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

REPLY MEMORANDUM OF LAW IN SUPPORT OF
DEFENDANTS' MOTION TO DISMISS PLAINTIFF'S COMPLAINT

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INTRODUCTION

The FTC's Opposition is largely devoted to trying to explain how its Complaint alleges things that it does not and cannot. Invoking a style guide and doubling down on its use of ambiguous verbiage and verb tenses, the FTC attempts to defend its failure to clearly and definitively allege that the Complaint's challenged conduct is ongoing or about to occur—a gating issue for pursuing its claims in this forum. The FTC's verbal gymnastics aside, the allegations here challenge solely dated advertisements, language in a discontinued MCA Agreement, and ACH withdrawal practices that are not alleged to be ongoing. As such, the FTC does not invoke the statutory authority to have its claims heard by this Court and its Complaint should be dismissed.

Even if its claims were properly before the Court, each fails for other reasons. Count I of the Complaint alleges only fragments of advertisements without necessary context, as the FTC's Opposition concedes. Count II ignores the express fee disclosures in the MCA Agreement, while the Opposition attempts to dismiss those disclosures by, among other things, presenting the Court with the same carefully cropped screenshot from its Complaint that conveniently excludes the very language in the agreement that undermines its argument. Count III ignores express authorization by merchants for withdrawals that the FTC purports to challenge as unfair, while the Opposition contends that contractual terms like "received" and "delivered" are unclear and beyond the understanding of commercial parties, and asks the Court to read into the allegations averments nowhere in the Complaint. The FTC's arguments about how its six boilerplate and conclusory paragraphs plausibly plead a claim for individual liability are to no avail as they are inconsistent with applicable law. Finally, the FTC's defense of its request for ancillary relief asks this Court to ignore the plain text of Section 13(b) and the clear trend of authority in other circuits, in favor of following precedent in this Circuit that has been called into doubt.

ARGUMENT[1]

I. THE FTC HAS FAILED TO MEET THE REQUIREMENTS OF SECTION 13(B)

A. The FTC Has Failed To Allege Ongoing or Imminent Conduct

The FTC contends that its Complaint should be interpreted broadly to satisfy the requirements of Section 13(b). While the Court may draw reasonable inferences from the well-pleaded factual averments of the Complaint, what the FTC asks this Court to do here is find that its pleading says things it does not. When the FTC has reason to believe wrongful conduct is ongoing, it has no need to dance around Section 13(b)'s clear requirement to allege ongoing or imminent conduct, and it avers the required allegations specifically and unequivocally.[2]

This Court need look no further than the FTC's allegations in similar matters. The contrast is stark. In *FTC v. Vyera Pharmaceuticals*, the FTC did not employ elusive language; nor did it rely on the Chicago Manual of Style. Instead, it addressed its burden to allege ongoing or imminent conduct head on, pleading that "[the defendants'] unlawful scheme . . . ***continues to this day***," Mot. at 15; *see also* Chuk Decl. Ex. 3. The Complaint here contains no comparable allegations.

The FTC's attempt to salvage its claims by pointing to its use of the "present tense" in certain phrases in the Complaint is unavailing. Opp. at 17. The FTC points to Paragraphs 12 and 13 of the Complaint, which are mere general allegations about Defendants' business, and Paragraph 14, which is nothing more than a summary of the Complaint devoid of independent factual averment. None of these paragraphs purports to allege facts of ongoing or imminent conduct. The allegations the FTC identifies for each of Counts I, II, and III are no different. For

[1] All terms defined in the Memorandum of Law in Support of Defendants' Motion to Dismiss Plaintiff's Complaint (Dkt. 18) ("Mot.") have the same meanings herein. The FTC's Opposition (Dkt. 24) is referred to herein as "Opp."

[2] The words "reason to believe" in Section 13(b) do not confer on the FTC unreviewable discretion to file suit. Mot. at 13 (citing *FTC v. Shire ViroPharma, Inc.*, 17 F.3d 147, 159 n.17 (3d Cir. 2019)). Here, as in *Shire*, there is "no evidence" to support any "reason to believe" that Defendants are violating or about to violate the law. *Id.*

Count I (Challenged Advertisements), the FTC points to its use of the present tense to describe what certain Challenged Advertisements say, but those paragraphs do not allege that any advertisement is currently or "about to" be disseminated. Compl. ¶¶ 16, 17; *see also id.* ¶¶ 19, 20 (cited Opp. at 17 but containing no mention of any Challenged Advertisement). The same is true for Count II (challenged fee disclosures in the MCA Agreement), where the only relevant use of the present tense is to describe the contents of the MCA Agreement that the FTC does not allege was in use after October 2018. *See id.* ¶¶ 22, 25. Finally, for Count III (challenged ACH withdrawals), the FTC points to Paragraphs 33 and 34, which describe isolated incidents not connected to any time period, and Paragraph 35, a summary allegation that incorporates other allegations for factual averments that are in the present perfect tense. *Compare id.* ¶ 35 ("***As indicated above***, customers each typically pay . . .") *with, e.g.*, *id.* ¶ 29 ("unauthorized overpayments ***have been*** a typical occurrence") (emphasis added). The FTC's use of the present tense in the Complaint does not plausibly allege ongoing or imminent conduct.[3]

Simply stated, the Complaint does not allege that any Challenged Advertisement is current or "about to" be disseminated, or that the MCA Agreement containing the challenged fee disclosures was used beyond October 2018. Nor does the Complaint aver factual content sufficient to support an inference that the challenged ACH withdrawal practice is ongoing or imminent.

B. The FTC Has Also Failed To Allege That Conduct Is Likely to Recur

The FTC argues in the alternative that even if the challenged conduct has ceased, it has alleged such conduct is likely to recur. The FTC misstates the applicable burden. Citing cases

[3] The FTC's reliance on the phrase "at least" along with the present perfect tense—including in the preliminary statement in its Opposition—similarly does not plausibly allege ongoing conduct. Mot. at 14–15. The FTC cites *Dobrova v. Holder* and the Chicago Manual of Style (Opp. at 17), which define the present perfect tense as referring "'to (1) a time in the indefinite past . . ., or (2) a past action that comes up to and touches the present.'" 607 F.3d 297, 301–02 (2d Cir. 2010) (quoting the Chicago Manual of Style ¶ 5.119 (15th ed. 2003)). But neither *Dobrova* nor the Chicago Manual of Style suggest that the present perfect tense signifies ongoing or future conduct.

interpreting different statutes—the Securities Act of 1933 and the Securities Exchange Act of 1934—the FTC seeks to import a standard for alleging conduct likely to recur that is nowhere in the FTC Act; namely, a "realistic likelihood of recurrence." But even under this newly imported standard, the Complaint fails as the FTC's argument relies on its plucking a single word from the Complaint—"pattern"—to suggest that it has alleged a realistic likelihood of recurrence. Opp. at 19 (quoting Compl. ¶ 14). Naked allegations "about a 'pattern' of violations" are insufficient to survive a motion to dismiss. *D'Alessandro v. City of New York*, 713 F. App'x 1, 11 n.12 (2d Cir. 2017).[4] Conclusory statements about the possibility of conduct occurring in the future are not a vehicle through which the FTC may satisfy its statutory requirement.[5]

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

To the extent the Complaint is not dismissed on Section 13(b) grounds, the FTC has failed to meet its pleading obligations under Section 5 of the FTC Act.

As the FTC acknowledges, "[a] court should focus on the overall impression created by" challenged advertising. Opp. at 3. While initially arguing that it appended "full advertisements" to the Complaint, the FTC later admits that the Challenged Advertisement at Exhibit A is a fragment, and then attempts to remedy that deficiency by referring to a web archive not referenced in or appended to the Complaint. Opp. at 5 n.2. The FTC is not "entitled to amend its [C]omplaint

[4] The allegations concerning the Individual Defendants that the FTC points to do not relate to any time period. Paragraphs 12–14, as explained above, do not allege ongoing conduct or conduct that is realistically likely to recur.

[5] The FTC relegates to a footnote an argument about the effect of the parties' tolling agreement (Opp. at 16 n.11), which is not alleged or incorporated by reference in the Complaint. The tolling agreement is a red herring. First, the FTC cannot sidestep its burden imposed by Section 13(b) by virtue of an agreement between the parties. Second, the tolling agreement concerns only the period between the Tolling Date (April 27, 2020) and the Termination Date (August 3, 2020, when the Complaint was filed). The argument Defendants make here is not directed to conduct during that period. Rather, the FTC's Complaint does not plausibly allege ongoing or imminent conduct as of either the Tolling Date or the Termination Date. Unlike in *FTC v. Educare Centre* or *In re Sanctuary Belize Litigation* (cited Opp. at 18), there is no factual dispute here, only deficient allegations. The FTC's invocation of the tolling agreement, however, suggests that ***it*** believes that at least some of the challenged conduct ceased before the Complaint was filed. *See also* Opp. at 18 n.12 and 20 (arguing that Defendants "***were***" (not "are") violating or about to violate the law).

through statements made in motion papers." *D'Alessandro*, 713 F. App'x at 11 n.12; *Troy v. City of New York*, 2014 WL 4804479, at *1 (S.D.N.Y. Sept. 25, 2014), *aff'd*, 614 F. App'x 32 (2d Cir. 2015). The Court should not consider that web archive or the other new information set forth only in the FTC's Opposition (including another web archive and the identification of which URLs allegedly relate to Exhibits A and D, where the exhibits themselves have no URLs) on this motion. Opp. at 5 nn. 2 & 3.

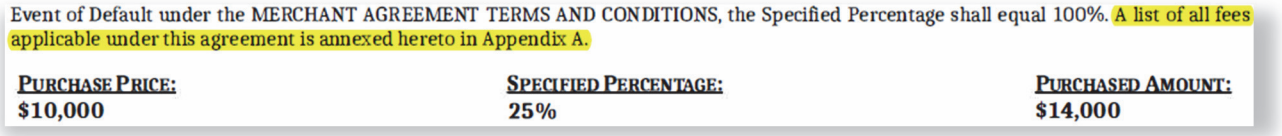
Like Exhibits A and D, some if not all of the other Challenged Advertisements are clearly fragments. *E.g.*, Compl. Exs. F, G. Critically, while the Complaint alleges some of the "words" that the FTC contends the Defendants used in the Challenged Advertisements, what is missing are allegations about "where the representation was made" or "what other information was readily available to one reading it." These are fatal deficiencies. Mot. at 17 (citing *Bel Canto Design Ltd. v. MSS HiFi, Inc*., 2012 WL 2376466, at *16 (S.D.N.Y. June 20, 2012)); *see also Fink v. Time Warner Cable*, 714 F.3d 739, 742 (2d Cir. 2013) (affirming dismissal of claims where the record did not contain all of the allegedly deceptive advertisements).[6]

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

With respect to Count II, the FTC attempts to explain away the fact that its Complaint wholly ignores an appendix to the MCA Agreement that details the fees to be paid by a merchant, along with language on the first page of the Agreement that directs the merchant to that appendix. It does so by arguing that merchants were led to believe they would receive no less than the amount stated in the "Purchase Price" reflected on the first page of the Agreement and that the appendix

[6] That *Bel Canto* and *Fink* do not involve the FTC Act is immaterial. *See, e.g.*, *FTC v. Brown & Williamson Tobacco Corp*., 778 F.2d 35, 40 & n.2 (D.C. Cir. 1985) (looking to Lanham Act cases in considering FTC Act Section 5 claim); *FTC v. Crescent Publ'g Grp.*, 129 F. Supp. 2d 311, 321 & n.67 (S.D.N.Y. 2001) (applying same analysis under FTC Act Section 5 and New York General Business Law § 349, which "was drafted to parallel" FTC Act Section 5).

itself was buried somewhere deep into the Agreement. To make its point, the FTC offers a carefully cropped screenshot of a portion of the first page of the Agreement where the Purchase Price is referenced, one that conveniently excludes the sentence immediately preceding the reference to the Purchase Price. A slightly enlarged screenshot reveals that key reference, which is highlighted below:


Event of Default under the MERCHANT AGREEMENT TERMS AND CONDITIONS, the Specified Percentage shall equal 100%. A list of all fees applicable under this agreement is annexed hereto in Appendix A.

PURCHASE PRICE:	SPECIFIED PERCENTAGE:	PURCHASED AMOUNT:
$10,000	25%	$14,000

Nor is the appendix (Appendix A), which required a separate signature from the merchant, a "subsequent . . . disclaimer," as the FTC contends. It is not a fine print or otherwise inconspicuous reference to fees, but rather a prominent, full page description of applicable fees which required a separate signature by the merchant.[7] *E.g.*, Mot. at 19; Compl. Ex. J at YEL-0000001556.

Equally unavailing is the FTC's attempt to sidestep Defendants' argument that the FTC has not indicated where a reasonable small business owner would understand the fees would come from, if not the Purchase Price, calling it a rhetorical question. Opp. at 7.[8] There is nothing "rhetorical" about it. It is a question that the FTC's Complaint must (but does not) plausibly

[7] The FTC's disclaimer cases are clearly distinguishable. Opp. at 7. *FTC v. Cyberspace.Com LLC*, 453 F.3d 1196, 1200 (9th Cir. 2006) ("fine print . . . notices on the reverse side of" solicitations); *Brown & Williamson Tobacco Corp.*, 778 F.2d at 42-43 ("fine print legend" in an "inconspicuous corner" of advertisements).

[8] The FTC erroneously cites the materiality standard for "express" claims while challenging the MCA Agreement's purported "failure . . . to inform" consumers of fees and the deduction of such fees from the Purchase Price, Opp. at 6, 7 n.5, which is not an express claim. And the FTC does not otherwise satisfy its pleading burden on materiality. FTC's reliance on *FTC v. Five-Star Auto Club* is a similar mismatch. Opp. at 6. In *Five-Star Auto Club*, receiving a free car and earning money were the "primary lure" for consumers to join the membership program at issue. The FTC has not alleged that receiving a certain set amount as the Purchase Price was a "primary lure" (or anything analogous) for merchants here.

answer to survive a motion to dismiss: how is the alleged misrepresentation "likely to mislead" a reasonable small business owner? Mot. at 19.

In short, the Complaint's silence as to the disclosure of fees on the first page of the MCA Agreement, and the acknowledgement of those fees required by Appendix A, renders Count II implausible under the *Iqbal/Twombly* standard, warranting dismissal.[9]

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

Count III of the Complaint fails to state a claim because the so-called "unauthorized" ACH withdrawals that it challenges were explicitly authorized under the MCA Agreement. The FTC's argument that Defendants' position relies on an "after-the-fact, strained interpretation" of the Agreement's express terms merits no lengthy response. Opp. at 10. There is nothing unclear about the Agreement by which a merchant authorized debits from its account until Yellowstone "receives" payment in full and until the Purchased Amount "has been delivered by Merchant to [Yellowstone]." Mot. at 7, 21 (citing Compl. Ex. J at YEL-0000001549 and 1559).

The FTC also conflates the two categories of ACH withdrawals it challenges (withdrawals during the ACH settlement lag period prior to receipt of the last payment toward the Purchased Amount versus other withdrawals). Only the first category of withdrawals is alleged to have occurred on more than a couple of isolated occasions, but as explained in the Motion and above, such withdrawals were expressly authorized by merchants. *See* Mot. at 7–9, 20–23.[10] Nor can the

[9] *See, e.g.*, *Singer v. Am. Express Centurion Bank*, 2018 WL 2138626, at *4 (S.D.N.Y. May 9, 2018) (dismissing challenge to account renewal disclosure where disclosures were provided on pages three, seven, and eight of twelve-page credit card statement); *Jones v. Suburban CJ of AA, LLC*, 2017 WL 1374697, at *3 (E.D. Mich. Apr. 17, 2017) (dismissing challenge to disclosures where relevant terms were expressly included and disclosed in contract, including on the bottom of the first page onto the second page); *Robins v. Glob. Fitness Holdings, LLC*, 838 F. Supp. 2d 631, 647 (N.D. Ohio 2012) (dismissing claim with prejudice because plaintiffs had not alleged that fees inconsistent with the unambiguous terms of written contracts were charged).

[10] The FTC cites *FTC v. Crescent Publishing Group*. Opp. at 10. The defendants in that case required users to enter a credit card number to get a free tour of their website, after which the credit card would be charged. The lack of clarity as to when the free tour ended and when charges began is not analogous to the express authorizations here, which are in the very agreement that governs a merchant's relationship with Yellowstone. The FTC's argument that

FTC attempt to amend its Complaint by raising a question in opposition that is not the subject of any allegation in its pleading. Opp. at 9–10. Whether merchants understood the extent of their authorization is a separate, secondary question not addressed by any allegations of the Complaint.

The FTC also asks the Court to read non-existent allegations into the Complaint for each of the elements of its unfairness claim. For the first element ("substantial injury to consumers"), the FTC states, "the Complaint alleges that Defendants commonly pocketed these unauthorized withdrawals *permanently*," Opp. at 9 (emphasis in original), but cites to no such allegation in the Complaint. And there is none. *See also* Opp. at 10 (referring to a purported allegation that Defendants "ke[pt] unauthorized payments for themselves" without any citation). The Complaint's sole reference to refunds is bereft of any factual averment. *See* Mot. at 9, 22–23.

For the second element (any injury was "not reasonably avoidable"), the FTC states, "consumers have no mechanical way to stop these overcollections," (Opp. at 11), but the "support" for that statement (Compl. ¶¶ 31, 33) contains no discussion of whether consumers can stop ACH debits. In fact, the Agreement expressly addresses actions taken by a merchant to stop payment or otherwise avoid remittances due and owing. *See* Compl. Ex. J at YEL-0000001556 (detailing fees that apply "if a merchant directs the bank to reject our debit ACH" or "if a merchant blocks [Yellowstone's] ACH debit").

For the third element ("not outweighed by countervailing benefits), the Complaint contains no factual allegations that support the FTC's assertion that "Defendants' unauthorized withdrawals detailed in the Complaint provide no countervailing benefits to their consumers." Opp. at 11. These extra assertions that are in the Opposition but not in the Complaint should be disregarded,

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the authorization was expressly limited to the Purchased Amount, on the other hand, is contradicted by the face of the MCA Agreement. Compl. Ex. J at YEL-0000001549 and 1559 (the authorizations); *see also, e.g.*, Mot. at 23 (fees in excess of the Purchased Amount may be assessed in certain scenarios).

and Count III should otherwise be dismissed for failure to plausibly plead an unfairness claim.

V. THE FTC'S INDIVIDUAL LIABILITY CLAIMS SHOULD BE DISMISSED

The FTC's individual liability claims should also be dismissed, as they consist of boilerplate and conclusory language insufficient to confer liability on the Individual Defendants. The FTC relies on a single, clearly distinguishable case—*FTC v. Tax Club*—while suggesting its allegations are unlike those in *FTC v. Quincy Bioscience*, in which conclusory allegations similar to those here were legally insufficient to hold an individual liable for a corporate defendant's alleged misconduct.

The allegations here are unlike those in *FTC v. Tax Club*, which included allegations that individual defendants participated in wrongful acts by "creat[ing] sample sales scripts" that guided sales representatives to "falsely claim they [were] calling consumers 'on behalf of' a particular lead source." 994 F. Supp. 2d 461, 472 (S.D.N.Y. 2014). Rather, the Complaint consists of general and conclusory allegations (like the Individual Defendants "reviewed and provided feedback and approval for advertising content and claims") along with broad descriptions of Defendants' job duties. *See also FTC v. Quincy Bioscience Holding Co.*, 389 F. Supp. 3d 211, 221 (S.D.N.Y. 2019) (dismissing individual liability claim based on "conclusory" allegations). Here, the FTC's Complaint relies on adverbs like "closely" or "directly" but does not allege sufficient factual content to support an inference that either Individual Defendant directly participated in or had the authority to control any of the challenged conduct. Indeed, nearly all of the FTC's allegations here do not even differentiate between the two Individual Defendants.

Further, there are no plausible allegations of participation probative of knowledge here; nor are there independent allegations of knowledge.[11] The Complaint's allegations are "untethered

[11] The FTC again turns to facts outside its own pleading in invoking its pre-suit investigation. Opp. at 13. The FTC cannot amend its Complaint, which does not mention the pre-suit investigation, through its opposition brief. In any

to virtually any supportive facts," warranting dismissal. *FTC v. Swish Mktg.*, 2010 WL 653486, at *5 (N.D. Cal. Feb. 22, 2010).

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

The clear trend adopted by the most recent circuit courts to address the issue holds that non-injunctive relief is not available under Section 13(b). Mot. at 28–31. While generally a district court is required to follow binding circuit precedent, as Defendants showed, a district court may depart from existing circuit authority following that authority's subsequent rejection by other courts. *Ore & Chem. Corp. v. Stinnes Interoil, Inc.*, 606 F. Supp. 1510, 1512 (S.D.N.Y. 1985) (cited Mot. at 31). This Court should follow the plain text of Section 13(b), and the *Credit Bureau* and *AbbVie* courts, and dismiss the Complaint's requests for any non-injunctive, ancillary relief, including monetary relief.

The Complaint's request for a disgorgement remedy should further be dismissed in accordance with *Liu v. SEC*. The FTC argues that it seems "unlikely" that Defendants did not "receive[] or retain[]" any purported ill-gotten gains. Opp. at 22. But the FTC has failed to plead the opposite. *See supra* at 8 (discussing unsupported assertions that Defendants kept withdrawn funds "permanently"); *see also* Opp. at 22 (arguing that the Complaint alleges that Defendants' conduct "result[ed] in consumers agreeing to pay money to Defendants" while citing Paragraph 23, which alleges no such thing). The Court should not credit assertions in an opposition brief that appear nowhere in the Complaint and should dismiss the request for a disgorgement award.

CONCLUSION

For the foregoing reasons, the Complaint should be dismissed with prejudice.

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event, the FTC's suggestion that the Individual Defendants had knowledge of any unlawful conduct during the pre-suit investigation is unavailing because the FTC has not plausibly alleged that any challenged conduct was ongoing during, or even the subject of, its pre-suit investigation.

Dated: October 23, 2020

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