgment against some defendants and entered default judgment against the remaining defendants. (Id. at 13.) Then, in 2016, the Arizona Attorney General's Office brought criminal charges against the MNF principals, and as of January 25, 2017, all four defendants entered guilty pleas. (Id.)

During the investigation and prosecution of the MNF scheme, the FTC discovered that the defendants named in the instant matter (collectively, "Defendants") played an integral role in facilitating the MNF scheme. (Doc. 184 at 8.)

Defendant EPS is an ISO that markets payment processing services to merchants. (Doc. 85 at 10.) EPS served as the ISO to numerous entities involved in the MNF scheme and set up and approved the merchant accounts for the fictitious entities. (Id.) Defendant Dorsey is the CEO and co-owner of EPS, and Defendant McCann is the managing member and co-owner of EPS. (Id. at 10-11.) Dorsey and McCann were responsible for approving all merchant applications submitted to EPS. (Id. at 44-47.) Defendant Michael Peterson ("Peterson") is the former risk manager of EPS. (Id. at 11.)

EPS used three sales agents to market its services: Defendant Jay Wigdore ("Wigdore"), Defendant Michael Abdelmesseh ("Abdelmesseh"), and Defendant Nikolas Mihilli ("Mihilli") (collectively, the "KMA-Wigdore Defendants"). (Id. at 7.) Wigdore is the president of Defendant Electronic Payment Services, Inc. ("EP Services") and director of Defendant Electronic Payment Solutions of America ("EPSA"). (Id. at 9.) Abdelmesseh is a director of EPSA and managing member of Defendant KMA Merchant Services, LLC ("KMA"). (Id.) Mihilli is an officer and member of Defendant Dynasty Merchants, LLC ("Dynasty"). (Id.) According to the First Amended Complaint ("FAC"), EPS processed consumer transactions through the fictious entities' merchant accounts and then transferred the money to the above-mentioned companies associated with the KMA-Wigdore Defendants. (Id. at 6.)

The FTC brought this action on July 28, 2017 under § 13(b) of the Federal Trade Commission Act (the "FTC Act"), and the Telemarketing and Consumer Fraud and Abuse Prevention Act, seeking permanent injunctive relief, restitution, disgorgement, and other relief on behalf of consumers who were allegedly defrauded by Defendants. (Id. at 3.)

II. MOTION TO DISMISS

EPS moves to dismiss the FTC's claim for monetary relief – specifically, restitution and disgorgement – pursuant to Federal Rule of Civil Procedure 12(b)(6). (Doc. 153.) However, because EPS filed its Answer to the FTC's FAC prior to filing the instant motion, the Court will construe EPS's motion as a motion for judgment on the pleadings under Federal Rule of Civil Procedure 12(c).

A. Legal Standard

A motion asserting dismissal for failure to state a claim must be made before pleading if a responsive pleading is allowed. Fed. R. Civ. P. 12(b). A motion to dismiss for failure to state a claim for relief made after an answer is filed should be treated as a motion for judgment on the pleadings under Federal Rule of Civil Procedure 12(c). Aldabe v. Aldabe, 616 F.2d 1089, 1093 (9th Cir. 1980).

Rule 12(c) provides that "[a]fter the pleadings are closed – but early enough not to

delay trial – any party may move for judgment on the pleadings." Fed. R. Civ. P. 12(c). "Judgment on the pleadings is proper when, taking all the allegations in the pleadings as true, the moving party is entitled to judgment as a matter of law." Honey v. Distelrath, 195 F.3d 531, 532 (9th Cir. 1999). Judgment on the pleadings is only appropriate when the moving party establishes no material fact remains to be resolved. Doleman v. Meiji Mut. Life Ins., 727 F.2d 1480, 1482 (9th Cir. 1984). Dismissal on the pleadings is inappropriate if the facts as pled would entitle the non-moving party to a remedy. See Merchs. Home Delivery Serv., Inc. v. Hall & Co., 50 F.3d 1486, 1488 (9th Cir. 1995). "The [c]ourt cannot consider evidence outside the pleadings unless the [c]ourt treats the motion for judgment on the pleadings as a motion for summary judgment under Rule 56." Phillips & Assocs., P.C. v. Navigators Ins., 764 F. Supp. 2d 1174, 1175 (D. Ariz. 2011).

B. Discussion

EPS moves to dismiss the FTC's claim for equitable monetary relief, arguing restitution and disgorgement are not permissible forms of equitable relief ancillary to an injunction under § 13(b) of the FTC Act. (Doc. 153-1 at 3.)

Section 13(b) of the FTC Act states that "the Commission may seek, and after proper proof, the court may issue, a permanent injunction." 15 U.S.C. § 53(b). While this provision mentions only injunctive relief, the Ninth Circuit Court of Appeals has interpreted this provision as authorizing district courts to grant "any ancillary relief necessary to accomplish complete justice." F.T.C. v. Commerce Planet, Inc., 815 F.3d 593, 598 (9th Cir. 2016) (quoting F.T.C. v. Pantron I Corp., 33 F.3d 1088, 1102 (9th Cir. 1994)); see also F.T.C. v. H. N. Singer, Inc., 668 F.2d 1107, 1113 (9th Cir. 1982). This includes monetary relief such as restitution and the disgorgement of ill-gotten gains. See Commerce Planet, 815 F.3d at 598-99; F.T.C. v. Neovi, Inc., 604 F.3d 1150, 1159-60 (9th Cir. 2010); Pantron I Corp., 33 F.3d at 1102.

While EPS concedes that the Court has the authority to grant ancillary equitable relief, EPS cites Kokesh v. Securities and Exchange Commission, 137 S. Ct. 1635 (2017), for the proposition that the monetary relief the FTC seeks is a penalty, not equitable relief,

and is therefore impermissible under § 13(b). (Doc. 153-1 at 3, 7.) In Kokesh, the Supreme Court held that disgorgement constitutes a penalty, not equitable relief, for purposes of imposing a five-year statute of limitations under a Security and Exchange Commission ("SEC") statute. 137 S. Ct. at 1639. However, the Supreme Court specifically limited the applicability of Kokesh to the SEC's statute of limitations, stating "[n]othing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings" generally. Id. at 1642 n.3.

The Ninth Circuit recognized this limitation in Federal Trade Commission v. AMG Capital Management, LLC, 910 F.3d 417 (9th Cir. 2018). In a unanimous opinion, the Ninth Circuit found that Kokesh did not overturn Ninth Circuit precedent because it was not "clearly irreconcilable" with prior circuit authority that permits courts to grant ancillary equitable relief under § 13(b). AMG Capital Mgmt., 910 F.3d at 427. In so finding, the court reasoned that Kokesh expressly limited its applicability by declining to address whether courts possessed authority to order disgorgement in SEC proceedings generally. Id. Moreover, the court reasoned the Ninth Circuit has continuously authorized courts to grant equitable remedies, including restitution and disgorgement, under § 13(b). Id. The three-judge panel found that it remained bound by Ninth Circuit precedent because this circuit authority was not "clearly irreconcilable with the reasoning or theory of" Kokesh. Id. Although Judge O'Scannlain and Judge Bea noted in a special concurrence that Kokesh did call into question the viability of Ninth Circuit precedent, see id. at 433, absent an en banc review explicitly overruling that precedent, Commerce Planet remains controlling authority.

Accordingly, the Court finds that the monetary relief the FTC seeks is a permissible form of equitable relief pursuant to Ninth Circuit precedent. See Commerce Planet, 815 F.3d at 598-99. Despite the apparent similarities between equitable monetary relief under § 13(b) and disgorgement in SEC proceedings, the Ninth Circuit in AMG Capital Mgmt. found that Kokesh was not entirely inconsistent with circuit precedent such that it expressly or impliedly overturned circuit authority. See 910 F.3d at 427. Therefore, the Court finds

that the FTC may permissibly seek monetary relief ancillary to an injunction under § 13(b). See Commerce Planet, 815 F.3d at 598-99.

EPS next argues that the Court should revisit the Ninth Circuit precedent articulated in Commerce Planet. (Doc. 153-1 at 14.) However, the Court declines EPS's invitation to set aside or "revisit" Ninth Circuit precedent as it has no authority to do so. See Hart v. Massanari, 266 F.3d 1155, 1175 (9th Cir. 2001) ("A district court bound by circuit authority … has no choice but to follow it, even if convinced that such authority was wrongly decided.").

Based on the foregoing, the Court denies EPS's motion to dismiss the FTC's claim for monetary relief. (Doc. 153.)

III. MOTION TO AMEND ANSWER

EPS moves to amend its amended answer pursuant to Federal Rule of Civil Procedure 15. (Doc. 170.) The Court filed a pretrial case management schedule on February 1, 2018, setting a sixty-day deadline for the parties to amend their pleadings. (Doc. 78 at 2.) Because the Court has already filed the pretrial case management schedule and the deadline to amend pleadings has long passed, Federal Rule of Civil Procedure 16, which requires good cause to amend a scheduling order, controls the inquiry into whether the pretrial case management schedule should be modified.

A. Background

On May 31, 2019, EPS filed a motion to amend its answer, cross-claims, and third-party claims, requesting that the Court grant it leave to assert four cross-claims against Defendant Peterson based on Peterson's alleged theft of EPS's funds. (Doc. 170 at 1-2.) EPS contends that it discovered the facts underlying its cross-claims at Peterson's May 16 and 17, 2019 deposition and filed the instant motion in response. (Id. at 7.) The Court discusses the facts relevant to the discovery of EPS's cross-claims below.

On November 15, 2015 and March 2, 2016, the FTC issued a Civil Investigative Demand ("CID") to Peterson seeking testimonial evidence. (Doc. 175-1 at 2.) Pursuant to the CID, Peterson appeared for a non-public, investigational hearing on April 21, 2016.

(Id.; Docs. 170 at 3; 175 at 9.) Counsel for EPS represented Peterson at the hearing. (Doc. 175 at 9.) At the hearing, the FTC questioned Peterson about two check payments he received from entities associated with the KMA-Wigdore Defendants. (Id.) The FTC showed Peterson copies of these checks. (Id.) Peterson's endorsement and bank account number x1402 appeared on the back of each check. (Id.; Doc. 175-1 at 17-18.) Peterson testified he did not receive compensation outside of his EPS salary from the KMA-Wigdore Defendants and these payments were of a personal nature. (Docs. 170 at 3; 175 at 9.)

In 2017, the Department of Treasury contacted EPS regarding an investigation into $1,000,000 in funds that the Department believed had been taken by an EPS employee. (Doc. 197 at 5, 7.) The Department indicated that the funds had been transferred into a checking account at Academy Bank, belonging to another EPS employee, not Peterson. (Id. at 7-8.)

On July 28, 2017, the FTC filed the instant action. (Docs. 1; 175 at 9.) EPS arranged for counsel to represent Dorsey, McCann, and Peterson in the matter because Peterson was employed by EPS at that time. (Doc. 175 at 9.) However, Peterson left EPS on September 30, 2017 – the same day that Peterson, EPS's Chief Operating Officer ("COO") Anthony Maley, Dorsey, and McCann were scheduled to meet with a merchant-client regarding the missing $1,000,000. (Id. at 9-10.) Counsel for EPS represented Peterson until October 30, 2018, when the Court granted EPS counsel's motion to withdraw. (Id. at 11.)

As the litigation progressed, the FTC provided EPS with a review copy of its electronically-stored information ("ESI") production pursuant to the Mandatory Initial Discovery Pilot ("MIDP") program on January 17, 2018. (Docs. 197 at 3; 175 at 10; 175-1 at 3.) Included in this production were bank records for entities associated with the KMA-Wigdore Defendants, reflecting payments to Peterson. (Docs. 175 at 10; 175-1 at 3.) The production also included a spreadsheet, generated by an EPS employee, that highlighted transfers from EPS's Diverted Funds Account to a routing number linked to a bank account at Academy Bank. (Docs. 197 at 3; 175 at 10; 175-1 at 3.) The Diverted Funds Account is a holding account controlled by EPS and Merrick Bank for pending transactions suspected

of fraud.[2] (Doc. 170 at 4.)

On August 7, 2018, the FTC propounded discovery requests on Peterson, Dorsey, McCann, and EPS, which included Requests for Production and Interrogatories. (Doc. 175 at 10.) The FTC also served a subpoena on Academy Bank on that date. (Id.)

In the interrogatory served on Peterson, the FTC requested information about payments Peterson received from the Diverted Funds Account and stated in a footnote that "Appendix 2 contains examples of payments from the Diverted Funds Account into your Academy Bank account x1402." (Doc. 175-1 at 120 n.2.) Appendix 2, titled "Payments from Diverted Funds Account to Academy Bank Account x1402," was attached to the interrogatory, listing examples of numerous transfers from the Diverted Funds Account into Peterson's bank account. (Id. at 130.) The FTC also requested information about payments Peterson received from the KMA-Wigdore Defendants. (Id. at 122.) The FTC attached Appendix 3, titled "Checks from Wigdore/Abdelmesseh Entities or Dynasty Payable to Peterson," to the interrogatory. (Id. at 131.) This appendix detailed examples of checks that were made payable to Peterson drawn on bank accounts from entities associated with the KMA-Wigdore Defendants. (Id.)

Similar to the interrogatory served on Peterson, the interrogatories served on both Dorsey and McCann requested information about all payments made to Peterson from the Diverted Funds Account. (Id. at 79, 99.) The interrogatories contained a footnote, stating "Appendix 2 contains examples of payments from the Diverted Funds Account into Peterson's Academy Bank account x1402." (Id. at 79 n.2, 99 n.2.) Appendix 2, titled "Payments from Diverted Funds Account to Academy Bank Account x1402," was attached to Dorsey's and McCann's Interrogatories. (Id. at 89, 109.)

In the subpoena served on Academy Bank, the FTC requested information regarding two bank accounts associated with Peterson – specifically, bank accounts x1402 and

[2] "Normally, the funds that a merchant is entitled to receive as a result of a credit card transaction are delivered electronically to the merchant's bank account." (Doc. 170 at 4.) However, for suspicious transactions, "EPS or Merrick Bank had the ability to divert those funds into another account until the issue involving the suspicious transaction was resolved. The account where the funds are held pending this resolution is referred to as the Diverted Funds Account." (Id.)

x0106. (Docs. 175 at 10; 175-1 at 150-51.)

On the day the FTC propounded its discovery requests, the FTC emailed counsel for all the parties, notifying them of the discovery requests and attached to the email copies of the Requests for Production, Interrogatories, and Subpoena. (Doc. 175 at 10.)

In October 2018, the FTC produced to all parties its first supplemental MIDP ESI production. (Id.; Doc. 175-1 at 5, 157.) The supplemental production included Academy Bank's response to the FTC's subpoena. (Docs. 175 at 11; 175-1 at 5, 157.) The documents produced included copies of signature cards, bank statements, and images of deposited checks from two bank accounts associated with Peterson. (Doc. 175 at 11.)

Peterson did not respond to the FTC's discovery request, so on November 29, 2018 the FTC mailed him a letter, notifying him of the outstanding requests. (Id.) Then, on December 18, 2018, the FTC spoke with Peterson over the phone. (Id. at 12; Docs. 175-1 at 5-6; 197 at 4.) During the conversation, Peterson stated that the transfers listed in Appendix 2 ("Payments from Diverted Funds Account to Academy Bank Account x1402") of the August 7, 2018 Interrogatory were bonuses authorized by Dorsey. (Doc. 175 at 12.) Peterson also stated that the payments listed in Appendix 3 ("Checks from Wigdore/Abdelmesseh Entities or Dynasty Payable to Peterson") of the August 7, 2018 Interrogatory were payments that the KMA-Wigdore Defendants made to Peterson for help with fighting chargebacks. (Id.)

EPS served discovery requests on the FTC on February 25, 2019, requesting summaries of the FTC's conversations with Peterson and any evidence of payments from the KMA-Wigdore Defendants to Peterson. (Id.; Doc. 197 at 4.) On April 26, 2019, the FTC produced summaries of its conversations with Peterson. (Docs. 175 at 12; 197 at 4.) In response to EPS's request for evidence of payments from the KMA-Wigdore Defendants, the FTC reproduced copies of Appendix 3 from the August 7, 2018 Interrogatory. (Docs. 175 at 12; 197 at 4.)

On May 16 and 17, 2019, Peterson was deposed. (Docs. 175-1 at 6-7; 197 at 5.) At the deposition, Peterson rolled back his prior testimony. That is, he admitted to accepting

"kickbacks" from the KMA-Wigdore Defendants, stated that the KMA-Wigdore Defendants offered to pay him for "chargeback consulting services," testified that he disclosed the KMA-Wigdore Defendants' payments to EPS's COO, and admitted to accepting transfers from the Diverted Funds Account into his Academy Bank account. (Docs. 175-1 at 6-7; 197 at 4.)

In response to Peterson's deposition, EPS filed the instant motion to amend its answer to assert cross-claims against Peterson. (Doc. 170.)

B. Legal Standard

After a district court has filed a pretrial case management schedule pursuant to Federal Rule of Civil Procedure 16, establishing a timetable for amending pleadings, Rule 16 standards control any modification. See Johnson v. Mammoth Recreations, Inc., 975 F.2d 604, 607-08 (9th Cir. 1992). Pursuant to Rule 16, a case management schedule shall not be modified except by leave of court upon a showing of good cause. Fed. R. Civ. P. 16(b)(4). The good cause standard primarily considers the diligence of the party seeking the amendment. See Johnson, 975 F.2d at 609. A district court may modify a pretrial schedule if amendment cannot reasonably be sought despite the diligence of the party seeking the modification. Id.

"The good cause standard typically will not be met where the party seeking to modify the scheduling order has been aware of the facts and theories supporting amendment since the inception of the action." In re W. States Wholesale Nat. Gas Antitrust Litig., 715 F.3d 716, 737 (9th Cir. 2013). Similarly, a party does not show good cause where it does not conduct a basic investigation into the circumstances underlying its claims until after the deadline to amend has passed. See, e.g., Hernandez v. Select Portfolio Servicing, Inc., CV 15-1896 PA (AJWx), 2016 WL 770869, at *3 (C.D. Cal. Feb. 24, 2016).

If the party is able to establish good cause, then the party must also demonstrate that the amendment is proper under Rule 15. See Johnson, 975 F.2d at 608. Rule 15 permits a party to amend a pleading "with the opposing party's consent or the court's leave. The

court should freely give leave when justice so requires." Fed. R. Civ. P. 15(a)(2). Although leave to amend "shall be freely given when justice so requires," it "is not to be granted automatically." Zivkovic v. S. Cal. Edison Co., 302 F.3d 1080, 1087 (9th Cir. 2002) (citing Jackson v. Bank of Haw., 902 F.2d 1385, 1387 (9th Cir. 1990)). A district court may deny a motion for leave to amend if permitting an amendment would, among other things, cause an undue delay in the litigation or prejudice the opposing party. See Jackson, 902 F.2d at 1387; see also Solomon v. N. Am. Life & Cas. Ins., 151 F.3d 1132, 1139 (9th Cir. 1998) (affirming district court's denial of motion to amend pleadings filed on the eve of the discovery deadline). A court's discretion to deny leave to amend is particularly broad where Plaintiff has previously been granted leave to amend. Sisseton-Wahpeton Sioux Tribe v. United States, 90 F.3d 351, 355-56 (9th Cir. 1996).

While the Rule 15 factors should be analyzed with "extreme liberality" toward favoring amendments, see United States v. Webb, 655 F.2d 977, 979 (9th Cir. 1981), the moving party cannot "appeal to the liberal amendment procedures afforded by Rule 15" unless it first "satisf[ies] the *more stringent* 'good cause' showing required under Rule 16." AmerisourceBergen Corp. v. Dialysist W., Inc., 465 F.3d 946, 952 (9th Cir. 2006) (emphasis in original).

C. Discussion

EPS requests leave to amend its amended answer to add cross-claims against Peterson for deceit based on fraud, civil conspiracy to commit deceit based on fraud, conversion and theft, and breach of fiduciary duty. (Doc. 170 at 1-2.) EPS alleges that it did not have a basis for asserting these additional cross-claims against Peterson until Peterson rolled back his prior testimony at the May 2019 deposition.[3] (Id. at 7.) Accordingly, EPS contends that it was "diligent in ferreting out Peterson's theft and deception and in asserting the added claims against him as soon as EPS had a good faith

[3] The Court notes a discrepancy in EPS's pleadings. EPS states in its motion to amend that it did not discover facts underlying its cross-claims – that is, Peterson's theft – until Peterson's deposition in May 2019. (Doc. 170 at 7.) However, in its Reply, EPS states that it first learned about Peterson's theft on April 26, 2019 when it received the FTC's discovery responses. (Doc. 197 at 6.)

basis for the claims." (Doc. 197 at 7.)

In opposition, the FTC contends that EPS was not diligent in seeking an amendment. (Doc. 175 at 14-15.) The FTC argues that the facts that form the basis of EPS's cross-claims were readily ascertainable as early as Peterson's testimony in 2016. (Id. at 15.) If not in 2016, then the FTC argues that the facts were discernible at least by January 2018, when the FTC disclosed a spreadsheet to EPS that highlighted transfers from the Diverted Funds Account to Peterson's bank account. (Id.) Because EPS waited to assert its cross-claims until after Peterson's deposition, the FTC contends that EPS was not diligent. (Id.)

Here, the Court finds that EPS was not diligent in seeking to amend its answer because the facts underlying EPS's cross-claims were readily discernible sooner than Peterson's May 2019 deposition. Although the FTC contends that EPS knew or should have known of the facts underlying its cross-claims as early as Peterson's hearing in 2016, the Court disagrees. At the time of Peterson's hearing, Peterson was employed by EPS, and EPS had no reason to question the veracity of his testimony. Thus, Peterson's then testimony regarding payments from the KMA-Wigdore Defendants would not have put EPS on notice of potential cross-claims.

Nor could the spreadsheet disclosed in the FTC's January 2018 MIDP production have put EPS on notice of potential cross-claims. The FTC contends that because the spreadsheet highlighted transfers from the Diverted Funds Account into an Academy Bank account, EPS should have investigated Peterson for theft at that time. (Doc. 175 at 15.) However, EPS states that it did not further investigate because it "assumed that the Academny [*sic*] Bank account" listed in the spreadsheet "was the one related to the other EPS employee and the matter being investigated by the Treasury Department." (Doc. 197 at 8.) While EPS's "assumption" does not constitute due diligence, the Court agrees with EPS that the facts underlying its cross-claims were not likely discoverable at this time. At the time the FTC produced the spreadsheet, EPS was already aware of transfers from the Diverted Funds Account into a bank account at Academy Bank because of the Department of Treasury's investigation. Because the spreadsheet provided no additional information

about the bank account – i.e., the account number or the account owner – at Academy Bank, the spreadsheet alone would not have prompted EPS to further investigate the transfers, or, more specifically, Peterson.

However, the Court finds that EPS should have been on notice of the facts underlying its cross-claims as early as August 7, 2018 – the date the FTC emailed counsel copies of its discovery requests and subpoena to Academy Bank. First, the interrogatories attached to the email asked about payments Peterson received from the Diverted Funds Account and attached an appendix, detailing transfers that were made to "*Peterson's* Academy Bank account *x1402*." (Doc. 175-1 at 79 n.2, 99 n.2 (emphasis added).) This information should have put EPS on notice that Peterson was potentially involved in the transfers from the Diverted Funds Account. Moreover, because the subpoena served on Academy Bank requested information about bank accounts associated with Peterson, and, more specifically, bank account number x1402, EPS should have considered that the Academy Bank account suspected of receiving funds from the Diverted Funds Account was associated with Peterson. Given the numerous indications of Peterson's involvement in the transfers from the Diverted Funds Account, the Court finds that EPS should have known of the facts underlying its cross-claims at this time.

Even if the facts underlying EPS's cross-claims were not readily discernible at that time, the Court finds that the FTC's October 2018 supplemental disclosures should have put EPS on notice of its potential cross-claims. In the FTC's October 2018 supplemental disclosures, the FTC provided Academy Bank's response to its subpoena, which included copies of checks deposited into Peterson's bank account, substantiating the transfers from the Diverted Funds Account. (Doc. 175 at 11.) Accordingly, EPS should have been on notice of Peterson's involvement in the transfers from the Diverted Funds Account and should have investigated Peterson at that time. By stating that EPS should have been on notice, the Court is not suggesting that EPS should have filed its motion to amend at that time. Indeed, the Court is aware of the obligations imposed on attorneys by Federal Rule of Civil Procedure 11 and the Model Rules of Professional Conduct. However, at the very

least, a reasonable attorney under the circumstances would have undertaken further inquiry to determine whether Peterson was involved in the transfers from the Diverted Funds Account. EPS, however, failed to investigate further, failed to propound any discovery requests on Peterson,[4] and instead, waited until Peterson verbally confirmed his involvement during his May 2019 deposition – nearly seven months later – to assert its cross-claims; this does not constitute due diligence. See, e.g., Act Grp., Inc. v. Hamlin, No. CV-12-567-PHX-SMM, 2014 WL 1285857, at *6-7 (D. Ariz. Mar. 28, 2014) (finding lack of due diligence where movant had prior knowledge of facts underlying claims yet waited until it had sworn testimony to request leave to amend). Thus, the Court finds that EPS was not diligent in requesting leave to amend its answer and failed to establish good cause to amend the pretrial case management schedule.

Moreover, even if EPS had demonstrated due diligence, the Court notes that the cross-claims that EPS seeks to assert appear to be unrelated to the core proceeding before the Court. That is, allowing EPS to join the claims would be permissive in nature. Accordingly, the Court will deny EPS's motion to amend its answer. (Doc. 170.)

IV. MOTION FOR JUDGMENT ON THE PLEADINGS

Under Federal Rule of Civil Procedure 12(c), Dorsey and McCann move for judgment on the pleadings, contending the FTC failed to allege sufficient facts in the FAC to establish they are "violating" or "about to violate" the FTC Act. (Doc. 173-1 at 1-2, 8.)

A. Legal Standard

Rule 12(c) of the Federal Rules of Civil Procedure provides that "[a]fter the pleadings are closed – but early enough not to delay trial – any party may move for judgment on the pleadings." Fed. R. Civ. P. 12(c). "Judgment on the pleadings is proper when, taking all the allegations in the pleadings as true, the moving party is entitled to

[4] EPS states that it could have propounded discovery on Peterson, but because Peterson failed to respond to the FTC's discovery request, "there was no reason to believe Peterson would have been any more responsive to a discovery request from EPS." (Doc. 197 at 9.) EPS further contends that it did not propound discovery at that time because "the deposition of Peterson had been scheduled and EPS knew it would have the opportunity to ask Peterson about the additional checks at his deposition." (Id.) EPS's arguments are contrary to a showing of due diligence.

judgment as a matter of law." Honey, 195 F.3d at 532-33. Judgment on the pleadings is only appropriate when the moving party establishes no material fact remains to be resolved. Doleman, 727 F.2d at 1482. Dismissal on the pleadings is inappropriate if the facts as pled would entitle the non-moving party to a remedy. See Merchs. Home Delivery Serv., Inc., 50 F.3d at 1488. "The court cannot consider evidence outside the pleadings unless the court treats the motion for judgment on the pleadings as a motion for summary judgment under Fed. R. Civ. P. 56." Phillips & Assocs., P.C., 764 F. Supp. 2d at 1175.

B. Discussion

Dorsey and McCann move for judgment on the pleadings, contending that the FTC has failed to plead sufficient facts to invoke the FTC's limited authority under 15 U.S.C. § 53(b). (Doc. 173-1 at 4.) Because the FAC states that Defendants' unlawful conduct ceased in 2013, Dorsey and McCann argue that the FTC has failed to allege that they are "violating" or "about to violate" the law pursuant to § 53(b). (Id. at 8-9.) In support, Dorsey and McCann cite Federal Trade Commission v. Shire ViroPharma, Inc., 917 F.3d 147 (3d Cir. 2019), for the proposition that the plain language of the statute prohibits the FTC from bringing a claim under § 53(b) based on allegations of long-past conduct – that is, the FTC must allege a current or imminent violation of the FTC Act. (Id. at 6.) Because this proposition is contrary to the standard articulated by the Ninth Circuit in Federal Trade Commission v. Evans Products Co., 775 F.2d 1084, 1087 (9th Cir. 1985), the Court declines to follow Shire ViroPharma.[5]

In opposition, the FTC emphasizes that it may bring an action for permanent injunction whenever it has "*reason to believe*" an individual "is violating, or is about to violate" the FTC Act and contends that such belief is unreviewable. (Doc. 184 at 10 (emphasis in original).) However, even if the FTC's "reason to believe" is reviewable, the FTC argues that it pled sufficient facts based upon Defendants' past conduct to establish that the FTC had reason to believe that Dorsey and McCann are violating or about to violate

[5] The Court also notes that it is improper to cite other circuit authority in disregard for controlling Ninth Circuit precedent without stating that Defendants intend to request an en banc review of that controlling precedent.

the law. (Id. at 14.)

Although the Court declines to rule on whether the FTC's "reason to believe" is reviewable, the Court agrees with the FTC that it has pled sufficient facts to withstand Dorsey and McCann's motion.

Section 53(b) states that the FTC may seek an injunction if it has "reason to believe" a person "is violating, or is about to violate" any law enforced by the FTC. 15 U.S.C. § 53(b). A court's power to grant injunctive relief survives the discontinuance of illegal conduct. United States v. W. T. Grant Co., 345 U.S. 629, 633 (1953). Indeed, "[a]n inference arises from illegal past conduct that future violations may occur. The fact that illegal conduct has ceased does not foreclose injunctive relief." F.T.C. v. Citigroup Inc., No. 1:01-CV-606-JTC, 2001 WL 1763439 (N.D. Ga. Dec. 27, 2001) (internal quotations omitted) (quoting S.E.C. v. Koracorp Indus., Inc., 575 F.2d 692, 698 (9th Cir. 1978)). The voluntary cessation of violative conduct does not vitiate the need for injunctive relief if there is a possibility that the defendant is "free to return to his old ways." W. T. Grant Co., 345 U.S. at 632; F.T.C. v. Affordable Media, LLC, 179 F.3d 1228, 1237 (9th Cir. 1999) (internal quotations and citations omitted); F.T.C. v. Sage Seminars, Inc., No. C 95-2854 SBA, 1995 WL 798938, at *6 (N.D. Cal. Nov. 2, 1995) (citing W. T. Grant Co., 345 U.S. at 632). Indeed, courts should be wary of a defendant's termination of illegal conduct when a defendant voluntarily ceases unlawful conduct in anticipation of formal intervention. Id. (citing W. T. Grant Co., 345 U.S. at 632 n.5.) Thus, in the Ninth Circuit, if a violation of the FTC Act has ceased, an injunction will issue under § 53(b) if the FTC has reason to believe that the past conduct is "likely to recur." F.T.C. v. Evans Prods. Co., 775 F.2d 1084, 1087 (9th Cir. 1985).[6]

To determine whether past conduct is likely to recur, courts consider the totality of

[6] District courts in the Ninth Circuit have applied this standard to determine whether the FTC has pled a plausible claim for relief under 15 U.S.C. § 53(b). See, e.g., F.T.C. v. Qualcomm Inc., No. 17-CV-00220-LHK, 2019 WL 2206013 (N.D. Cal. May 21, 2019); F.T.C. v. Vemma Nutrition Co., No. CV-15-01578-PHX-JJT, 2015 WL 11118111 (D. Ariz. Sept. 18, 2015); F.T.C. v. Merch. Servs. Direct, LLC, No. 13-CV-0279-TOR, 2013 WL 4094394 (E.D. Wash. Aug. 13, 2013); F.T.C. v. Infinity Grp. Servs., Inc., No. SACV 09-977 DOC (MLGx), 2009 WL 10672411 (C.D. Cal. Sept. 2, 2009); F.T.C. v. Equinox Int'l Corp., No. CV-S-990969HBR (RLH), 1999 WL 1425373 (D. Nev. Sept. 14, 1999).

the circumstances surrounding the defendant's conduct including "the degree of scienter involved; the isolated or recurrent nature of the infraction; the defendant's recognition of the wrongful nature of his conduct; the likelihood, because of defendant's professional occupation, that future violations might occur; and the sincerity of his assurances against future violations." S.E.C. v. Murphy, 626 F.2d 633, 655 (9th Cir. 1980); F.T.C. v. Magui Publishers, Inc., Civ. No. 89-3818RSWL(GX), 1991 WL 90895, at *15 (C.D. Cal. Mar. 28, 1991).

Here, the Court finds that the FTC has pled sufficient facts to establish that it has "reason to believe" Dorsey and McCann's violations are "likely to recur." See Evans Prods., 775 F.2d at 1087. Although Dorsey and McCann contend that the need for a permanent injunction is vitiated because the alleged unlawful conduct ended in 2013, the Court is unconvinced. As pled in the FAC, Dorsey and McCann ceased their alleged unlawful conduct in 2013. (Doc. 85 at 5, 11, 49.) Because the FTC's prosecution of the MNF scheme also occurred in 2013, the Court finds it reasonable to infer that Dorsey and McCann's cessation took place in response to the FTC's litigation. Accordingly, Dorsey and McCann's cessation of their unlawful conduct can hardly be classified as voluntary. Moreover, Dorsey and McCann further contend that an injunction is unnecessary because the FTC has failed to allege that Dorsey and McCann have "violated the FTC Act in the interim time between 2014 and July 2017" – the date the FTC filed the instant matter. (Doc. 173-1 at 10.) The Court finds this argument equally unconvincing. The FAC alleges that the FTC litigated the MNF scheme from 2013 through 2015, and the Arizona Attorney General's Office prosecuted the MNF principals from 2016 through 2017. (Doc. 85 at 13.) Because the government has continually prosecuted aspects of this scheme since 2013, the Court finds that Dorsey and McCann's lack of continued violations fails to qualify as a voluntary discontinuance, and thus, the need for a permanent injunction is not vitiated.

The Court further finds that the FTC alleged a reasonable belief of likely recurrence because the FAC contends that Dorsey and McCann were integral in intentionally perpetrating the MNF scheme. See Murphy, 626 F.2d at 655 (considering the degree of

scienter involved to determine whether past conduct is likely to recur). To perpetrate the scheme, EPS sales agents created at least 23 fictitious entities and submitted the entities' merchant applications to EPS for underwriting approval. The FAC alleges that Dorsey and McCann were directly responsible for approving all merchant applications submitted to EPS and approved many applications despite each application containing various indications of fraud. (Doc. 85 at 44-47.) Accordingly, because the FAC indicates a pattern and practice of Dorsey and McCann automatically approving fictious merchant applications, the Court finds the FTC alleged a reasonable belief that the conduct is likely to recur.

Last, in conjunction with the above-mentioned factors, the Court is convinced that the FTC has sufficiently pled a reasonable belief that Dorsey and McCann's past wrongs are likely to recur because Dorsey and McCann remain in the same professional occupation. See Murphy, 626 F.2d at 655 (considering defendant's occupation to determine whether past conduct is likely to recur). At the time of the alleged violations, Dorsey was the CEO and co-owner of EPS, and McCann was the managing member and co-owner of EPS. (Doc. 85 at 10-11.) The FTC also alleges that Dorsey and McCann continue to be "at the helm of EPS, which continues to approve and board merchants and utilize sales agents." (Docs. 184 at 18; 85 at 10-11.) Because Dorsey and McCann are engaged in the same professional occupation, the Court finds that they could easily reengage in similar unlawful conduct in the future absent a permanent injunction. See, e.g., F.T.C. v. Accusearch Inc., 570 F.3d 1187, 1202 (10th Cir. 2009) (finding past conduct likely to recur where the defendant remained in the same industry such that it had the capacity to engage in similar unfair acts or practices in the future).

Therefore, the Court finds that the FTC has pled sufficient facts that indicate a reasonable belief that Dorsey and McCann's past conduct is likely to recur. See Evans Prods., 775 F.2d at 1087. Thus, the Court denies Dorsey and McCann's Motion for Judgment on the Pleadings (Doc. 173) because the FTC has pled a plausible claim for injunctive relief under 15 U.S.C. § 53(b).

V. CONCLUSION

Based on the foregoing,

IT IS HEREBY ORDERED denying Defendants Electronic Payment Systems, LLC and Electronic Payment Transfer, LLC's Motion to Dismiss Plaintiff Federal Trade Commission's Claim for Monetary Relief. (Doc. 153.)

IT IS FURTHER ORDERED denying Defendants Electronic Payment Systems, LLC and Electronic Payment Transfer, LLC's Motion to Amend its Amended Answer, Crossclaims, and Third-Party Claims. (Doc. 170.)

IT IS FURTHER ORDERED denying Defendants John Dorsey and Thomas McCann's Motion for Judgment on the Pleadings. (Doc. 173.)

Dated this 28th day of August, 2019.

Honorable Stephen M. McNamee
Senior United States District Judge