UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

FEDERAL TRADE COMMISSION, Plaintiff, v. YELLOWSTONE CAPITAL, LLC, a New York limited liability company, FUNDRY, LLC, a New York limited liability company, YITZHAK D. STERN, a/k/a Isaac Stern, individually and as an officer of Yellowstone Capital, LLC and Fundry, LLC, and JEFFREY REECE, individually and as an officer of Yellowstone Capital, LLC and Fundry, LLC, Defendants.	:	No. 1:20-CV-06023-LAK

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS'
<u>MOTION TO DISMISS PLAINTIFF'S COMPLAINT</u>

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Defendants Yellowstone Capital, LLC ("YSC"), Fundry, LLC ("Fundry," together with YSC, "Yellowstone"), Yitzhak D. Stern a/k/a Isaac Stern ("Stern"), and Jeffrey Reece ("Reece," together with Stern, the "Individual Defendants"), by their undersigned counsel, respectfully submit this memorandum of law in support of their motion to dismiss the Complaint of Plaintiff the Federal Trade Commission ("FTC") pursuant to Federal Rule of Civil Procedure 12(b)(6).[1]

PRELIMINARY STATEMENT

As the FTC's Complaint notes, thousands of small businesses across the country that cannot qualify for traditional loans seek funding in the form of a merchant cash advance ("MCA"). *See* Compl. ¶¶ 6, 12. An MCA is a revenue-based financing arrangement in which a company provides a business ("merchant" or "merchant-seller" in industry parlance) with an up-front payment in exchange for a portion of the business's future sales receipts, which are debited from the business in installment payments. The infusion of funds from an MCA can enable a small business to satisfy many critical needs—from meeting payroll obligations to expanding facilities or investing in infrastructure and technology—that it otherwise would be unable to fulfill when traditional banks and lenders turned it away.

The FTC has overextended itself in this litigation. One FTC Commissioner recently commented that he is looking for a "systemic solution" that "makes sure" that "they"—referring to Yellowstone and other defendants in recently filed FTC lawsuits, or perhaps the merchant cash advance industry more broadly—"***can all be wiped out*** before they do more damage" (emphasis added).[2] The FTC is not and should not be in the business of "wiping out" a critical source of

[1] A copy of the Complaint ("Compl.") (Dkt. 1) is attached as Exhibit 1 to the accompanying Declaration of Stephen R. Chuk, dated October 2, 2020 ("Chuk Decl.").

[2] Gretchen Morgenson, *Feds Crack Down on Lenders Targeting Small Businesses With High-Interest Loans, Abusive Collection Tactics*, NBC News (Aug. 11, 2020, 9:00 AM), https://www.nbcnews.com/business/economy/feds-crack-down-lenders-targeting-small-businesses-high-interest-loans-n1236167. The Court may take judicial notice of this statement. *See Staehr v. Hartford Fin. Servs. Grp., Inc.*, 547 F.3d 406, 425 (2d Cir. 2008) (district court did not abuse

small business funding like Yellowstone, even if it could be shown to have engaged in deceptive or unfair practices that should be stopped (which the FTC has not plausibly alleged here). This litigation, like the Commissioner's statement, is an example of government overreach. It is based on an incorrect and improper application of the Federal Trade Commission Act (the "FTC Act"), 15 U.S.C. § 41 *et seq*.

The FTC's Complaint purports to assert three substantive claims. It alleges that: (i) certain of Yellowstone's historic advertisements made inaccurate statements regarding whether interested businesses would be required to provide collateral or a personal guarantee in connection with an MCA issued by Yellowstone; (ii) Yellowstone's contracts did not adequately disclose up-front fees to merchants; and (iii) Yellowstone did not discontinue auto-debiting bank accounts of merchants prior to when the merchants had remitted the full amount due to Yellowstone. Each of these claims fails as a matter of law for numerous reasons.

First, the FTC lacks the statutory authority to bring its claims in federal court. Critically, none of the challenged conduct, to the extent it even occurred or was actionable, is plausibly alleged to be ongoing or "about to" occur. This is insufficient to invoke Section 13(b) of the FTC Act, the authorizing statute under which the FTC purports to bring this action. Section 13(b) enables the FTC to file suit in federal court to enjoin acts or practices ***only*** if the FTC has reason to believe a defendant "is violating, or is about to violate" a provision of law. In other words, Section 13(b) applies only to ongoing or imminent conduct, not past conduct. Here, the FTC engages in verbal gymnastics in the Complaint because it cannot (and does not) plausibly allege ongoing or imminent conduct. The Complaint should therefore be dismissed in its entirety.

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its discretion in taking judicial notice of media reports that "were offered to show that certain things were said in the press"); *Christa McAuliffe Intermediate Sch. PTO, Inc. v. de Blasio*, 364 F. Supp. 3d 253, 263–64 (S.D.N.Y.), *aff'd*, 788 F. App'x 85 (2d Cir. 2019) (taking judicial notice of statements made by government official in news interview).

Second, each of the three counts of the FTC's pleading is also insufficient as none allege a plausible claim under *Iqbal/Twombly*.

With respect to Count I, the FTC alleges that purported Yellowstone advertisements included the claims "no collateral" or "no personal guarantee." But the FTC has improperly isolated three to twelve words from each advertisement it challenges and fails to plead sufficient context to evaluate any of the advertisements from the perspective of a reasonable merchant. Accordingly, the FTC's allegations fail to meet the standard for evaluation of advertisements under Section 5 of the FTC Act and Count I should be dismissed.

With respect to Count II, the FTC alleges that Yellowstone's up-front fees were insufficiently disclosed. But this Count does so by cherry-picking language from a discontinued version of Yellowstone's MCA agreement (the "MCA Agreement"), while omitting any mention of the clear and conspicuous language in the very same document that expressly discloses these fees. Importantly, the Complaint ignores that the very first page of the MCA Agreement refers to Appendix A—entitled "Fee Structure"—which sets forth the applicable fees that the Complaint alleges were somehow insufficiently disclosed. Moreover, Appendix A was not concealed; to the contrary, it required a separate signature from the merchant. The FTC's failure to acknowledge, much less address, key aspects of the MCA Agreement, which is properly before the Court on this motion, renders its claim implausible under the *Iqbal/Twombly* standard.

In Count III, the FTC contends that a 4 or 5-day lag between when daily installment payments were ***withdrawn*** from a merchant's account and when they were actually ***received*** by Yellowstone resulted in temporary overpayments, and that Yellowstone's initial withdrawal of these payments constituted an unfair business practice. But here again, the FTC's allegations are flatly inconsistent with the MCA Agreement on which they rely. That agreement contains clear authorizations by the merchant for such ACH withdrawals. The unambiguous terms of these authorizations render this claim implausible too.

In addition, to the extent that Yellowstone initially collected any funds beyond what was due and owing under any MCA agreement (including fees thereunder), the FTC has not plausibly alleged that any of these temporary overpayments were not properly refunded or applied to a new cash advance balance as directed by the same merchant, or that merchants were otherwise cognizably injured, a required element of this claim.

Third, the FTC's claims seeking to hold Yellowstone's CEO Stern and its President Reece individually liable for Yellowstone's purported unlawful acts are also insufficient as a matter of law. The Complaint does not meet the required standard for pleading the direct participation or control and knowledge necessary to state a claim of individual liability against those individuals. The threadbare allegations as to the Individual Defendants constitute legal conclusions masquerading as factual averments.

Fourth, the FTC's requested remedies should be dismissed based on recent developments in the case law. Overruling its decision in *FTC v. Amy Travel Services, Inc.*, 875 F.2d 564 (7th Cir. 1989), the Seventh Circuit in *FTC v. Credit Bureau* held in August 2019 that Section 13(b) of the FTC Act does not authorize monetary relief. In doing so, it expressly cast doubt on the Second Circuit's decision in *FTC v. Bronson Partners, LLC*, 654 F.3d 359 (2d Cir. 2011), which relied on *Amy Travel* and its progeny in concluding that Section 13(b) authorizes the FTC to seek monetary relief. The Supreme Court has since granted certiorari in *Credit Bureau*. Two days ago, the Third Circuit agreed with the *Credit Bureau* decision and similarly ruled that Section 13(b) does not authorize monetary relief. *FTC v. AbbVie Inc.*, -- F.3d .--, 2020 WL 5807873 (3d Cir. 2020). In light of *Credit Bureau* and *AbbVie*, and given that the FTC's request for a disgorgement award is also defective because it is impermissibly punitive under the Supreme Court's recent decision in *Liu v. SEC*, the Court should dismiss the FTC's request for any ancillary, non-injunctive relief to the extent that the Complaint is not dismissed on other grounds.

RELEVANT ALLEGED FACTS

Yellowstone offers financial products known as Merchant Cash Advances to small businesses. Compl. ¶ 12. An MCA is a form of revenue-based financing available to small businesses that are in need of prompt funding, but which often cannot qualify for bank loans or traditional forms of financing. *See id.* The basic structure of a Yellowstone MCA, which is governed by a written MCA agreement, consists of an up-front payment by Yellowstone to a small business merchant-seller (the "Purchase Price") in exchange for a specified percentage of an agreed-upon amount of the merchant-seller's future business receipts (the "Purchased Amount") being remitted to Yellowstone in installment payments, which may be made on a daily basis. *See id.* ¶ 21; *see also* Compl. Ex. J.

A. The FTC's Complaint

After a lengthy civil investigation, the FTC filed its Complaint on August 3, 2020. Dkt. 1. In its Complaint, brought pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b) (*see, e.g.*, Compl. ¶ 51), the FTC asserts two misrepresentation claims, both allegedly in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a) (Count I concerning alleged advertisements and Count II concerning alleged disclosures about up-front fees) and one claim of an unfair act or practice allegedly in violation of Section 5 of the FTC Act, 15 U.S.C. §§ 45(a), (n) (Count III, concerning alleged aspects of Yellowstone's installment payment withdrawal system). Compl. ¶¶ 41-49.

Although the Complaint does not contain any factual allegations that this purported conduct is ongoing or imminent, the FTC nonetheless requests injunctive relief "to prevent future violations of the [FTC Act] by Defendants" as well as ancillary relief such as "rescission or reformation of contracts, restitution, the refund of monies paid, and the disgorgement of ill-gotten monies." *Id.* at 14 (Prayer For Relief).

B. Alleged Advertisements

The FTC alleges that Yellowstone previously disseminated (or caused to be disseminated) advertisements that contained the words "no collateral" or "no personal guarantee." Compl. ¶¶ 15–18 & Exs. A–I. The Complaint points to three types of past alleged advertisements: online advertisements (Compl. ¶ 16), a video advertisement (*id.* ¶ 17), and a direct mail piece (*id.* ¶ 18) (collectively, the "Challenged Advertisements"). Each of the Complaint's links to the purported online advertisements is inactive. Chuk Decl. Ex. 2 (screenshots of each of the pages linked to in paragraph 16 of the Complaint).[3] The FTC does not allege that the video advertisement is currently being disseminated to the public. And the direct mail piece states on its face that it is from 2015. Compl. ¶ 18 & Ex. I. The FTC has not alleged that Yellowstone is currently disseminating the Challenged Advertisements, or that Yellowstone is "about to" disseminate the Challenged Advertisements again.

C. Alleged Fee Disclosures

The FTC alleges that the Purchase Price paid by Yellowstone to a merchant-seller pursuant to a Yellowstone MCA agreement is reduced by certain up-front fees, Compl. ¶ 25, and that Yellowstone failed to properly disclose these fees would be deducted from the Purchase Price. *Id.* ¶¶ 44-46. The Complaint bases these allegations on a version of Yellowstone's MCA agreement

[3] Because the FTC alleges that the Challenged Advertisements have been disseminated on these websites and that the websites belong to Defendants (Compl. ¶ 16), the websites are incorporated by reference into the Complaint. Alternatively, the Court may take judicial notice of these websites. *See, e.g.*, *Volpe v. Am. Language Commc'n Ctr., Inc.*, 200 F. Supp. 3d 428, 430 (S.D.N.Y. 2016) (judicial notice taken of information publicly announced on a website), *aff'd*, 692 F. App'x 51 (2d Cir. 2017); *Arnold v. ABC, Inc.*, No. 06-cv-1747 (GBD), 2007 WL 210330, at *1 n.2 (S.D.N.Y. Jan. 29, 2007) (considering related website in evaluating challenged advertisement on motion to dismiss); *see also Staehr*, 547 F.3d at 426 (judicial notice could be taken of publicly available materials).

that it states was used "until at least October 2018." *Id.* ¶ 22; *see* Compl. Ex. J (the MCA Agreement). The FTC does not allege that the MCA Agreement is currently being used by Yellowstone, or that Yellowstone will imminently revert to it.

The FTC alleges that fees are mentioned "several pages into the contract." Compl. ¶ 25. But in fact, a disclosure of fees appears on the ***first page*** of the MCA Agreement, immediately preceding the Purchase Price, alerting merchants that the agreement is subject to fees and directing them to a more fulsome explanation of them in Appendix A. *See* Compl. Ex. J at YEL-0000001549 ("A list of all fees applicable under this agreement is annexed hereto in Appendix A"). Appendix A, of which the Complaint omits any mention, is entitled "Fee Structure." *Id.* at YEL-0000001556 ("Origination Fee," "ACH Program Fee," "Bank Fee," etc.). Merchants must independently sign Appendix A. *Id*. The Complaint does not allege that a reasonable merchant entering into a version of the MCA Agreement with Yellowstone would fail to see and apprehend these disclosures.

D. Alleged ACH Practices

The FTC alleges that Yellowstone withdrew "money from customers' accounts in excess of the amounts customers authorized, by continuing to withdraw daily payments from customers' accounts after they have already fully repaid the 'Purchased Amount'" (*i.e.*, the full amount a merchant is to repay Yellowstone). Compl. ¶ 29. The Complaint does not include a specific time frame for when this conduct allegedly occurred and does not contain any factual allegation indicating whether the challenged conduct is ongoing or "about to" occur.

The first page of the MCA Agreement referenced in the Complaint—indeed, its first two sentences—states that merchants authorize Yellowstone to withdraw agreed-upon daily installment payments via ACH Debit until the Purchased Amount "***has been delivered*** by Merchant to [Yellowstone]" and "until such time as [Yellowstone] ***receives payment in full*** of the Purchased Amount." Compl. Ex. J at YEL-0000001549 (emphasis added). Moreover, the ACH

Authorization Form executed by merchant-sellers, which is attached to the MCA Agreement, expressly incorporates the terms of the MCA Agreement. *See, e.g.*, *id.* at YEL-0000001559 ("***In exchange for products and/or services listed above***, the undersigned hereby authorizes [Yellowstone] to electronically draft via the Automated Clearing House system the amounts indicated . . . .") (emphasis added).

The MCA Agreement, on the first page, also states, "Merchant understands that it . . . will be held responsible for any fees incurred by [Yellowstone] resulting from a rejected ACH attempt or an event of default (See Appendix A)." *Id.* at YEL-0000001549. And Appendix A (as described above) is a Fee Structure that requires a separate signature from the merchant-seller and identifies various fees that will be assessed, including in the event of a "Rejected ACH," "Default," etc. *Id.* at YEL-0000001556.

The Complaint challenges two types of ACH transfers: so called "overpayments" due to Yellowstone's ACH system's 4 or 5-day processing lag—discussed below—and vague allegations concerning "numerous instances" in which additional ACH transfers were made after the "4-5 days associated with their typical 'lag' or 'debit delay.'" Compl. ¶ 32. With respect to the latter, the FTC offers a conclusory reference to two consumer interactions, *id.*, alleging that two unidentified customers contacted Yellowstone about purported overpayments. The Complaint does not indicate, for instance, if these unidentified customers had breached their MCA agreements or otherwise incurred additional fees beyond the Purchased Amount that were due and owing to Yellowstone under their respective agreements. Nor does the Complaint allege more than two occurrences of this type of ACH transfer or this type of consumer complaint.

With respect to alleged "overpayments" resulting from the ACH processing lag, the Complaint alleges that Yellowstone collected "4-5 or more unauthorized payments" after merchants had "repaid" their Purchased Amount. Compl. ¶ 30. In other words, some temporary over-collection may have occurred, according to the Complaint, due to a 4 to 5-day ACH processing lag between when a payment was "withdrawn" from a merchant's account and when that payment was actually received by Yellowstone. That could be because debiting of daily installment payments continued until Yellowstone's ***receipt*** of the full Purchased Amount, a receipt that took a few days to be processed by the ACH system. The Complaint references five purported interactions between merchants and Yellowstone or within Yellowstone that discuss the ACH delay. *Id.* ¶¶ 30-31. As to alleged customer injury, the FTC asserts that, "in numerous instances," additional ACH transfers were refunded only in response to merchant complaints, and that "sometimes" refunds took "weeks or months." *Id.* ¶ 34. The Complaint does not allege a single instance of a delayed refund; nor does it allege that Yellowstone did not as a general matter refund any purported overpayment or properly apply the balance to another MCA with the same merchant.

The Complaint also references two purported complaints concerning merchants who had allegedly been subject to overdraft fees from their banks due to Yellowstone's ACH withdrawals. Compl. ¶ 33. The Complaint does not provide any factual averments concerning these complaints, including if the alleged "overpayments" that resulted in overdraft fees fell outside the terms of Yellowstone's agreements with the merchants, or if these were anything other than isolated incidents. The first page of the MCA Agreement states that Yellowstone "is not responsible for any overdrafts or rejected transactions that may result from [Yellowstone's] ACH debiting the specified amounts under the terms of this agreement." Compl. Ex. J at YEL-0000001549.

E. Individual Defendants Stern and Reece

Individual Defendants Stern and Reece are the Chief Executive Officer and President, respectively, of both YSC and Fundry. *Id.* ¶¶ 8, 9. Only six paragraphs in the FTC's Complaint even mention the Individual Defendants. *Id.* ¶¶ 8-10, 20, 26, 36. These paragraphs state as follows:

¶	**Allegation**
8	Defendant **Yitzhak D. Stern**, also known as Isaac Stern ("Stern"), is a founder and the Chief Executive Officer of both [YSC] and Fundry. At all times material to this Complaint, acting alone or in concert with others, he has formulated, directed, controlled, had the authority to control, or participated in the acts and practices set forth in this Complaint. Defendant Stern, in connection with the matters alleged herein, transacts or has transacted business in this District and throughout the United States.
9	Defendant **Jeffrey Reece** ("Reece") is the President of both [YSC] and Fundry. At all times material to this Complaint, acting alone or in concert with others, he has formulated, directed, controlled, had the authority to control, or participated in the acts and practices set forth in this Complaint. Defendant Reece, in connection with the matters alleged herein, transacts or has transacted business in this District and throughout the United States.
10	Defendants Stern and Reece have formulated, directed, controlled, had the authority to control, or participated in acts and practices of the Corporate Defendants that constitute the common enterprise.
20	Defendants Stern and Reece have closely overseen and directed Defendants' day-to-day advertising and marketing efforts. Among other things, they have directly managed the work of Defendants' marketing agents. They have also frequently reviewed and provided feedback and approval for advertising content and claims. In fact, Defendants Stern and Reece have specifically reviewed copies of advertisements that claim the Defendants do not require collateral.
26	In numerous instances, Defendants Stern and Reece have received messages detailing the difference between the funding amount promised to specific consumers in Defendants' contracts and the significantly lower amount disbursed to those same consumers after additional fees were withheld.
36	Defendants Stern and Reece have closely overseen and managed Defendants' servicing and collection of payments from consumers. They have directly supervised their in-house servicers and disseminated relevant policies and practices to them. Additionally, Defendants Stern and Reece have known about, and communicated with their in-house servicers about, the existence of unauthorized overpayments by consumers.

Upon these boilerplate and conclusory allegations, the Complaint seeks to hold Stern and Reece individually liable for Yellowstone's purported wrongful conduct.

STANDARD OF REVIEW

To survive a motion to dismiss pursuant to Rule 12(b)(6), a plaintiff must plead "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S.

544, 570, 127 S. Ct. 1955, 1974 (2007). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S. Ct. 1937, 1949 (2009). This standard "asks for more than a sheer possibility that a defendant has acted unlawfully," and a pleading that offers only "'labels and conclusions' or 'a formulaic recitation of the elements of a cause of action will not do.'" *Id.* at 678 (quoting *Twombly*, 550 U.S. at 555, 127 S. Ct. at 1965). Indeed, such conclusory statements "are not entitled to the assumption of truth." *Id.* at 679; *see also Cantor Fitzgerald Inc. v. Lutnick*, 313 F.3d 704, 709 (2d Cir. 2002) (a court should "give no credence to [a] plaintiff's conclusory allegations").

In deciding a Rule 12(b)(6) motion, a district court must accept as true all well-pleaded factual allegations in the complaint and draw reasonable inferences in the plaintiff's favor. *United States v. Bank of New York Mellon*, 941 F. Supp. 2d 438, 450 (S.D.N.Y. 2013) (Kaplan, J.). A court may rely upon "documents attached to the complaint as exhibits," documents incorporated by reference in the complaint," and "'matters of which judicial notice may be taken.'" *Id.* & n.74 (quoting *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 153 (2d Cir. 2002)).

ARGUMENT

I. THE FTC HAS FAILED TO PLEAD FACTS NECESSARY TO INVOKE ITS AUTHORITY UNDER SECTION 13(B) OF THE FTC ACT

As pled, the Complaint concerns conduct that, if it occurred at all, occurred in the past. The FTC has not plausibly alleged any ongoing or imminent misconduct. Because Section 13(b)—the provision of the FTC Act under which the FTC purports to bring the present action—allows the FTC to file suit in federal court only when the defendant "is violating, or is about to violate" the law, the Complaint's allegations of past conduct are legally insufficient. Each of the

Complaint's three Counts must be evaluated separately under this standard—whether the Count alleges conduct that is ongoing or "about to" occur.

A. The FTC May Challenge Only Ongoing or Imminent Conduct, Not Past Conduct, Under Section 13(b)

The FTC is an administrative body that "possess[es] only such powers as are granted by statute." *Arrow-Hart & Hegeman Elec. Co. v. FTC*, 291 U.S. 587, 598, 54 S. Ct. 532, 537 (1934). The bounds of FTC authority to file suit directly in federal court without first going through administrative proceedings are circumscribed by Section 13(b) of the FTC Act, which provides in relevant part:

> Whenever the Commission has reason to believe . . . that any person, partnership, or corporation ***is violating, or is about to violate***, any provision of law enforced by the [FTC] . . . the Commission . . . may bring suit in a district court of the United States to enjoin any such act or practice.

15 U.S.C. § 53(b) (emphasis added).

As Section 13(b) unambiguously requires the FTC to have reason to believe that a defendant "is violating" or "is about to violate" the law, the authority it bestows on the FTC is limited to challenging ongoing or imminent conduct.

The Second Circuit has not yet addressed the meaning of Section 13(b)'s "is violating" or "is about to violate" language. But it is "axiomatic" that the plain meaning of a statute controls its interpretation, and that judicial review must end at the statue's unambiguous terms. *Lee v. Bankers Tr. Co.*, 166 F.3d 540, 544 (2d Cir. 1999); *Aslanidis v. U.S. Lines, Inc.*, 7 F.3d 1067, 1073 (2d Cir. 1993) ("If the words of a statute are unambiguous, judicial inquiry should end, and the law interpreted according to the plain meaning of its words."). Congress's use of the present tense in Section 13(b) by its plain text forecloses the FTC from bringing suit under that provision on the sole basis of allegations of past conduct. *See United States v. Wilson*, 503 U.S. 329, 333, 112 S. Ct. 1351, 1354 (1992) ("Congress' use of a verb tense is significant in construing statutes"); *Barscz* *v. Dir., Office Workers' Comp. Programs*, 486 F.3d 744, 749-50 (2d Cir. 2007) (a statute in the present tense "refer[s] *only* to the present tense") (emphasis in original); *see also FTC v. Crescent Pub. Grp., Inc*., 129 F. Supp. 2d 311, 323 (S.D.N.Y. 2001) (Kaplan, J.) (in the preliminary injunction context, requiring the FTC to establish a likelihood of continuing or future recurrences of the challenged behavior under Section 13(b)).

The Third Circuit in *FTC v. Shire ViroPharma, Inc.* came to the same conclusion, holding that the plain text of Section 13(b) unambiguously prohibits "existing or impending conduct" only and that it does not permit the FTC to bring a claim based on past conduct "without some evidence that the defendant 'is' committing or 'is about to' commit another violation." 917 F.3d 147, 156 (3d Cir. 2019). *Shire*, like the present action, involved claims that the defendant had violated Section 5 of the FTC Act, on account of which the FTC sought a permanent injunction and restitution. The *Shire* court affirmed the dismissal of the FTC's complaint, which had alleged only past conduct without sufficient factual allegations from which the court could infer that the law was "about to" be violated.

The *Shire* court also expressed disapproval of the FTC's argument that Section 13(b)'s "reason to believe" language confers upon it unreviewable discretion to file suit. *See* 15 U.S.C. § 53(b) ("***Whenever the Commission has reason to believe***—(1) that any person, partnership, or corporation is violating, or is about to violate, any provision of law . . . [the FTC] may bring suit in a district court of the United States to enjoin any such act or practice.") (emphasis added). The court found this argument unpersuasive because there was "no evidence" in the complaint to "support" any "reason to believe" on the part of the FTC that the defendant was violating the law on an ongoing basis or "about to violate" the law. *Shire*, 917 F.3d at 159 n.17.

B. The FTC Has Not Plausibly Alleged That Any Misconduct "Is" Occurring Or "Is About To" Occur

The FTC has failed to allege the requisite facts to invoke Section 13(b)—that is, ongoing or imminent conduct. With respect to Count I, the Complaint points to no Challenged Advertisements that are current or "about to" be disseminated. The Complaint alleges that the online advertisements it references were available on certain websites, but none of the advertisements are visible on the mentioned websites. *Compare* Compl. ¶ 16 *with* Chuk Decl. Ex. 2. The Complaint does not allege that the sole video advertisement it references is currently being disseminated to the public. *See* Compl. ¶ 17. The final Challenged Advertisement, the direct mail piece, states on its face that it is from 2015. *See* Compl. ¶ 18 & Ex. I.

Furthermore, each of the Complaint's key allegations concerning the Challenged Advertisements in Count I is in the present perfect tense (*i.e.*, "Defendants ***have disseminated***" advertisements), which plausibly alleges only that at some point in the past (*e.g.*, perhaps in 2015), Defendants disseminated the Challenged Advertisements. Compl. ¶¶ 15-18, 41, 42. The present perfect tense does not indicate that any such advertisements currently are or are "about to" be disseminated. The FTC's use of the phrase "[s]ince at least 2015"—unsupported by any factual allegations—has the same effect. *Id.* ¶ 15. Without any additional factual averment, that phrase plausibly alleges only that the Challenged Advertisements were disseminated in 2015. *Id.* ¶ 15. The FTC has therefore failed to invoke its Section 13(b) authority with respect to Count I.

Even more starkly, with respect to Count II, the FTC again uses ambiguous verbiage about the challenged fee disclosures in the MCA Agreement, alleging that such disclosures continued "***until at least*** October 2018." *Id*. ¶ 22 (emphasis added). That averment does not plausibly allege when after October 2018 (if ever) the purported challenged disclosures existed, much less that they continue to this day or are "about to" continue.

Finally, with respect to Count III, the Complaint's allegations provide no time frame whatsoever for the handful of consumer interactions alleged, and again rely solely on an obfuscating use of the present perfect tense and the phrase "[s]ince at least 2015"—unsupported by any factual averments—in an unsuccessful attempt to blur the lines between past conduct and ongoing or imminent conduct. *Id.* ¶¶ 29, 30, 31, 32, 47. Notably, the Complaint uses the present tense only in conclusory sentences to describe customer interactions that the Complaint's other allegations make clear occurred in the past. *Id.* ¶¶ 33, 34, 35. Use of an indeterminate verb tense alone cannot satisfy the FTC's pleading obligations under Section 13(b). The FTC has therefore failed to plausibly plead ongoing or imminent conduct sufficient to invoke its Section 13(b) authority as to each of the three Counts in the Complaint.

FTC v. Vyera Pharmaceuticals, LLC, a case in which the defendants' motion to dismiss was recently denied, provides an instructive contrast to the FTC's pleading failure in the present case. No. 20-cv-0706 (DLC), 2020 WL 4891311, at *7 (S.D.N.Y. Aug. 18, 2020). In *Vyera*, the court found that the Third Circuit's *Shire* decision was distinguishable because the FTC had alleged that the *Vyera* defendants "were at that very moment actively engaged in" the alleged violations. *Id.* at *6. Indeed, in the very first paragraph of the *Vyera* complaint, the FTC alleged, "[The defendants'] unlawful scheme to maintain a monopoly . . . ***continues to this day***" (emphasis added). Complaint at 1, *FTC v. Vyera Pharm.*, *LLC*, No. 20-CV-0706 (DLC) (S.D.N.Y. Jan. 27, 2020), Dkt. 4.[4] The distinctions between the FTC's two pleadings demonstrate that when the FTC has reason to believe there is ongoing or imminent conduct, it alleges it expressly and directly, as opposed to using ambiguous verb tense and other imprecise verbiage.

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[4] Attached as Exhibit 3 to the accompanying Chuk Decl.

Here, as in *Shire* and in contrast to *Vyera*, the Complaint should be dismissed for its failure to plead "factual content" that would allow the Court to plausibly infer that the FTC Act "is" or "is about to be" violated such that the FTC may invoke its Section 13(b) authority.

II. COUNT I FAILS TO STATE A CLAIM UNDER SECTION 5 OF THE FTC ACT

In its Count I, the FTC has failed to plead sufficient factual allegations for the Court to evaluate the Challenged Advertisements as required under Section 5 of the FTC Act—in context and from the perspective of small business owners acting reasonably under the circumstances. Count I should therefore be dismissed.

To state a claim for deceptive advertising under the FTC Act, the FTC must allege: (1) a representation, omission or practice that (2) is likely to mislead consumers acting reasonably under the circumstances and (3) is material. *FTC v. Verity Int'l, Ltd.*, 443 F.3d 48, 63 (2d Cir. 2006). As the Second Circuit explained in *FTC v. Sterling Drug, Inc.*, 317 F.2d 669, 674 (2d Cir. 1963), in determining whether a representation is likely to mislead consumers, it is necessary "to consider the advertisement in its entirety and not to engage in disputatious dissection. The entire mosaic should be viewed rather than each tile separately." Further, each representation must be evaluated in the context of the "relevant audience"—here, small business owners. *See FTC v. Publishers Bus. Servs., Inc.*, 821 F. Supp. 2d 1205, 1223 (D. Nev. 2010) (representations are evaluated in the context of the "relevant audience").

In describing the Challenged Advertising, the FTC has done the opposite of the Second Circuit's directive in *Sterling Drug*: it specifically engages in "disputatious dissection[s]" and evaluates isolated words rather than the whole "mosaic" of the full advertisements in context. 317 F.2d at 674. The FTC picks between three to twelve words from the Challenged Advertisements (*see* Compl. ¶¶ 16-18) and, in many instances, has not even attached enough of certain documents to identify what they are or where they came from. *See, e.g.*, Compl. Exs. F, G, H. Because each of the links to websites on which Yellowstone is alleged to "have disseminated" the Challenged Advertisements is broken, the purported context of those advertisements cannot be evaluated. *See* Chuk Decl. Ex. 2. And the FTC has provided no additional information about where or how small business owners would encounter any of the Challenged Advertisements. These are fatal pleading flaws. Without the required context, it is impossible to evaluate the advertisements "in [their] entirety." *Sterling Drug*, 317 F.2d at 674. The FTC's fragmented and flimsy allegations are insufficient to identify the necessary context of the challenged representations. Count I should therefore be dismissed for failure to state a claim. *See, e.g.*, *Bel Canto Design, Ltd. v. MSS HiFi, Inc.*, No. 11-cv-6353 (CM), 2012 WL 2376466, at *16 (S.D.N.Y. June 20, 2012) (dismissing false advertising claims where sufficient context, such as "where the representation was made . . . and what other information was readily available to one reading it," had not been alleged).

III. COUNT II FAILS TO STATE A CLAIM UNDER SECTION 5 OF THE FTC ACT

Count II of the Complaint is also a "misrepresentation" claim under Section 5 of the FTC Act and is thus governed by the same legal standards as Count I. Here too, the FTC has failed to allege sufficient factual matter to transport its claims "across the line from conceivable to plausible." *Twombly*, 550 U.S. at 570, 127 S. Ct. at 1974. The FTC ignores critical "tiles" in the "mosaic" of Yellowstone's fee disclosures and thus fails to plausibly allege that the totality of the fee disclosures is likely to mislead a reasonable small business owner. Count II should therefore be dismissed as well.

The FTC contends that Yellowstone violated Section 5(a) of the FTC Act by failing to disclose that certain fees would be deducted from the Purchase Price (*i.e.*, the total dollar amount to be provided to the merchant). Compl. ¶¶ 44-46. The Complaint alleges that the first page of the MCA Agreement "prominently set forth" the Purchase Price and other figures, *id.* ¶ 22, but mentioned fees that would be withheld from the Purchase Price only "several pages into the contract." *Id.* ¶ 25. These allegations are flatly inconsistent with the MCA Agreement's actual terms and ignore the broader context of the fee disclosures made by Yellowstone in multiple locations throughout that agreement.

As an initial matter, the Complaint's allegations ignore that the applicable fees were set forth in a fee schedule—Appendix A, prominently titled "Fee Structure"—that a merchant must separately review and sign in order to enter into any MCA Agreement. *See* Compl. Ex. J. at YEL-0000001556. Appendix A identifies in detail each of the fees the merchant is subject to—including an "Origination Fee," "ACH Program Fee," and "Bank Fee," etc. *Id.* at YEL-0000001556. It is black-letter law that disclosures made in a signed contract are deemed to have been received, understood, and assented to. *See, e.g.*, *Eisen v. Norton*, No. 13-cv-6226 (KBF), 2015 WL 1055923, at *5 (S.D.N.Y. Mar. 11, 2015) (plaintiff did not lack access to any hidden material facts where the necessary facts were contained in a one-page release that she had signed); 27 Williston on Contracts § 70:114 (4th ed.) ("It is a fundamental principle of contract law that a person who signs a contract is presumed to know and be bound by its terms and consents."). This is particularly true here, where the MCA Agreement, including Appendix A, required signatures by small business owners in connection with their businesses, not by lay or unsophisticated parties. *See Publishers Bus. Servs., Inc.*, 821 F. Supp. 2d at 1223 (representations evaluated in the context of the "relevant audience"). Significantly, the Complaint does not even acknowledge Appendix A's existence, much less allege that a reasonable business owner would fail to see and apprehend its clear and conspicuous fee disclosures.

Not only does the Complaint omit any mention of Appendix A, but it also ignores that this fee schedule is expressly referenced on the ***first page*** of the MCA Agreement itself, ***immediately preceding*** the financing terms, including the Purchase Price. *See* Compl. Ex. J at YEL-0000001549. Thus, merchant-sellers are expressly informed that "A list of all fees applicable under this agreement is annexed hereto in Appendix A." *Id.*

Contrary to the impression created by the Complaint's selective allegations about the fee disclosures, Appendix A is not a footnote or paragraph buried in the middle of the contract, but rather a fee schedule referred to in the Agreement, appended to the Agreement, and required to be signed separately by the merchant, that identifies in detail each of the fees to which the agreement is subject. Having ignored key language of the MCA Agreement, the Complaint also does not address where a reasonable merchant would understand that these fees, which are first mentioned on the first page of the agreement immediately preceding the stated Purchase Price, would come from, if not from the Purchase Price itself.

Taken together, as required under the *Sterling Drug* standard, the mosaic of fee disclosures apparent from the face of the MCA Agreement (including Appendix A, which the FTC ignores) undercuts the Complaint's conclusory allegations that the select fee disclosures it does mention would be misleading to a reasonable consumer. Count II should therefore be dismissed. *See, e.g.*, *Ricatto v. M3 Innovations Unlimited, Inc.*, No. 18-cv-8404 (KPF), 2019 WL 6681558, at *4 (S.D.N.Y. Dec. 6, 2019) (considering the operative contracts that were appended to the complaint in addition to the allegations of the complaint and holding that plaintiff had failed to state a claim); *see also Echostar DBS Corp. v. Gemstar-TV Guide Int'l, Inc.*, No. 05-cv-8510 (DAB), 2007 WL 438088, at *4 (S.D.N.Y. Feb. 8, 2007) (stating that "if the allegations of a complaint are contradicted by documents incorporated in the complaint, the documents control and the court need not accept the allegations of the complaint as true") (collecting cases).

IV. COUNT III FAILS TO STATE A CLAIM UNDER SECTION 5 OF THE FTC ACT

To state a claim that an act or practice is unfair, the FTC must plausibly allege that it (1) "causes or is likely to cause substantial injury to consumers" which is (2) "not reasonably avoidable by consumers themselves" and (3) "not outweighed by countervailing benefits to consumers or to competition." 15 U.S.C. § 45(n); *see also Crescent Pub. Grp.*, 129 F. Supp. 2d at 322. Count III, which purports to assert such a claim, is facially deficient as to all three elements.

A. The FTC Has Failed To Plead That Any ACH Withdrawals Are "Causing Or Likely To Cause Substantial Injury to Consumers"

The Complaint does not plausibly allege that Yellowstone engaged in any unfair conduct. Instead, its allegations are built on a foundation of incorrect premises. The FTC purports to challenge two kinds of ACH withdrawals by Yellowstone: (i) withdrawals that occurred during a 4 to 5-day ACH settlement lag caused by Yellowstone's payment processing system and (ii) withdrawals that occurred outside of that 4 to 5-day period. In doing so, the FTC ignores critical aspects of the MCA Agreement it references and does not allege "factual content" that would permit an inference that either of these alleged practices is "causing or likely to cause substantial injury to consumers."[5]

1. Merchants Expressly Authorized Yellowstone To Continue Withdrawals During The ACH Processing Lag Period

The Complaint's allegations concerning withdrawals during the ACH processing lag period ignore the express authorization for such withdrawals contained in the MCA Agreement.

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[5] The FTC also points to two instances where merchants may have been charged overdraft fees by their banks but, as explained *supra* at 9, it has not connected those allegations to any purported unfair act or practice.

In that agreement, which is attached to the Complaint and cited therein, merchants authorized Yellowstone Capital, LLC to "remit" the agreed-upon installment payments "on a daily basis" until Yellowstone "***receives*** payment in full of the Purchased Amount." Compl. Ex. J at YEL-0000001549 (emphasis added); *see also, e.g.*, *id.* & at YEL-0000001559 (merchants authorized Yellowstone to withdraw agreed-upon installment payments via ACH Debit until the Purchased Amount "***has been delivered*** by Merchant to [Yellowstone]" while the ACH Authorization Form itself incorporates by reference the terms of the MCA Agreement) (emphasis added). Given the plain meaning of the term "receives," merchant-sellers consented to make ACH transfers until all amounts due and owing to Yellowstone under the MCA Agreement had been received by Yellowstone (*i.e*., deposited in Yellowstone's account).

In that regard, the Complaint also acknowledges that the ACH processing system at issue involves a 4 to 5-day lag between the time a payment is withdrawn from a merchant-seller's account and when it is actually received by Yellowstone. *E.g.*, Compl. ¶ 30 (the "debit delay" is "simply the way [Yellowstone's ACH] processor works"). To the extent additional ACH withdrawals were initiated during a 4 to 5-day period while a merchant-seller's earlier debit—that when received by Yellowstone would constitute the final payment—was pending (*i.e*., in transit in the ACH system but prior to Yellowstone's receipt), such later debit or debits were expressly authorized by the agreement. The Complaint's conclusory references to any such ACH transactions as "unauthorized," *see, e.g.*, ¶¶ 14, 29, therefore, are directly contradicted by the very document cited by the FTC. The FTC's allegations therefore cannot transport the FTC's claim "across the line from conceivable to plausible." *Twombly*, 550 U.S. at 570, 127 S. Ct at 1974.

These alleged unauthorized ACH transactions (if they occurred) fail to meet the standard of "causing or likely to cause substantial injury to consumers"—because they were in fact authorized. In addition, the Complaint does not plead a single instance where any temporary overpayment was not refunded to the merchant-seller, or applied (and thus credited) to a new MCA with the same merchant-seller. The Complaint asserts, in conclusory fashion, only that Yellowstone "in numerous instances" refunded overpayments "only in response to complaints from customers." Compl. ¶ 34. The Complaint contains no factual averments to explain this conclusory assertion—it does not allege how many complaints were made, whether any injury resulted, or when consumer complaints that resulted in a refund occurred (for instance, whether complaints were made before Yellowstone received the full Purchased Amount).

As other courts have held, this type of allegation, including the FTC's favored phrase "in numerous instances," is too "nondescript" to suffice, even under the generous standards of a motion to dismiss. *See* Order Re: Defendant's Motion to Dismiss and Request for Judicial Notice at 23, *FTC v. LendingClub Corp*., No. 3:18-cv-2454 (N.D. Cal. Oct. 3, 2018), Dkt. 53[6] (dismissing FTC unfair practices claim based on defendant's allegedly unauthorized ACH withdrawals where the FTC did not "not allege how many" consumers were charged "or provide even a rough approximation") (hereinafter "*LendingClub* MTD Order"); *compare* Complaint at 21, *FTC v. LendingClub Corp*., No. 3:18-cv-2454 (N.D. Cal. Apr. 25, 2018), Dkt. 1[7] (alleging that in "numerous instances," defendant had initiated ACH withdrawals of money from consumer bank accounts for loan payments without authorization, or in amounts in excess of the amounts authorized by consumers) *with* Compl. ¶ 33 ("in some instances"); *Id.* ¶ 34 ("sometimes"); *Id.* ¶¶ 32, 34, 47 ("numerous instances").

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[6] Attached as Exhibit 4 to the accompanying Chuk Decl.

[7] Attached as Exhibit 5 to the accompanying Chuk Decl.

The allegation that "Defendants ***sometimes*** take weeks or months to refund these payments to customers" is impermissibly vague and insufficient for the same reasons. *Id.* ¶ 34 (emphasis added). The Complaint contains no factual averments about whether this allegedly happened a meaningful number of times, when refunds were processed, or why refunds were allegedly processed on an extended time frame. In contrast, the FTC has pleaded that in at least one instance, Yellowstone stopped ACH debits early (*i.e.*, before the "typical" 4-5 day lag had elapsed) when a customer complained after the first day of temporary overpayment. *Id.* ¶ 31. Because the FTC has not supported its vague references to "numerous instances" or "some instances" with "sufficient facts alleging substantial injury," the "FTC's unfairness claim must fail." *See LendingClub* MTD Order at 24 (citing *Twombly*, 550 U.S. at 570, 127 S. Ct. at 1973-74).

2. The FTC Has Not Pleaded That ACH Withdrawals Involved Anything Other Than Funds Due and Owing to Yellowstone

The FTC's other challenge to Yellowstone's ACH withdrawal practices—concerning ACH withdrawals that purportedly fell outside the 4 to 5-day ACH lag period—fares no better.

The Complaint fails to acknowledge those provisions of the MCA Agreement that detail scenarios in which amounts in excess of the Purchased Amount may become due and owing to Yellowstone under the terms of the Agreement, such as in the event of default or other triggering events specifically set forth in the Agreement. *See, e.g.*, Compl. Ex. J at YEL-0000001549 ("Merchant understands that it . . . will be held responsible for any fees incurred by YCL resulting from a rejected ACH attempt or an event of default (See Appendix A)," with Appendix A being a fee schedule that requires a separate signature from the merchant-seller).

Meanwhile, the allegations relating to this category of ACH withdrawal practices appear in a single conclusory paragraph of the Complaint. That paragraph (paragraph 32) obliquely references two purported merchant comments, but contains no other averment beyond a generalized allegation that "in numerous instances," "unauthorized" withdrawals occurred. Compl. ¶ 32. There is no indication that "numerous instances" refers to anything other than the two merchants referenced. There is also no factual averment as to the context concerning the two consumer comments, including whether or not the withdrawals referenced in the comments were due and owing to Yellowstone under the applicable MCA agreements—*i.e.*, whether or not they were truly "unauthorized." This is fatal to the FTC's claim. *See supra* at 19 (citing *Ricatto*, 2019 WL 6681558, at *4 and *Echostar*, 2007 WL 438088, at *4). Here too, the Complaint's conclusory label of "unauthorized" should be given no weight. *Cantor Fitzgerald*, 313 F.3d at 709. And the general allegation that "in numerous instances," certain ACH withdrawals may have occurred is too vague to withstand a motion to dismiss. *See LendingClub* MTD Order at 24 (granting motion to dismiss where FTC alleged only that challenged conduct had occurred "in numerous instances").

Because the FTC cannot rely on wholly conclusory allegations about possible injury to tilt the balance in its favor, these empty allegations are insufficient. The need at the pleading stage for allegations plausibly suggesting liability (not merely consistent with the plaintiff's theory of liability) reflects the threshold requirement of Rule 8(a)(2) that the plaintiff's "'plain statement' possess enough heft to 'show that the pleader is entitled to relief.'" *Twombly*, 550 U.S. at 557, 127 S. Ct. at 1966.

B. The FTC Has Failed To Plead That Any Injury Is Not "Reasonably Avoidable"

The FTC has also not sufficiently alleged that any injury is not reasonably avoidable by merchants. An injury is reasonably avoidable if consumers "have reason to anticipate the impending harm and the means to avoid it," or if consumers are aware of, and are reasonably capable of pursuing potential avenues toward mitigating the injury after the fact. *Davis v. HSBC*

Bank Nevada, N.A., 691 F.3d 1152, 1168–69 (9th Cir. 2012) (citing *Orkin Exterminating Co., Inc. v. FTC*, 849 F.2d 1354, 1365–66 (11th Cir. 1988)).

The exact alleged injury that merchants needed to be able to anticipate or mitigate is not identifiable from the Complaint due to the FTC's generalized assertions. However, as alleged in the Complaint, merchants did in fact contact Yellowstone to avoid perceived excess payments. *See, e.g.*, Compl. ¶ 31 (describing a consumer who "complained after the first day of overpayment" and for whom ACH debits were stopped early). As such, the Complaint does not plausibly allege that any consumer injury could not have been reasonably avoided.

C. The Complaint Does Not Allege Injurious Net Effects from Automated Withdrawals

Finally, Count III is also facially deficient because it contains no factual allegation that Yellowstone's automated withdrawals had a net-negative effect on consumers. *Am. Fin. Servs. Ass'n v. FTC*, 767 F.2d 957, 975 (D.C. Cir. 1985) (An act or practice does not "unfairly injure[] consumers unless it is injurious in its net effects."). The FTC's Complaint says nothing about this required element of its claim; much less does it contain sufficient allegations to defeat a motion to dismiss. Because the convenience to merchants of automated withdrawals indisputably provides consumer benefits, the Complaint's failure to address this required element, let alone plead facts sufficient to show that the alleged harms outweigh these benefits, is fatal to its claim. For this reason as well, Count III should be dismissed.

V. <u>THE FTC HAS NOT ALLEGED A SUFFICIENT BASIS FOR INDIVIDUAL LIABILITY</u>

The Complaint also fails to state a claim for individual liability against Stern and Reece. To state a basis for individual liability, the FTC must plead that Stern and Reece (1) participated directly in the challenged acts or had authority to control them ***and*** (2) knew of the challenged acts or practices. *FTC v. Verity Int'l, Ltd.*, 335 F. Supp. 2d 479, 499 (S.D.N.Y. 2004) (Kaplan, J.)

(citation omitted); *see also FTC v. Moses*, 913 F.3d 297, 306 (2d Cir. 2019) ("An individual may be held liable under the [FTC Act] for a corporation's deceptive acts or practices if, with knowledge of the deceptive nature of the scheme, he either participates directly in the practices or acts or has authority to control them.") (citations and internal quotation marks omitted). The FTC has failed to meet its pleading burden with respect to either Individual Defendant.

Here, the Complaint contains only conclusory allegations about Stern and Reece's alleged conduct, none of which satisfy either of the two requirements for imposing individual liability.

The assertions about jurisdiction are irrelevant to these requirements. Compl. ¶¶ 8, 9 (Stern and Reece each "transacts or has transacted business in this District and throughout the United States").

The allegations as to the job titles of Stern and Reece (Chief Executive Officer, and President, respectively, of both YSC and Fundry) also are insufficient in and of themselves to meet the required standard for a claim of individual liability. *Id.* ¶¶ 8-9. *See, e.g.*, *FTC v. Swish Mktg.*, No. 09-cv-3814 (RS), 2010 WL 653486, at *5–6 (N.D. Cal. Feb. 22, 2010) (dismissing individual claim against corporate defendant's CEO and rejecting FTC argument that the individual's status as CEO, standing alone, demonstrated his control over the company, where the complaint presented "no facts to tie [the individual] to the . . . scheme or to suggest his knowledge").

The FTC fails to meet the requirement that the Individual Defendants participated in or had authority over the alleged illegal acts. The FTC attempts to establish the Individual Defendants exercised the requisite authority over Yellowstone by alleging, in conclusory fashion, that they "formulated, directed, controlled, had the authority to control, or participated in the acts and practices" set forth in the Complaint (*id.* ¶¶ 8-10); that they "have closely overseen and directed" Yellowstone's day-to-day advertising and marketing efforts, "directly managed" the work of the companies' marketing agents, and "frequently reviewed and provided feedback and approval for advertising content and claims" (*id.* ¶ 20); and that they "have closely overseen and managed" Yellowstone's servicing and collection of payments from merchants and "directly supervised . . . in-house servicers" and disseminated relevant policies and practices to them. *Id.* ¶ 36.

Such conclusory allegations are legally insufficient. *See, e.g.*, *FTC v. Quincy Bioscience Holding Co., Inc.*, 389 F. Supp. 3d 211, 221 (S.D.N.Y. 2019) (allegations as to title, shareholder status, and conclusory allegations that individual defendant Beaman "participated in the acts and practices," gave "media interviews," "signed research agreements, pre-approved research proposals, and reviewed Defendants' advertising" were insufficient to state a claim of individual liability). While the allegations of paragraphs 20 and 36 relate topically to a type of misconduct claimed in the Complaint, each allegation is completely devoid of factual averments and is therefore not "entitled to the assumption of truth." *Iqbal*, 556 U.S. at 680, 129 S. Ct. at 1950. To the contrary, such unsupported allegations should be disregarded. *Cantor Fitzgerald*, 313 F.3d at 709 ("we give no credence to plaintiff's conclusory allegations."). The allegations of paragraphs 8-10 are likewise "legal conclusions masquerading as factual conclusions" that the Court should also not accept. *Rolon v. Henneman*, 517 F.3d 140, 149 (2d Cir. 2008).

The Complaint fares no better with its allegations that the Individual Defendants "reviewed copies of advertisements that claim Yellowstone and Fundry do not require collateral" (Compl. ¶ 20); "received messages" "[i]n numerous instances" "detailing the difference" between funding amounts promised versus disbursed to consumers after fees were withheld (*id.* ¶ 26); and "have known about, and communicated with their in-house servicers about, the existence of" alleged overpayments by consumers. *Id.* ¶ 36. Here again, not one of these supposed instances is averred in the Complaint. These too are thus legal conclusions masquerading as factual conclusions and should not be accepted. *See Quincy Bioscience*, 389 F. Supp. 3d at 221 (allegation that individual defendant "reviewed . . . advertising" was insufficient).

The FTC also fails to meet the second required element: the FTC does not allege—in conclusory fashion or otherwise—that either Individual Defendant had knowledge "of the deceptive nature" of a scheme. *See Moses*, 913 F.3d at 306. As with the statements aimed at the Individual Defendants' exercise of authority, the Complaint does not provide the requisite factual averments regarding the purported "knowledge" of Stern and Reece to state a claim for individual liability. *Iqbal*, 556 U.S. at 679, 129 S. Ct. 1950.

In short, the Complaint's conclusory allegations regarding Stern and Reece are insufficient, and the claims against those individuals should be dismissed for that reason.

VI. THE FTC'S REQUEST FOR ANCILLARY RELIEF SHOULD BE DISMISSED

The Complaint not only suffers from the fatal pleading defects described above, but it is also defective insofar as it seeks ancillary relief other than injunctive relief under Section 13(b). Because the only relief authorized by Section 13(b) is injunctive relief, any request for relief of other kinds should be dismissed. The FTC's request for a disgorgement award is defective for the additional reason that it is impermissibly punitive under the Supreme Court's recent decision in *Liu v. SEC*.

A. Longstanding Precedent In *Amy Travel* Has Been Overruled

Last August, the Seventh Circuit held that Section 13(b), which the FTC purports to invoke here, does not authorize the FTC to seek monetary relief. *See FTC v. Credit Bureau Ctr., LLC*, 937 F.3d 764, 786 (7th Cir. 2019), *cert. granted sub nom.*, -- S. Ct. --, 2020 WL 3865251 (2020). In so holding, the Seventh Circuit overruled its own three-decades-old precedent in *FTC v. Amy Travel Service, Inc.*, which had become the standard interpretation of Section 13(b). Specifically, *Amy Travel* had enabled district courts "to order any ancillary equitable relief necessary to effectuate the exercise of granted powers," including equitable monetary relief. 875 F.2d 564, 572 (7th Cir. 1989).

The *Credit Bureau* panel justified overruling its prior precedent, noting that the plain text of Section 13(b) mentions ***only*** injunctive relief. *See* 15 U.S.C. § 53(b) ("Whenever the Commission has reason to believe—(1) that any person, partnership, or corporation is violating, or is about to violate, any provision of law . . . [the FTC] may bring suit in a district court of the United States ***to enjoin*** any such act or practice.") (emphasis added). Relying on: (i) Section 13(b)'s plain text; (ii) the "harm at which [Section 13(b)] is directed," where Section 13(b) provides a procedural remedy for "present" or "future 'imminent' harms" that could be redressed by injunctive relief, not compensation for past violations; and (iii) Section 13(b)'s limited role within the FTC Act's overall remedial scheme, where two other detailed remedial provisions in the FTC Act expressly authorize restitution but impose additional procedural hurdles, the *Credit Bureau* panel overruled *Amy Travel*'s "starkly atextual" interpretation of Section 13(b) and concluded that Section 13(b) does not authorize an award of restitution. 937 F.3d at 767, 783, 786.

Other courts that have subsequently examined remedies available under Section 13(b) have made decisions in lockstep with the recent *Credit Bureau* decision. On September 30, 2020, the Third Circuit reversed a district court's finding that Section 13(b) provided the FTC authority to seek disgorgement as a remedy. In so ruling, the Third Circuit echoed the *Credit Bureau* court's "thorough and well-reasoned" opinion, holding that "district courts lack the power to order disgorgement under Section 13(b)." *AbbVie*, 2020 WL 5807873, at *34, 36. Like the *Credit Bureau* court, the Third Circuit relied upon Section 13(b)'s plain text, the context that Section 13(b) applies only to "imminent or ongoing" violations that could be redressed by injunctive relief, and the provision's role in the FTC Act's overall remedial scheme, among other reasons, in reaching its conclusion. *Id.* at *33-34.

B. The FTC's Request for Ancillary Relief Should Be Dismissed

Credit Bureau and *AbbVie* have cast significant doubt on the Second Circuit reading of Section 13(b). Relying on *Amy Travel*, which was then good law, and its progeny, the Second Circuit in *FTC v. Bronson Partners, LLC* found that Section 13(b) permits courts to "grant ancillary equitable relief, including equitable monetary relief," despite the court acknowledging that the provision's "express text refers only to injunctive relief." 654 F.3d 359, 365 (2d Cir. 2011). As the *Credit Bureau* court pointed out, the Second Circuit in *Bronson Partners* did not examine whether judicial implication of an equitable monetary remedy into Section 13(b) "comports with the [FTC Act's] text and structure" (indeed, it does not), or consider the effect of the Supreme Court's significant shift away from its formerly "capacious" view of judicially implied remedies in the *Amy Travel* era. *Credit Bureau*, 937 F.3d at 776, 785. Instead, "the Second Circuit summarily followed the lead of other circuits in reading [S]ection 13(b) to include an implied power to order restitution." *Id.* at 779 n.3.

In *AbbVie,* the FTC once again relied on the Second Circuit ruling in *Bronson Partners* and similar rulings from other courts of appeal that Section 13(b)'s grant of authority includes restitution or disgorgement as equitable relief. The *AbbVie* court acknowledged these holdings, but in determining that Section 13(b) did not authorize disgorgement, observed that "until recently, no circuit had examined whether reading a [monetary] remedy into section 13(b) comports with the [FTC Act]'s text and structure." *AbbVie*, 2020 WL 5807873, at *34 (citing *Credit Bureau*, 937 F.3d at 785) (internal quotation marks omitted). Indeed, the *AbbVie* court found that its interpretation, which properly limited the scope of 13(b), "harmonized" the FTC Act's provisions. *Id*.

On July 9, 2020, the Supreme Court granted certiorari in the *FTC v. Credit Bureau Center* matter. 2020 WL 3865251. In light of the legal developments since the Second Circuit's decision in *Bronson Partners*, the question of whether Section 13(b) permits the FTC to seek ancillary relief, including monetary relief, is an important and as yet uncertain one in this Circuit. But the text of Section 13(b) is clear: the statute mentions only injunctive relief. And such a limitation is in accordance with the FTC Act's overall enforcement scheme.

Although the general rule is that a federal district court is bound by its circuit's precedent, a district court also should not rely on older precedents that have been rejected in later decisions. *See Ore & Chem. Corp. v. Stinnes Interoil, Inc.*, 606 F. Supp. 1510, 1512 (S.D.N.Y. 1985). Here, the Second Circuit's decision in *Bronson Partners* is not only contrary to the clear text of Section 13(b) and to the remedial structure of the FTC Act, but it has also been rejected by the Seventh Circuit in *Credit Bureau*. The very foundation upon which the Second Circuit premised its holding in *Bronson Partners*—specifically, the Seventh's Circuit's analysis and holding in *Amy Travel*, and subsequent cases that followed *Amy Travel*—has also since been reexamined and overruled by the Seventh Circuit. Further, as the *Credit Bureau* court noted, *Bronson Partners* is contrary to Supreme Court pronouncements on judicially implied remedies. The ancillary, non-injunctive relief sought by the FTC should therefore be dismissed. *See* Compl. at 14 (Prayer for Relief) ("pursuant to Section 13(b)," the FTC requests an "[a]ward" of "such relief as the Court finds necessary to redress injury to consumers resulting from Defendants' violations of the [FTC Act], including rescission or reformation of contracts, restitution, the refund of monies paid, and the disgorgement of ill-gotten monies").

C. The FTC's Request for Disgorgement Should Be Dismissed Because It Is Impermissibly Punitive Under *Liu v. SEC*

Even were the Court to conclude that Section 13(b) authorizes the FTC to seek ancillary relief other than injunctive relief—notwithstanding the unambiguous text of Section 13(b) to the contrary—the FTC's request for a monetary disgorgement award should be dismissed because it is impermissibly punitive under the Supreme Court's recent decision in *Liu v. SEC*, 140 S. Ct. 1936 (2020).

In *Liu*, the Supreme Court addressed whether the SEC may seek disgorgement in civil proceedings pursuant to 15 U.S.C. § 78u(d)(5)'s authorization that it may seek "equitable relief." While the words "equitable relief" do not appear in Section 13(b) of the FTC Act, if the Court concludes that Section 13(b) authorizes the FTC to seek ancillary relief other than injunctive relief, then the ancillary relief that would be available would be "equitable relief." *See Bronson Partners*, 654 F.3d at 365 (holding that "ancillary equitable relief, including equitable monetary relief" is available under Section 13(b)). The Supreme Court in *Liu* held that any award of monetary disgorgement under 15 U.S.C. § 78u(d)(5) must be properly circumscribed to avoid being transformed into a punitive sanction beyond the historical scope of "equitable relief." 140 S. Ct. at 1944.

Disgorgement is clearly punitive when it is ordered against a defendant for profits that accrued to a third party. *See, e.g.*, *Belknap v. Schild*, 161 U.S. 10, 25–26, 16 S. Ct. 443, 448 (1896) ("The defendants, in any such suit, are therefore liable to account for such profits only as have accrued to themselves from the use of the invention, and not for those which have accrued to another..."); *Keystone Mfg. Co. v. Adams*, 151 U.S. 139, 14 S. Ct. 295 (1894) (reversing profits award that was based on what third persons had made from the use of the invention rather than what defendant had made from infringement). This is consistent with longstanding equitable principles limiting profits-based remedies to the parties that actually retained the allegedly ill-gotten gains. *See City of Elizabeth v. Am. Nicholson Pavement Co.*, 97 U.S. 126 (1878) (holding that, where a city engaged contractors to install pavement in a manner that infringed a third party's patent, the contractors, the only parties to make a profit, were responsible, even though the parties answered jointly).

The same analysis would apply to Section 13(b) of the FTC Act if the Court concludes that ancillary relief other than injunctive relief is available under that statutory provision. However, nowhere in its Complaint does the FTC allege any supposed "ill-gotten monies" to be disgorged, much less that they were retained by Yellowstone, as required by *Liu*. The FTC simply relies on a boilerplate request for disgorgement, among other equitable relief, in the Prayer for Relief. Compl. at 14 (Prayer for Relief). Even accepting *arguendo* the FTC's conclusory references to "unauthorized" payments withstand scrutiny on this motion, which they do not, the Complaint fails to plausibly allege that Yellowstone remains in "possession of the thing to be restored," such that the imposition of disgorgement could conceivably be appropriate under the Supreme Court's guidance in *Liu*. 140 S. Ct. at 1945 (quoting *Jennings v. Carson*, 8 U.S. 2, 21 (1807)).

In other words, the Complaint does not allege that Yellowstone actually received and retained any so-called "unauthorized" payments. Without any allegation (1) of "ill-gotten monies" subject to disgorgement and (2) that any such monies were received and retained by Yellowstone, the FTC's request for disgorgement is a purely punitive measure, clearly impermissible under Section 13(b) and under *Liu*.

For all these reasons, the FTC's request for ancillary relief, including for disgorgement, should be dismissed.

CONCLUSION

For the foregoing reasons, the Complaint should be dismissed with prejudice, in whole or in part.

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PROSKAUER ROSE LLP

By: */s/Christopher E. Ondeck*
Christopher E. Ondeck (admitted *pro hac vice*)
Stephen R. Chuk
1001 Pennsylvania Avenue, NW
Suite 600 South
Washington, DC 20004-2533
Tel.: (202) 416-6800
condeck@proskauer.com
schuk@proskauer.com

David A. Picon
Tiffany M. Woo
Eleven Times Square
New York, NY 10036-8299
Tel.: (212) 969-3000
dpicon@proskauer.com
twoo@proskauer.com

Attorneys for Defendants