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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Consumer Financial Protection Bureau,

Plaintiff,

v.

Morgan Drexen, Inc.,
and
Walter Ledda, individually, and as owner, officer, or manager of Morgan Drexen, Inc.,

Defendants.

Case No. SACV13-01267 JLS (JEMx)

PLAINTIFF'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT OR IN THE ALTERNATIVE SUMMARY AJDUDICATION OF THE ISSUES AGAINST DEFENDANTS

HON. JOSEPHINE L. STATON

Hearing Date: November 21, 2014
Time: 2:00pm
Place: Courtroom 10-A (Santa Ana)

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I. Introduction

The Consumer Financial Protection Bureau brought this action to stop a nationwide debt settlement scheme that preys on financially distressed consumers who are in debt. Defendants Morgan Drexen, Inc. and company CEO Walter Ledda lure consumers into signing up for debt settlement services on the promise that Defendants and attorneys with whom they are affiliated will negotiate with consumers' creditors and settle their debts. Defendants promise these services in exchange for an advance fee—a fee unlawfully charged to a consumer before Defendants have settled their debts—ranging from $1,000 to $3,250. Defendants also represent that consumers will become "debt free in months" and will not have to pay any up-front fees. In fact, the overwhelming majority of enrollees never become debt free. For those who do, the process takes years. Moreover, contrary to Defendants' advertising, consumers are charged up-front fees–since October 27, 2010, nearly 60,000 consumers in all fifty states have paid more than $90.7 million in these fees.

The Bureau now moves for summary judgment against Defendants. Their conduct violates the Consumer Financial Protection Act ("CFPA") and the Telemarking Sales Rule ("TSR"), and has had a devastating impact on the nation's most vulnerable consumers. The pleadings, discovery, and declarations provided to the Court show that there is no genuine issue as to any material facts; thus, the Bureau is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). To ensure that consumer harm is redressed and that Defendants do not engage in unlawful practices again, the Bureau seeks a permanent injunction and order, which are described more fully in Section IV and in the Proposed Order the Bureau has submitted to the Court. Alternatively, the Bureau requests that the Court summarily adjudicate the issues for which there are no genuine issues of material fact.

II. Statement of Material Facts[1]

A. The Parties

1. Plaintiff

The Bureau is an independent agency charged by Congress with the responsibility of enforcing the CFPA and other Federal consumer financial laws, including the TSR, 12 U.S.C. §§ 5491, 5565. It may bring civil actions against persons violating these laws to "seek all appropriate legal and equitable relief including a permanent or temporary injunction as permitted by law." 12 U.S.C. § 5564.

2. Morgan Drexen, Inc.

Morgan Drexen, Inc., a Nevada corporation, was founded in 2007 by Defendant Walter Ledda. UF 3, 341. Its business address is 675 Anton Blvd., Costa Mesa, CA 92626. UF 1. Among other things, Morgan Drexen markets and provides debt settlement services to consumers nationwide. UF 19-54.

3. Walter Ledda

Since Morgan Drexen's inception, Defendant Walter Ledda has been the company's President and Chief Executive Officer. UF 13. For most of the relevant time period, Ledda has been the controlling member of the Board of Directors and the controlling shareholder. UF 12, 16-18, 245, 342. In these capacities, Ledda has exercised control over the day-to-day affairs of the company.[2] UF 341-371.

B. Defendants Charge Illegal Up-Front Fees For Debt Settlement Services

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[1] A detailed statement of uncontroverted facts (separately numbered), with appropriate citations to the evidentiary record, has been filed herewith pursuant to Local Civil Rule 56.1 and is referred to hereinafter as "Statement of Facts." Uncontroverted facts are referred to as "UF [number]."

[2] Prior to founding Morgan Drexen, Ledda ran a debt settlement company named National Consumer Council, Inc. UF 435-438. In 2005, Ledda entered into a settlement agreement with the Federal Trade Commission ("FTC"), under which he agreed, *inter alia*, to a permanent injunction against making misrepresentations in the provision of debt settlement services. UF 438.

1. Morgan Drexen's Role in Debt Settlement

Morgan Drexen is a California-based company that provides debt settlement services nationwide. UF 1, 19. It claims to provide support to attorneys who provide debt settlement services. UF 19. In fact, Morgan Drexen performs virtually all aspects of the debt settlement program in which it enrolls consumers. Among other things, Morgan Drexen:

- Advertises for debt settlement services nationwide;
- Receives telephone calls from consumers who respond to the telephone numbers listed in its advertisements;
- Performs consumer intake;
- Determines how much consumers who enroll in the debt settlement program will pay each month;
- Assigns consumers to attorneys;
- Sends letters to creditors instructing them to call Morgan Drexen rather than the assigned attorney;
- Directly negotiates consumers' debts with creditors;
- Determines which consumer debts to negotiate and when;
- Determines what strategies to employ when negotiating with creditors;
- Receives debt settlement offers from creditors;
- Handles all paperwork relating to consumers' debts; and
- Administers consumers' and attorneys' accounts to pay creditors and itself.

UF 20-54.

Consistent with its role, Morgan Drexen receives 85% to 95% of all money paid by consumers for these debt settlement services. UF 111. Generally, the attorneys in whose names Morgan Drexen provides debt settlement services receive a minimum monthly payment of $1,250 for a client base of 300 to 500 clients. UF 116. The "local counsel" who review settlements are paid $250 per month to review up to 50 settlements–*i.e.*, $5 per settlement–that Morgan Drexen

has negotiated with creditors. UF 74. This review, which takes a matter of minutes, generally is the only debt settlement work attorneys perform. UF 67-71.

The consumers who sign up for Morgan Drexen's debt settlement services are financially vulnerable: their average income is $22,600 and they enroll an average of 14 debts totaling thousands of dollars into the program. UF 422, 405, 407, 410, 414, 418.

2. Business Model Prior to the TSR Amendments

Between 2007 and October 2010, consumers paid up-front fees for Morgan Drexen's debt settlement services. UF 75-77. Consumers also paid a monthly servicing fee of $45 to $55, regardless of whether Morgan Drexen settled any debts, and a contingency fee if a debt was settled. UF 79. This business model was lucrative: between 2008 and 2010, Morgan Drexen's annual revenue was $19,615,815, $36,018,152, and $44,198,217, respectively, and in 2009, Morgan Drexen earned more than $3 million in profit. UF 4-11.

In 2009, Morgan Drexen learned that the FTC was considering amending the TSR to prohibit the receipt of up-front fees for debt settlement services. UF 80. At the time, Morgan Drexen derived approximately 50% of its revenue from the up-front fees consumers were charged for debt settlement services. UF 83. Morgan Drexen considered the TSR amendments' proposed ban on up-front fees for debt settlement services a threat to its business. UF 84.

In response, Ledda devised a model Morgan Drexen used to continue to charge up-front fees for debt settlement services under the guise of providing "bankruptcy services" once the proposed rule became effective UF 87-91. To implement this plan, Morgan Drexen revised the contract structure of its debt settlement program so that consumers sign two contracts: one for debt settlement services, under which the consumer is not charged an up-front fee, and one for bankruptcy-related services, under which the consumer is charged an up-front engagement fee of between $1,000 and $3,250, and a monthly maintenance fee of

$50. UF 92, 99-108. When Morgan Drexen was considering implementing this "dual program," attorneys with whom Morgan Drexen was affiliated expressed concerns that the proposed bankruptcy model contravened standard bankruptcy practice. UF 247. Morgan Drexen ignored these concerns.

Shortly before October 27, 2010, when the FTC amendments became effective, Morgan Drexen began enrolling consumers who were seeking debt settlement services into the dual program and charging them an engagement fee and monthly fees prior to settling the consumers' debts. UF 124, 126, 128-131.

3. Business Model After the Amendments to the TSR

Since the October 27, 2010 advance-fee ban, Morgan Drexen has continued to provide the same debt settlement services it provided prior to the TSR amendment, when it charged up-front fees for debt settlement services. UF 195-199. Morgan Drexen has also continued to advertise nationwide for debt settlement services on television and radio. UF 139-141. Many of these advertisements not only tout debt settlement services, but state that consumers who enroll can "start [their] life over without filing bankruptcy." UF 140. Consumers call Morgan Drexen in response to these advertisements because they are interested in signing up for the advertised debt settlement services, not because they are interested in signing up for any bankruptcy-related services. UF 142-146. Indeed, Morgan Drexen's own F.R.C.P 30(b)(6) designee acknowledged that 90% of consumers she observed called because they wanted debt settlement services. UF 143.

(a) Consumers Only Want Debt Settlement Services, But Morgan Drexen Signs Them Up For The Dual Program

Despite advertising for debt settlement and fielding calls from consumers who seek debt settlement services, Morgan Drexen aggressively pushes consumers to enroll into the dual program, in which they are charged thousands of dollars of up-front fees for purported bankruptcy services they do not want. UF 147-192.

Morgan Drexen employs a carrot and stick approach to get its employees to enroll consumers in the dual program. First, it provides financial incentives for its employees to close deals. Legal Intake Specialists ("LIS"), who speak directly to consumers, and Production Managers, who oversee teams of LIS, are compensated through a commission structure that is based on the number of consumers the LIS enroll. UF 160-167 Under this structure, LIS receive twice as much credit for enrolling a consumer into the dual program as they do for enrolling a consumer into the debt settlement only program.[3] *Id*. Morgan Drexen further incentivizes LIS with bonuses for exceeding weekly production quotas. UF 167.

Morgan Drexen has also pressured its employees to steer consumers into the dual program through a fear-based, boiler-room environment in which LIS and Production Managers are constantly monitored, reprimanded, and fired if they do not hit weekly enrollment quotas. UF 174, 176, 178-184. Former Production Managers describe recurring work-place meetings during which a supervisor threatened to fire all Production Managers if their LIS teams did not meet weekly enrollment quotas. UF 181. The Supervisor, and in turn the Production Managers, threatened to write up or fire LIS if they did not meet their quotas. UF 177-78. Morgan Drexen routinely carried out these threats and demoted or fired LIS and Production Managers for missing their weekly enrollment quotas. UF 182.

To meet their quotas, LIS have engaged in widespread misrepresentations to dupe consumers who only wanted debt settlement services into enrolling in the dual program. UF 186-192. According to one former Production Manager, who monitored five to six hours of phone calls between LIS and consumers each week from 2010 to 2013, LIS would say what they needed to say to get consumers to enroll in the dual program. UF 187. Among other things, LIS:

[3] In addition to the dual program, Morgan Drexen also offers a debt settlement only program, in which a consumer is *not* charged an up-front fee.

- Tell consumers that if they want debt settlement services, they must sign up for the dual program and fill out bankruptcy-related paperwork;
- Tell consumers that if they sign up for debt settlement services under the dual program, no bankruptcy work will occur unless and until the consumer explicitly states that he or he wants to file for bankruptcy;
- Tell consumers that they will not be charged fees for any bankruptcy-related services unless and until the consumer explicitly states that he or she wants to file for bankruptcy; and
- Tell consumers that, under the dual program, Morgan Drexen will use the consumers' monthly payments to pay off the consumers' debts, when, in fact, Morgan Drexen uses these monthly payments to pay off the up-front fee engagement fee and $50 monthly maintenance fee consumers are required to pay under the contract for purported bankruptcy services.
- Are instructed to state that the dual program is a way to "avoid bankruptcy;"

UF 147, 188-191.

Morgan Drexen's incentive structure and fear-based management of its employees has had the desired effect: of the 62,654 consumers who signed up for any program between October 27, 2010, and August 31, 2014, 59,507 consumers (95%) were enrolled in the dual program. UF 124. By contrast, during this same time period, only 449 consumers (0.7%) have enrolled in the debt settlement only program for which no up-front fees are charged. UF 133.

Consumers whom Morgan Drexen enrolls in the dual program do not understand that they have been signed up for bankruptcy services or that they have to pay an up-front fee. UF 193, 340. This misunderstanding is cemented by letters that Morgan Drexen sends (on attorney letterhead) to consumers in which it states: "We support your efforts to resolve your debts in a non-formal manner with your creditors without having to actually file a formal petition." UF 194.

Once a consumer is enrolled in the dual program, he or she immediately begins making monthly payments. UF 104, 108. Generally, Morgan Drexen applies these payments to the engagement fee and monthly servicing fee set forth

in the contract for bankruptcy services. UF 104. Generally, it is only once a consumer has paid these fees that funds are set aside for Morgan Drexen to use to settle the consumer's debts. UF 108.

(b) The Bankruptcy Contract Provides For Extremely Limited Services

The limited services set forth in the bankruptcy contract confirm it is nothing more than a pretext to continue charging up-front fees for debt settlement services. Under the bankruptcy contract: (1) Morgan Drexen conducts an intake interview, during which it asks the consumer to provide financial information, some of which is the same as the financial information obtained for debt settlement purposes; (2) Morgan Drexen prints out and mails three form bankruptcy notices to the consumer; and (3) Morgan Drexen prepares a draft bankruptcy petition based on information the consumer provided in a form questionnaire sent by Morgan Drexen. UF 202-203. Typically, these are the only services provided to a consumer who does not file for bankruptcy. UF 202-203, 207-213. If a consumer decides that he or she wants to file a bankruptcy petition, then he or she has the opportunity to consult with an attorney. UF 204. In those rare instances where the consumer does file for bankruptcy, the contract provides that an attorney will attend the meeting of creditors and assist in preparing any amendments to documents. UF 205. The contract expressly excludes any other legal services. UF 202, 206.

(c) Few Consumers Receive Legitimate Bankruptcy Services

From the date Morgan Drexen began enrolling consumers in the dual program in 2010 through August 31, 2014, the last date for which Morgan Drexen provided data, only 584 out of 61,476 dual program enrollees (0.95%) actually filed a bankruptcy petition. UF 126. This low number is hardly a surprise to Defendants. Before implementing the dual program, Defendants expected that a bankruptcy petition would be filed for only 10% - 12% of dual program enrollees. UF 296. By Defendants' own forecast, therefore, 88% - 90% of dual program

enrollees would not file a petition, would only receive debt settlement services, yet would pay thousands of dollars in up-front fees.

For the remaining 99% of dual program enrollees who do not file bankruptcy, the only bankruptcy-related "services" they receive are services (1) – (3) described above. UF 202-203, 294. Attorneys have little to no contact with these consumers. UF 207-213. Indeed, some of the assigned attorneys have little knowledge of bankruptcy practice. UF 232. In other cases, the assigned attorneys have not authorized bankruptcy work to be performed and/or have no idea that Morgan Drexen is performing any bankruptcy work. UF 248, 255, 257.

(d) Preparation of a Bankruptcy Petition Is Just a Debt Settlement Strategy and is of Little Value.

For the 99% of dual program enrollees who do not file bankruptcy, Morgan Drexen justifies charging thousands of dollars of up-front fees to prepare a bankruptcy petition because the petition purportedly serves as leverage in debt settlement negotiations. But this merely confirms that what Morgan Drexen is really providing are debt settlement services, and unlawfully charging advance fees for them.

The threat of bankruptcy is not only an expensive debt settlement strategy—costing consumers thousands of dollars of up-front fees—it is of questionable effectiveness. Morgan Drexen cannot quantify how the threat of bankruptcy creates leverage—*i.e.*, how it brings reluctant creditors to the negotiating table or improves the settlement terms agreed to by creditors. UF 299, 302-303. In fact, former Morgan Drexen settlement officers report that threats of bankruptcy make no difference in negotiations. UF 317, Cleary Decl. ¶ 13 (SJX 131), Hsieh Decl. ¶ 12 (SJX 132). Moreover, Morgan Drexen does not even threaten bankruptcy in all negotiations. UF 304. Morgan Drexen does not generally use the threat of bankruptcy with its "preferred creditors," with which negotiations involve only an

exchange of settlement offers over an internet portal.[4] UF 320-330. For other creditors, Morgan Drexen does not require its Settlement Officers, who negotiate directly with creditors, to verbally threaten bankruptcy, and they rarely do so. UF 307. In letters to creditors, Morgan Drexen did not state that the consumer had retained an attorney to prepare a bankruptcy petition (which hardly counts as a "threat") until 2012 or 2013. UF 311-312. And Morgan Drexen employees did not even have the option of including a draft bankruptcy petition in letters to creditors until 2013. UF 313. Thus, at least a significant amount of the 99% of consumers who did not file for bankruptcy paid thousands of dollars for a debt settlement negotiating tool that was not even used.

4. Consumers Complain About and Drop Out Of Morgan Drexen Programs At A Staggering Rate

Consumers complain directly to Morgan Drexen and to third parties about being charged up-front fees and not being able to easily cancel from the company's programs.[5] UF 334, 337-340. Despite these difficulties, consumers have cancelled at nearly same rate as new enrollment: since 2010, more than 66,000 consumers have cancelled Morgan Drexen's services, and of these, 25% to 40% have cancelled within three months of enrollment. UF 331-335. As these figures show, Morgan Drexen's business is a revolving door that extracts up-front fees immediately after consumers enroll in the program.

Consumers often do not receive a refund when they cancel, even if no debt was settled. UF 336. According to Morgan Drexen the up-front fee payments are nonrefundable, regardless of whether Morgan Drexen has obtained any

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[4] At least one "preferred creditor" states that Morgan Drexen has never expressly threatened bankruptcy or provided it with a draft bankruptcy petition. Bender Decl. ¶¶ 13-15 (SJX 135).

[5] For example, 244 consumers have complained to the Business Consumer Alliance ("BCA"), prompting the BCA to assign Morgan Drexen its lowest rating – "F" – for the years 2010 to 2014. UF 339, Burge Decl. ¶¶ 11, 13 (SJX 139).

settlements, because the consumer has received "services as contracted for," such as "enroll[ing] and process[ing] the Consumer's debts into the program." UF 336, Albanese Decl. ¶ 24(b) (SJX 137).

5. Consumers Are Harmed By Morgan Drexen's Conduct

Since October 27, 2010, 59,507 consumers whom Morgan Drexen has enrolled in the dual program have paid approximately $90.7 million in fees prior to Morgan Drexen settling one of their debts. UF 131.

C. Morgan Drexen's Deceptive Advertising Practices

Morgan Drexen compounds its violation of the TSR by misrepresenting its debt settlement services through national radio and television advertisements that declare, in urgent tones, that consumers should "Call now!" and state, "We can help!" Ad 3 (SJX 3). Through voiceover and large text plastered across the screen, the advertisements promise that consumers will "pay no up-front fees," and caution that this is a "limited offer," for a "limited time only." *Id*. Even Ledda has repudiated Defendants' "no up-front fees" claims, testifying that "I know that it is a claim that I don't feel comfortable with today." UF 398. Morgan Drexen's commercials also assert that consumers can "be debt free in months," if they sign up for the service. UF 372-397. In fact, for debt settlement clients who enrolled between January 4, 2010 and December 28, 2012, more than 60% of enrollees still have *not had a single debt settled*, let alone become debt free. UF 399. By Morgan Drexen's own admission, debt settlement typically takes 3-5 years to complete, and fewer than 6% of consumers who "complete" the program do so within 12 months. UF 400-401.

D. Walter Ledda Exercises Extensive Control Over Morgan Drexen

Until recently, when Ledda transferred all of his shares in Morgan Drexen to a trust that he controls and of which he is the beneficiary, Ledda directly owned 76.4% of Morgan Drexen. UF 17-18. He has also been the controlling member of the company's two person board of directors. UF 12, 345. As the company's founder and CEO, Ledda has the power to approve or disapprove new projects. UF 13, 341, 347, 350. He has the power to oversee any department he wants, and he oversees more than ten of them. UF 357-359. Ledda has the final say on the company's executive committee, which makes operational and strategic decisions. UF 360-362. In 2010, Ledda started holding and setting the agenda for weekly department manager meetings. UF 363-370. Ledda also exercises control over the day-to-day workings of the company. UF 371. For example: (1) Ledda devised, implemented, and oversaw the provision of debt settlement services under the dual model; (2) Ledda directed the company to create a "preferred creditor" program, under which Morgan Drexen negotiates with creditors through an internet portal and does not make bankruptcy threats; and (3) Ledda reviews Morgan Drexen's advertisements, and, among other things, decides when they should be further reviewed by outside counsel. UF 27-28 88, 351-353, 356, According to Ledda, at Morgan Drexen, "[e]ventually, the buck stops with me." UF 349.

III. LEGAL ARGUMENT

A. Defendants Are Sellers or Telemarketers of Debt Relief Services Under the TSR and Covered Persons under the CFPA

As set forth in Section II, the uncontroverted evidence demonstrates that Defendants are "sellers" or "telemarketers" of a "debt relief service" who engage in "telemarketing," as defined in the TSR,[6] and "covered persons" under the CFPA.[7]

[6] The TSR, 16 C.F.R. § 310.2(aa), defines "seller" as "any person who, in connection with a telemarketing transaction, provides, offers to provide, or

B. Defendants Have Violated The TSR By Charging Up-Front Fees For Debt Settlement Services(Count I)

The FTC justified its ban on advance fees on the context in which debt relief services are often offered. [8] Debt relief services "frequently take place in the context of high pressure sales tactics, contracts, of adhesion, and deception."[9] As described above, Defendants' conduct is exactly what the FTC sought to outlaw.

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arranges for others to provide goods or services to the customer in exchange for consideration." The TSR, 16 C.F.R. § 310.2(cc), defines "telemarketer" as "any person who, in connection with telemarketing, initiates or receives telephone calls to or from a customer or donor." The TSR, 16 C.F.R. § 310.2(m) defines "debt relief service" as "any program or service represented, directly or by implication, to renegotiate, settle, or in any way alter the terms of payment or other terms of the debt between a person and one or more unsecured creditors or debt collectors, including, but not limited to, a reduction in the balance, interest rate, or fees owed by a person to an unsecured creditor or debt collector. The TSR, 16 C.F.R. § 310.2(dd), defines "telemarketing" as "a plan, program, or campaign which is conducted to induce the purchase of goods or services or a charitable contribution, by use of one or more telephones and which involves more than one interstate telephone call."

[7] A "covered person" means any person, including any individual or business entity, that engages in "offering or providing a consumer financial product or service." 12 U.S.C. § 5481(6)(A) and (19). A "consumer financial product or service" includes "providing services to assist a consumer with debt management or debt settlement, modifying the terms of any extension of credit, or avoiding foreclosure." 12 U.S.C. § 5481(15)(A)(viii). The CFPA provides that "[i]t shall be unlawful for any covered person . . . to engage in any . . . deceptive . . . act or practice." 12 U.S.C. § 5536(a)(1)(B); *see also* 12 U.S.C. § 5531(a).

[8] The TSR prohibits a seller or telemarketer from "[r]equesting or receiving payment of any fee or consideration for any debt relief service until . . .[t]the seller or telemarketer has renegotiated, settled, reduced, or otherwise altered the terms of at least one debt pursuant to a settlement agreement, debt management plan, or other such valid contractual agreement executed by the customer" and "[t]he customer has made at least one payment pursuant to such agreement, plan, or contract." 16 C.F.R. § 310.4(a)(5)(i).

[9] Telemarketing Sales Rule, 75 Fed. Reg. 48,458, 48,485 (Aug. 20, 2010).

The uncontroverted evidence demonstrates that Morgan Drexen requests and receives impermissible up-front fees for debt settlement services: (1) Morgan Drexen advertises debt settlement services; (2) in response to these advertisements, consumers call Morgan Drexen seeking debt settlement services; (3) Morgan Drexen misleads consumers about the services they are signing up for; (4) as a result, approximately 95% of consumers seeking debt settlement services have been enrolled in the dual program; (5) consumers enrolled in the dual program believe they have signed up for debt settlement services, not bankruptcy-related services; (6) Morgan Drexen provides dual program enrollees with debt settlement services; (7) 59,507 consumers enrolled in the dual program have paid $90.7 million in fees in advance for at least one of their debts was settled; and (8) Morgan Drexen has received the vast majority of these fees. *See supra* Section II.

Defendants contend that the TSR does not apply to them because dual program enrollees are paying for bankruptcy services, not debt settlement services. This absurd position has no basis in fact or law: fewer than 1% of dual program enrollees file for bankruptcy, and Morgan Drexen provides only debt settlement services for the remaining 99%. *See supra* Section II-B-3(c), (d). Moreover, the purported bankruptcy services provide no tangible benefit to the remaining 99% of consumers, let alone anything that justifies charging thousands of dollars in upfront fees that these consumers cannot afford.[10] *Id*. In any event, the program that

[10] Recently, a Wisconsin Court reviewed an extensive record that included depositions and trial testimony from Morgan Drexen and attorneys with which it is affiliated, and found not only that Morgan Drexen exercised extensive control over the lawyers it purported to serve, which was a central issue in the case, but that the "bankruptcy" contract that is part of Morgan Drexen' dual program does not result in any service for consumers. UF425.The contract, the Court noted:

> [D]oes not allow for the provision of bankruptcy or legal services. Instead, the only relation to bankruptcy this new "hybrid" contract is that Morgan Drexen prepares a mock bankruptcy for the [consumer] and sends it to creditors in an effort to persuade them that the debtor is judgment proof. For this purported service, the [consumer] is charged an "engagement fee" as a

Defendants represent to consumers is one for debt settlement, not bankruptcy, and they are thus prohibited by the TSR from charging advance fees for those services.

Even assuming that there is some value to creating bankruptcy petitions for consumers who have no interest in filing for bankruptcy – and there is no evidence to support such a proposition – whatever value there is relates to debt settlement, not bankruptcy, and highlights the obvious: *the services for which Morgan Drexen requests and receives up-front fees concern debt settlement, not bankruptcy.*

In promulgating the TSR amendments, the FTC made clear that a provider cannot evade the rule by including a "product, such as educational material on how to manage debt, as part of the service it offers."[11] This is precisely what Defendants are doing here: they seek to evade the rule by adding another "product"–in this case, "bankruptcy services"–to the debt settlement services they always offered.

C.F.P.B. v. Gordon, Case No. 2:12-cv-06147-RSWL-MRW (C.D.Cal. June 26, 2013), appeal pending No. 13-5684, decided by Judge Anderson, confirms that a party cannot evade an up-front fee ban by bundling a service for which up-front fees are prohibited with another service for which the consumer must pay. In *Gordon*, the Bureau alleged that the defendants violated the Mortgage Assistance Relief Services Rule ("Regulation O") by, among other things, receiving up-front payments from consumers for mortgage assistance relief services before the consumers entered into loan modifications with their lenders.[12] Like Morgan Drexen, the *Gordon* defendants had consumers sign up for two services: one for loan modification assistance, purportedly free of charge, and one for "custom legal

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> purported legal retainer. However, if the debtor does want to hire an attorney and file for bankruptcy, the debtor must enter into a separate contract with the attorney and pay an additional fee.

UF 427.

[11] Telemarketing Sales Rule, 75 Fed. Reg. at 48,467.

[12] *Id*. at 4-5.

products," for which consumers were charged between $2,500 and 4,500 in up-front fees.[13] The primary defendant argued that he had not violated Regulation O because he only charged up-front fees for "custom legal products," not loan modification services.[14] Similar to Morgan Drexen's "bankruptcy services," these "custom legal products" consisted of "a qualified written request, demand letter, and draft complaint," all of which were "form templates."[15]

The Court saw through this ruse and concluded that the bundling of the "custom legal products" and the "free" loan modification services violated Regulation O because "simply labeling something a product does not change the fact that defendants were in fact charging advance fees for mortgage assistance relief services."[16] Moreover, the Court noted that the "defendants' marketing practices make it readily apparent that they were selling mortgage assistance relief services to consumers."[17]

As in *Gordon*, Defendants' attempt to evade the ban on up-front fees by "bundling" their debt settlement services with sham "bankruptcy services." UF 88, 135-136. And, as in *Gordon*, Defendants' advertising reveals what they are really selling: debt settlement services. Because there is no genuine issue as to any material fact that Defendants request and receive impermissible up-front fees, the Bureau is entitled to a judgment as a matter of law.[18]

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[13] *Id*. at 5.
[14] *Id*.
[15] *Id*.
[16] *Id*. (citing 75 Fed. Reg. 75092-01 at 75102 n.137 (2010) ("Providers should be aware that merely including a product, such as a book, in conjunction with the sale of services will not remove the transaction from coverage by the Rule."); 75 Fed. Reg. 43569-01 (2011); *Auer v. Robbins*, 519 U.S. 452, 461 (1997) (finding an agency's interpretation of its own regulations to be "controlling" unless the interpretation is "plainly erroneous or inconsistent with the regulation")).
[17] *Id*.
[18] Fed. R. Civ. P. 56(c).

C. Defendants Have Violated The TSR By Failing To Hold Consumer Funds Such That Consumers Own The Funds And Can Withdraw Them (Count II)

Defendants have also violated the TSR by taking up-front fees and refusing to remit them within seven days of a consumer's request.[19] As set forth in Section II-B-4, and in greater detail in the Statement of Undisputed Fact, Defendants routinely refuse to provide consumers with their funds within seven days of receiving a request. UF 336; Albanese Decl. ¶ 24.

D. Defendants Have Violated The TSR And The CFPA By Misrepresenting That Consumers Who Sign Up For Debt Relief Services Will Not Be Charged An Up-Front Fee And/Or Will Be Debt Free In Months (Count III, IV, V, and VI)

The TSR prohibits a seller or a telemarketer from making any material misrepresentations in connection with the sale of goods or services, including any material aspect of any debt relief service, such as the amount of time necessary to achieve the represented results.[20] The CFPA provides that "[i]t shall be unlawful for any covered person . . . to engage in any . . . deceptive . . . act or practice."[21]

An act or practice is deceptive under the TSR and CFPA if "first, there is a representation, omission, or practice, that second, is likely to mislead a consumer acting reasonably under the circumstances, and third, the representation, omission,

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[19] The TSR, 16 C.F.R. § 310.4(a)(5)(ii), provides that a seller or a telemarketer may request or require customers "to place funds in an account to be used for the debt relief provider's fees and for payments to creditors or debt collectors in connection with the renegotiation" or settlement of a debt, provided that, among other things: "[t]he customer owns the funds held in the account and is paid interest on the account" and "[t]he customer may withdraw from the debt relief service at any time without penalty and must receive all funds in the account, other than funds earned by the debt relief service in compliance with §310.4(a)(5)(i)(A) through (C), within seven (7) business days of the consumer's request."

[20] 16 C.F.R. §§ 310.3(a)(2)(ii) and (ix)

[21] 12 U.S.C. § 5536(a)(1)(B); *see also* 12 U.S.C. § 5531(a).

or practice is material."[22] A representation is deceptive if the overall "net impression"—taken as a whole—is likely to mislead consumers.[23]

In promulgating the amended TSR, the FTC recognized that "debt relief services are directed to financially distressed consumers, who are particularly vulnerable to the providers' claims," and that "sellers may exercise undue influence over highly susceptible classes of purchasers." 75 Fed. Reg. 48,485.

In this case, Defendants took advantage of vulnerable consumers saddled by debt, and violated the TSR and the CFPA by deceptively representing in advertisements that enrollees: (1) would pay "zero upfront fees" or "no upfront fees;" and/or (2) could "be debt free in months." UF 372-397. Both representations are false and misleading. As set forth in Section II, uncontroverted facts establish that Defendants charged up-front fees for debt settlement services. Defendants' "debt free months" representation is also wildly misleading. For consumers who enrolled between 2010 and 2012, 60 percent have *still never had one debt settled*. UF 399. Of those few enrollees who do "complete" the debt settlement program, fewer than 6% do so within a year. UF 401. Even Defendants admit that it typically takes consumers 36 to 60 months to complete the debt relief program. UF 400.

Express and deliberately implied claims, like those made by Defendants, are presumed to be material.[24] Moreover, Defendants' misrepresentations are material

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[22] *See, e.g., FTC v. Stefanchik*, 559 F.3d 924, 928, 930 (9th Cir. 2009) (internal citations and quotations omitted) (applying elements of deception claim under the FTC Act to claim under the TSR); *Gordon*, Case No. Case No. 2:12-cv-06147-RSWL-MRW at 4 (applying FTC Act standard to CFPA); *Illinois v. Alta Colleges*, No. 1:14–cv–03786, 2014 WL 4377579, at *4 (N.D. Ill. Sept. 4, 2014) (noting that standard for CFPA deception claim is the same as under the FTC Act).

[23] *FTC v. Cyberspace.Com LLC*, 453 F.3d 1196, 1200 (9th Cir. 2006) ("A solicitation may be likely to mislead by virtue of the net impression it creates ….").

[24] *See FTC v. Pantron I Corp.*, 33 F .3d at 1095-96 (express claims presumed material); *Kraft, Inc. v. FTC*, 970 F.2d 311, 314, 322-23 (7th Cir. 1992) (implied claims designed to induce purchase are material); *FTC v. Stefanchik*, No. C04-1852, 2007 WL 1058579, at *5 (W.D. Wash. April 3, 2007), *aff'd* 559 F.3d 924

because they "involve[] information that is important to consumers and, hence, likely to affect their choice of, or conduct regarding, a product."[25] In this case, Defendants misrepresentations go to the core of what consumers would find important: how long it takes to become debt free, and when and how much the consumer has to pay to become debt free.

Finally, consumers' reliance on Defendants' claims is reasonable. Consumers have the right to rely on express claims of marketers.[26] Consumers' reliance on implied claims is also presumptively reasonable where, as here, the seller's false claims go to the heart of the solicitation or the characteristics of the product or service offered.[27] In this case, the evidence establishes that Defendants' misrepresentations were likely to, and in fact did, mislead consumers acting reasonably under the circumstances. UF 372-397.

E. Individual Liability of Walter Ledda

Ledda is liable for the violations of the TSR and CFPA described herein. As set forth above, he is a "telemarketer" or "seller" of "debt relief products or services" under the TSR who is charging consumers fees before settling their debts and misrepresenting core aspects of the debt relief services he claims to provide to consumers. The evidence also overwhelmingly shows he is a "covered person"

(9th Cir. 2009) ("Implied claims are presumptively material where there is evidence that the seller intended to make the claim go to the heart of the solicitation or the characteristics of the product or service offered.").

[25] *Cyberspace.Com LLC*, 453 F.3d at 1201 (*quoting In re Cliffdale Associates, Inc.*, 103 F.T.C. 110, 165 (1984)).

[26] *See, e.g.*, *FTC v. Five-Star Auto Club*, 97 F. Supp 2d. 502, 528 (S.D.N.Y. 2000) ("Consumer reliance on express claims is … presumptively reasonable" (citation omitted)).

[27] *Stefanchik*, No. C04-1852, 2007 WL 1058579, at *5; s*ee Kraft, Inc.*, 970 F.2d at 322 ("Requiring proof of subjective reliance by each individual consumer would thwart effective prosecutions of large consumer redress actions and frustrate the statutory goals . . ."), *cert. denied*, 510 U.S. 1110 (1994); *FTC. v. Security Rare Coin & Bullion Corp.*, 931 F.2d 1312 (8th Cir. 1991).

who deceptively offers or provides services to consumers in violation of the CFPA. Furthermore, Ledda is a "related person" under the CFPA, and is thus deemed a "covered person" who is also subject to the CFPA's bar on deceptive practices.[28]

Ledda has been the company's Chief Executive Officer and its controlling shareholder. *See supra* Section II-D. In these capacities, Ledda has the managerial responsibility and power to control Morgan Drexen's practices and advertisements, which he exercises. *Id*. He has exercised control over the direction of the company, as well as its day-to-day operations. In particular, Ledda developed the idea for bundling sham "bankruptcy" services under the dual program, directed and oversaw the implementation of the program, and has profited from a scheme that has unlawfully drained millions of dollars from consumers already teetering on the edge of financial ruin. *Id*. Defendant Ledda also reviews each advertisement and know that, contrary to the claims in those advertisements, consumers are charged up-front fees for debt settlement and do not become debt free in months. *Id*. On these facts, Ledda is individually liable.[29]

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[28] "Related person" means "(i) any director, officer, or employee charged with managerial responsibility for, or controlling shareholder of, or agent for, such covered person; (ii) any shareholder, consultant, joint venture partner, or other person, as determined by the Bureau (by rule or on a case-by-case basis) who materially participates in the conduct of the affairs of such covered person; and (iii) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in any—(I) violation of any provision of law or regulation; or (II) breach of fiduciary duty." 12 U.S.C. § 5481(25)(C). A "related person . . . shall be deemed to mean a covered person for all purposes of any provision of Federal consumer financial law," including the CFPA and TSR. 12 U.S.C. § 5481(25)(B).

[29] *See Gordon*, Case No. 2:12-cv-06147-RSWL-MRW at 4 (holding the individual defendant liable for the acts of a corporate defendant under the CFPA because he participated in the deceptive practices or had authority to control them and had knowledge or was recklessly indifferent to the truth or falsity of the misrepresentations or was aware of a high probability of fraud along with an intentional avoidance of the truth) (citing *Stefanchik*, 559 F.3d at 928 (officer was

F. Remedies

The CFPA authorizes the Court to order any appropriate equitable relief, including disgorgement, restitution, compensation for unjust enrichment, the rescission of contracts, limits on the activities or functions of the person, and civil money penalties.[30]

1. Restitution

The Bureau seeks a judgment against Defendants, jointly and severally, in the amount of $90.7 million, as restitution for the impermissible up-front fees charged, as well as restitution of all fees paid by consumers who enrolled in a Morgan Drexen program in response to Defendants' deceptive advertisements.[31]

2. Injunctive Relief

The CFPA authorizes courts to determine appropriate equitable relief, including "limits on the activities or functions of the person."[32] "Courts enjoy broad discretion in fashioning suitable relief and defining the terms of a permanent injunction."[33]

Section I of the Proposed Order permanently bans Defendants from

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"at least recklessly indifferent" because he was warned by counsel and employees that scripts were unsubstantiated and consumers did not receive promised results)).

[30] 12 U.S.C. §§ 5565(a)(1) and (2); *see also FTC v. Commerce Planet, Inc.*, 878 F. Supp. 2d 1048, 1088 (C.D. Cal. 2012) ("Restitution may be measured by the 'full amount lost by consumers rather than limiting damages to defendant's profits.'") (quoting *Stefanchik*, 559 F.3d at 931).

[31] Disgorgement of ill-gotten gains is also a proper remedy. The appropriate measure of disgorgement is Defendants' gross revenues. *FTC v. Neovi, Inc.* 2009 U.S. Dist. LEXIS 649, at *29-30 (S.D. Cal. Jan. 7, 2009) (unpublished) (*citing SEC v. JT Wallenbrock & Assoc.*, 440 F. 3d 1109, 1113-15 (9th Cir. 2006), *aff'd*, 604 F.3d 1150 (9th Cir. 2010)). Defendants' yearly revenue is set forth in the Statement of Undisputed Facts. UF 4-10.

[32] 12 U.S.C. §§ 5565 (1) and (2)(G).

[33] *Church of the Holy Light of the Queen v. Holder*, 443 Fed. Appx. 302, 303 (9th Cir. 2011) (quoted in *FTC v. John Beck Amazing Profits, LLC*, 888 F. Supp.2d 1006, 1012 (C.D. Cal. 2012)).

participating in telemarketing and providing debt relief products and services. Such a ban is necessary and appropriate to protect consumers from future harm.[34] Despite the FTC's previous lawsuit against Walter Ledda, which resulted in injunctive relief barring Ledda from, among other things, making material misrepresentations, years of complaints from consumers, investigations by state regulatory agencies, and orders finding that Morgan Drexen has violated state law, Defendants have persisted in draining consumers of millions of dollars through their unlawful conduct. UF 425-439. Indeed, Defendants specifically created the dual model fiction of payment for "bankruptcy services" to skirt the requirements of federal consumer protection laws. Courts in this Circuit have imposed similar injunctive relief based on similar practices.[35]

Sections II and III of the Proposed Order also prohibit Defendants from making misrepresentations relating to consumer financial products or services and require substantiation for any claims regarding the benefits, performance, and efficacy of such products or services. The proposed order also contains various compliance monitoring and reporting provisions to ensure compliance with the ban

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[34] In determining the scope of permanent injunctions in similar cases involving claims of deception under the FTC Act and TSR, courts have considered: (1) whether the defendants acted in blatant disregard of the law; (2) whether defendants have a history of engaging in unlawful practices; and (3) whether the violations involve whether "technique of the deception" can easily be applied to a different product or service. *Litton Indus., Inc. v. FTC*, 676 F.2d 364 (1982); *see also John Beck*, 888 F. Supp. 2d at 1012 (citing *Litton*).

[35] *John Beck*, 888 F. Supp. 2d at 1012-13 (issuing broader permanent injunction barring certain defendants from engaging in, or assisting others in engaging in, telemarketing, rather than a less restrictive product-specific injunction); *see also Gill*, 265 F.3d 944, 957-58 (9th Cir. 2001) (ban on participation in credit-repair); *FTC v. Dinamica Finaciera LLC*, 2010 U.S. Dist. LEXIS 88000, at *49 (C.D.Cal. Aug. 19, 2010) (ban on marketing or selling loan modification or foreclosure relief service; *FTC v. Sameer Lakhany*, Case No. SACV12-0337-CJC (C.D.Cal. Feb. 28, 2013) (unpublished) (ban on mortgage assistance and debt relief products or services).

requirement and the other permanent injunctive provisions discussed above.[36]

3. Civil Money Penalties

The CFPA authorizes the Court to issue civil money penalties for violations of Federal consumer financial laws.[37] The CFPA governs remedies for all conduct occurring on or after July 21, 2011, the effective date of the statute.[38]

The CFPA provides for three tiers of civil money penalties, calibrated by scienter.[39] Each tier establishes a range of discretion, setting a maximum penalty for each violation. The first-tier provides for penalties of up to $5,000 on a strict-liability basis "for any violation of a law, rule, or final order or condition imposed in writing by the Bureau."[40] The second tier provides for penalties of up to $25,000 for each violation for "any person that recklessly engages in a violation of a Federal consumer financial law."[41] The third tier provides for penalties of up to $1,000,000 for each violation for "any person that knowingly violates a Federal consumer financial law."[42]

Defendants' violations of the TSR's advance fee ban are ongoing—1,174 days since the July 21, 2011, and counting. Between July 21, 2011 and August 31,

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[36] *See, e.g., FTC v. Direct Mktg. Concepts, Inc.*, 648 F. Supp. 2d 202, 213 (D. Mass. 2009) (including similar monitoring provisions to ensure compliance with permanent injunctions"); *FTC v. Think Achievement*, 144 F. Supp. 2d 1013, 1018 (N.D. Ind. 2000) (including provisions for records retention, notification of changed employment or residence, access to premises and monitoring); *FTC v. SlimAmerica*, 77 F.Supp. 2d 1263, 1276 (S.D. Fla. 1999) (record-keeping and monitoring provisions were appropriate to permit the FTC to police the defendants' compliance with the order).

[37] 12 U.S.C. § 5561(c)(1); *Tull v. United States*, 481 U.S. 412 (1987) (courts determine the amount of civil money penalties to be imposed).

[38] *See Landgraf v. USI Film Prods.*, 511 U.S. 244, 245 (1994) (as a general principle, "a court must apply the law in effect at the time it renders its decision.").

[39] 12 U.S.C. § 5565(c)(2).

[40] *Id.* at (c)(2)(A).

[41] *Id.* at (c)(2)(B).

[42] *Id.* at (c)(2)(C).

2014, the last date for which Defendants have provided data, at least 53,518 consumers have paid upfront fees prior to the settlement of any debt. UF 131. Defendants' violations of the TSR and the CFPA for deceptive statements in advertisements took place from prior to July 21, 2011 through at least April 11, 2014. UF 397. During that time period, at least 27,406 consumers enrolled in a Morgan Drexen program in response to these deceptive advertisements. UF 397.

Defendants' ongoing unlawful conduct is at a minimum reckless.[43] Black's Law Dictionary defines recklessness as "[c]onduct whereby the actor does not desire harmful consequences but . . . foresees the possibility and consciously takes the risk."[44] Defendants knew or should have known that they could not evade the TSR's ban on charging advance fees for debt settlement services with pretextual bankruptcy services. Defendants also knew or should have known that their advertisements for debt settlement were deceptive because: (1) consumers were, in fact, charged upfront fees for debt settlement services; and (2) Defendants' data showed that consumers did not become debt free in months.

The CFPA sets forth mitigating factors that the Court should consider when determining the amount of penalties to impose.[45] None of these factors weighs significantly in reducing the amount of the civil money penalties: Defendants have not acted in good faith, and to this day they continue to charge unlawful advance fees for debt settlement services; the gravity of Defendants' conduct and risks to consumers are severe, as Defendants prey upon the most financially vulnerable consumers who can least afford the thousands of dollars in up-front fees Defendants extract; and Ledda is a recidivist—in 2005, he entered into a settlement agreement with the FTC that required him to pay $1,356,000 and enjoined him from abusive telemarketing practices and making misrepresentations in connection

[43] Even if the Court does not find Defendants' violations to be reckless, they are still subject to up to a $5,000 per violation first tier penalty.
[44] Black's Law Dictionary 1053 (Bryan A. Garner ed., 8th ed. Abr. 2005).
[45] 12 U.S.C. § 5565(c)(3).

with the advertising, promotion, or sale of any good or service. UF 438.

Because of Defendants lengthy, ongoing, and reckless violations of Federal consumer financial laws, as well as the continued harm to consumers and the absence of any mitigating factors, the Bureau requests that the Court impose significant civil money penalties against Defendants.

IV. CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that the Court enter a permanent injunction banning Defendants from all telemarketing and debt relief services; enjoin Defendants from making material representations; award equitable monetary relief; and impose civil money penalties.

Respectfully submitted,
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