UNITED STATES DISTRICT COURT
DISTRICT OF KANSAS

FEDERAL TRADE COMMISSION,
STATE OF KANSAS,
STATE OF MINNESOTA, and
STATE OF NORTH CAROLINA,

Plaintiffs,

v.

AFFILIATE STRATEGIES, INC., et al.

Defendants.

Case No. 5:09-CV-04104-JAR-KGS

PLAINTIFFS' RESPONSE TO DEFENDANTS' OPPOSITION TO APPLICATION FOR PRELIMINARY INJUNCTION

I. INTRODUCTION

Plaintiffs, both in their initial Memorandum in Support of Temporary Restraining Order, and their Supplemental Memorandum in Support of Preliminary Injunction, have made out a strong and compelling case, supported by a plethora of credible evidence, for the imposition of a Preliminary Injunction in this matter. Plaintiffs' case is bolstered by the Court-appointed Receiver, whose Preliminary Report concluded, *inter alia*, that the corporate Defendants were insolvent and required significant cash in-flows from new consumer victims to meet their current obligations, and that individual Defendant Blackman received significant distributions from the corporate Defendants. Defendants, in their Joint Supplemental Memorandum in Opposition to Plaintiffs' Application for Preliminary Injunction ("Defendants' Supplemental Memorandum") fail, for the third time, to identify any consumer who received a grant using their services, and do not address the allegation of Plaintiffs' Complaint - that Defendants guaranteed to consumers that they would obtain a grant from the U.S. Government; that Defendants had a reasonable basis for representing they had a 70% success rate in obtaining grant funding; and that consumers who

purchased Defendants' goods and services were likely to receive grant monies. In this response, we will not re-present facts and arguments previously made, but will rebut Defendants' misstatements of the facts and the law in their Supplemental Memorandum**.**

II. STANDARD OF RELIEF

Defendants seek to re-argue the standard for granting a preliminary injunction pursuant to section 13(b) of the Federal Trade Commission Act, citing again the same case, *Schrier v. University of Colorado*, 427 F. 3d 1253 (10th Cir. 2005), they cited in their initial Opposition to Plaintiffs' Motion for Temporary Restraining Order. In Plaintiff's Supplemental Memorandum in Support Of Preliminary Injunction, at pp. 8-9, we discussed and distinguished this line of cases, and will not spend the Court's time reiterating that discussion.[1] As we noted there, the grant or denial of a request for preliminary injunction under Section 13(b) of the FTC Act entails a two-part analysis, employing a public interest test.

III. LIKELIHOOD OF SUCCESS

It is settled that in determining whether to grant a preliminary injunction under section 13(b), a district court must (1) determine the likelihood that the FTC will ultimately succeed on the merits and (2) balance the equities. *See FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1028-29 (7th Cir. 1988); *FTC v. Skybiz.com Inc.*, 2001 U.S. Dist. LEXIS 26175 (N.D. Okla. 2001).

Defendants argue that Plaintiffs are not likely to succeed on the merits of this action because they have not justified a finding of *unfairness*, citing to the FTC's 1984 Statement on

[1] In fact, Defendants initially agreed that the public interest standard applied by this Court in ordering the Temporary Restraining Order was the standard for granting preliminary injunctions. *See* Defendants' Opposition to TRO at n.3.

Unfairness. However, Plaintiffs' complaint is NOT grounded in unfairness. Rather, it is clear, (and Defendants so recognized in their initial Opposition at p. 7), that Plaintiff's complaint alleges deception and deceptive telemarketing practices in violation of Section 5(a) of the FTC Act, the Telemarketing Act, and the Consumer Protection and Deceptive Trade Practices Acts of the States of Kansas, Minnesota, and North Carolina. Thus, the Court should reject the Defendants' unfairness arguments at pp. 25-26 of their Supplemental Memorandum.

Defendants' claims concerning their grant-related goods and services are express claims. Defendants told consumers that they were "guaranteed a $25,000 grant from the U.S. Government," and falsely claimed to have a "70% success rate." These claims were both express, and material to a consumer's decision to purchase Defendants' goods and services. As more fully discussed in our initial Memorandum, Defendants' misrepresentations of their success rate (including the assurance of success inherent in their guarantee) are highly material and likely to mislead consumers. *See e.g., Kraft, Inc. v. FTC,* 970 F.2d 311, 322 (7th Cir. 1992). Moreover, it is reasonable for consumers to rely on express claims made by Defendants. *FTC v. Five-Star Auto Club,* 97 F. Supp 2d. 502, 528 (S.D.N.Y. 2000). Thus, Defendants' attack on the consumers who fell prey to their express, deceptive statements must fail. The thousands of consumers who paid millions of dollars to the Defendants were not, as Defendants state at p. 30 of their Supplemental Memorandum, "an insignificant and unrepresentative segment of the class of persons" who "unreasonably misunderstood" Defendants' express representations. Rather, these consumers reasonably relied on Defendants' success rate and guarantee claims to their detriment.[2] As one Court has observed, " the 'cardinal factor' in determining whether an act or

[2] Defendants claim, at p. 35 of their Supplemental Memorandum, that consumers did not (continued...)

practice is deceptive under § 5 is the likely effect the promoter's handiwork will have on the mind of the ordinary consumer." *FTC v. Freecom Communications, Inc.,* 401 F. 32 1192, 1202 (10th Cir. 2005). A further example of evidence of Defendants' deceptive conduct can be seen in the letter a consumer sent to the Defendants requesting a refund, as the grants he was applying for were non-existent. *See* Ex. D to Declaration of Larry E. Cook.

In addition, the net impression of Defendants' post cards and the representations in their sales scripts strongly suggested to consumers that Defendants would likely help them secure grant funding if the consumer purchased their services. Moreover, where necessary, a Court can interpret the meaning of Defendants' advertisements, and statements in their sales pitches, considering the overall net impression. *FTC v. US Sales Corporation*, 785 F. Supp. 737, 745 (N.D.Ill. 1992); *FTC v. Gill*, 71 F. Supp.2d 1030, 1043 (C.D.Ca. 1999).

Defendants have come forward with no evidence that 1) even one consumer received a grant; 2) they did not guarantee consumers government grants; or 3) they can substantiate their 70% success rate claim. Therefore, Plaintiffs will succeed on the merits of this action.[3]

---

[2](...continued)
purchase their goods and services based solely on postcards mailed to them, but that additional information was conveyed via telephone. In fact, this information was misleading and deceptive information contained in sales scripts used by Defendants' telemarketers. *See e.g.,* Exhibits 9-11 to Plaintiff's Supplemental Memorandum.

[3] Defendants suggest, at p. 36 of their Supplemental Memorandum, that they have a First Amendment right to disseminate marketing materials under established commercial speech jurisprudence. This argument fails. Defendants fail to acknowledge that the determination of whether commercial speech concerns unlawful activity or is misleading is the threshold test for determining whether it is protected by the First Amendment. Only if commercial speech is <u>not</u> misleading or does not concern unlawful activity must the government demonstrate under an intermediate level of scrutiny that the regulation of that speech supports a substantial government interest, that the restriction directly, materially advances that interest, and that the regulation is narrowly drawn. *Florida Bar v. Went For It, Inc.*, 515 U.S. at 623-34.

IV. BALANCE OF EQUITIES

Defendants take the position that the TRO entered by this Court, after opportunity for briefing by the Defendants and an extended oral argument, has done more harm than good, on the theory that consumers will not receive the products and services they have paid for. However, but for the law violations Defendants engaged in for over eighteen months, consumers would never have sent money to Defendants in the first instance. In addition, as discussed in Plaintiffs' Supplemental Memorandum, evidence discovered on the Defendants' business premises showed nascent marketing campaigns involving everything from government grants to work at home schemes. The public's interest in halting law violations and preserving assets for injured consumers is high. The Defendants' interest in breaking the law must, in the eyes of the law, be low. Thus, in balancing the equities, "district courts should consider the altered status quo in light of how it balances the harms between the parties and the public interest...." *O Centro Espirita v. Ashcroft*, 389 F. 3d 973, 1002 (10th Cir. 2004). The equities tip heavily in favor of the Plaintiffs.

Defendants also suggest that they complied and cooperated with state Attorneys General's Offices, and thus the Plaintiffs' failure to act sooner somehow prohibits seeking a preliminary injunction. Nothing could be farther from reality. Both the States of Kansas and Minnesota put Defendants on notice of their investigations, as early as November 2008. *See* Ex. 2. Defendants engaged in obfuscatory conduct in their discussions with the State Plaintiffs, purporting to negotiate with the States of Kansas and Minnesota. *See* Ex.1. Because of this, the Kansas Attorney General communicated his desire to commence litigation as early as February

of this year.[4] It appears that these Defendants would not stop their deceptive practices absent a court order to do so.

Lastly, Defendants allude to payment of refunds and suggest that evidence of refunds shows that the Defendants did not violate the law. This argument should be given no weight. *FTC v. Wilcox*, 926 F. Supp. 1091, 1100 (S.D.Fla. 1995) ("Whatever care defendants may have shown to soothe some complaining consumers ... does not undo the deception by which the payment was obtained in the first place."). *See also FTC v. Pantron I Corp.*, 33 F.3d 1088, 1103 (9th Cir. 1994) (holding that "the existence of a money-back guarantee is insufficient reason as a matter of law to preclude a monetary remedy"); *FTC v. Think Achievement Corp.*, 312 F.3d 259, 261 (7th Cir. 2002) (holding that an advertisement containing a money-back guarantee could still be fraudulent); *FTC v. SlimAmerica*, Inc., 77 F. Supp. 2d 1263, 1272-73 (S.D. Fla. 1999) ("The existence of a money-back guarantee, such as the one for Super-Formula in this case, is neither a cure for deception nor a remedy for consumer injury.").

V. ASSET FREEZE

In our Supplemental Memorandum, the Plaintiffs requested that the Court freeze the individual Defendants' assets. We submitted substantial evidence that shows that Defendants Blackman, Sevy and Rulsion had actual knowledge of deceptive acts and practices, were recklessly indifferent to the truth or falsity of the representations, and/or intentionally avoided

[4] If Defendants are suggesting that Plaintiffs have "unclean hands" in seeking to enforce the law, this argument fails. Courts have held that the equitable doctrine of unclean hands is inapplicable in a suit brought by a governmental agency on behalf of the public interest, the only exception being "if the agency's conduct is egregious and the resulting prejudice to the defendants rises to a constitutional level." *See e.g., FTC v. Image Sales and Consultants*, 1997 U.S. Dist. LEXIS 18942, *7 (N.D.Ind. 1997).

the truth about the fraudulent nature of their operation, under the *FTC v. Amy Travel Service, Inc.*, 875 F.2d 564, 574 (7th Cir. 1989) standard that Defendants do not dispute. We will not reiterate the evidence in our Supplemental Memorandum that showed, among other things, that Defendant Blackman received over $1.37 million in 2008-09; Defendant Sevy received over $200,000 in 2008-09; and Defendant Rulison received over $35,000 in 2009.

Defendants' Supplemental Memorandum goes to great lengths to show that the individual Defendants somehow did not know that the corporations they controlled were engaged in deceptive conduct. Evidence found on the Defendants' business premises, however, reveals exactly the opposite. As an initial matter, a late 2008 "Blackman Entity Ownership Structure" located on the business premises identifies Defendant Blackman as a shareholder, Officer, Director, or Manager no less than 20 times; likewise Defendants Sevy and Rulison are each identified at least 10 times in similar management roles. Ex. 3.[5]

With respect to Defendants' misrepresentations, Defendant Blackman himself ordered the type of language he wanted to use on Defendants' deceptive mailings:

> We Have Won 160 Million Dollars in Free Grant Money for Individuals Just like You
>
> Now all of Our Secrets have been Revealed in "The Professional Grant Writer"
>
> The US Government has Billions of dollars that it must give away every year. "The Professional Grant Writer" gives you everything you need to find the grant money you need and after you find it how to get your share GUARANTEED."

Ex. 5. As a recipient of this communication, Defendant Sevy was also well aware of, or should have known of, the corporate Defendants' misrepresentations. Evidence also reveals that

[5] A "Blackman Entity Ownership Structure" dated July 13, 2009 and produced at the asset deposition of Defendant Blackman, list each of the Individual Defendants as members and managers of various entities. Ex. 4.

Defendant Blackman was routinely involved in Defendants' telemarketing and grant writing operations. Ex. 6 (email transmitting telemarketing scripts); Ex. 7 (email about grant writing and hiring grant writers). Moreover, both Defendants Blackman and Sevy knew that certain grant providers identified in their research services probably did not actually exist. Ex. 8 (emails about Warburg Foundation).

Finally, Defendants were well aware of complaints against Defendants and long-standing allegations of fraudulent conduct. Indeed, as early as 2007, Defendants received a letter from the State of Oregon stating:

> "Your offer appears to be intended to mislead the recipient by making a guaranty that we know is too good to be true unless you intend to impose additional conditions which you are not disclosing to the consumer. Further, an unsophisticated consumer could easily infer from this mailing that the government's guaranteeing a $25,000 grant since there is no other entity mentioned to identify the source of the postcard."

Ex. 9 (email and Oct. 25, 2007, letter from the State of Oregon). The Individual Defendants received a myriad of other complaints about their practices, including one from the Chamber of Commerce in their hometown of Paola. Ex. 10 (email transmitting complaint from the Paola Chamber of Commerce); Ex. 11 (emails discussing concerns about garnering BBB complaints, contracted employee's concerns about fraud, and fraud investigation by the United States Postal Service). In addition, Defendants received numerous complaints from consumers. Ex. 12 (emails transmitting consumer complaints). As clearly stated in *Amy Travel*, "one may not enjoy the benefits of fraudulent activity and then insulate one's self from liability by contending that one did not participate directly in the fraudulent practices." *Id.*

Finally, Defendants do not dispute that all of their assets were derived from the fraudulent conduct at issue here, but claim that an asset freeze will have a devastating effect on their personal lives. However, evidence recently discovered by the Receiver shows that in 2009 alone, Defendant ASI paid personal expenses for cleaning services, landscaping services, and moving services. Plaintiffs believe, based on interviews with former employees, that these expenses were paid on behalf of Brett Blackman, and categorized as "executive expenses." *See* Ex. A to Declaration of Larry E. Cook.[6]

VI. THE RECEIVERSHIP SHOULD CONTINUE

Defendants do not contest the continuation of the Receivership, and the Receiver's Interim Report, as well as the Defendants own arguments at pp. 30-32 of their Supplemental Memorandum, makes it abundantly clear that the corporate Defendants' businesses were a common enterprise.[7] To allow the Defendants to regain their businesses and control over the scant corporate assets now being held by the Receiver would create an unreasonable risk that effective relief would be frustrated. *See FTC v. Skybiz.com Inc.*, 2001 U.S. Dist. LEXIS 26175 (N.D. Okla. 2001).[8]

---

[6] Defendants propose, and the Plaintiffs would not object to, a personal asset freeze that allows the individual Defendants to expend a reasonable amount per month for ordinary and necessary living expenses, subject to approval by the Court. However, given that restitution may be appropriate at the conclusion of this matter, the Court has a duty to ensure that restitution will be possible. *FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1031 (7th Cir. 1988).

[7] It appears that even the Defendants' bank was confused about the inter-relationship of Defendants' businesses, charging Defendant LPG's bank account for associated company Noobing's refunds. *See* Ex. B to Declaration of Larry E. Cook. Noobing also charged a consumer's account without authorization. *See* Ex. C to Declaration of Larry E. Cook.

[8] Defendants claim that counsel for Plaintiff FTC denied Defendants' counsel access to the business premises. In fact, Defendants' counsel, Travis Salmon, was in the offices of

(continued...)

VII. CONCLUSION

For the reasons set forth above and in the Plaintiffs' TRO Memorandum, Plaintiffs request that the Court issue the requested Preliminary Injunction and appoint a permanent Receiver.

Respectfully submitted,

LANNY D. WELCH
United States Attorney

s/ D. Brad Bailey
D. BRAD BAILEYAssistant United States Attorney
Ks. S.Ct. No. 11345
Federal Building, Suite 290
444 SE Quincy Street
Topeka, KS 66683-3592
Telephone: (785) 295-2850
Facsimile: (785) 295-2853
E-mail: Brad.Bailey@usdoj.gov
Local Counsel

s/ Meghan E. Barnds
MEGHAN E. BARNDS
Assistant Attorney General
Office of the Kansas Attorney General
Ks. S.Ct. No. # 23685
120 SW 10th Ave., 4th Floor
Topeka, Kansas 66612
Telephone: (785) 368-8242
Facsimile: (785) 291-3699
E-mail: Meghan.Barnds@ksag.org
Attorney for Plaintiff State of Kansas

s/ Carmen Christopher
CARMEN CHRISTOPHER
STEPHEN GURWITZ
GARY L. IVENS
Federal Trade Commission
600 Pennsylvania Ave., N.W., Rm. 286
Washington, DC 20580
Telephone: (202) 326-3643 (Christopher)
Telephone: (202) 326-3272 (Gurwitz)
Telephone: (202) 326-2330 (Ivens)
Facsimile: (202) 326-3395
E-mail: cchristopher@ftc.gov
E-mail: sgurwitz@ftc.gov
E-mail: givens@ftc.gov
Attorneys for Plaintiff FTC

[8](...continued)
Defendant ASI, and never asked to inspect the premises or documents of the Defendants. *See* Declaration of Stephen Gurwitz.

s/ Barbara Shaw
BARBARA SHAW
Assistant Attorney General
N.C. Department of Justice
P.O. Box 629
Raleigh, NC 27602
Telephone: (919) 716-6030
Facsimile: (919) 716-6050
E-mail: Bshaw@ncdoj.gov
Attorney for Plaintiff State of North Carolina

s/ Shannon M. Harmon
SHANNON M. HARMON
Assistant Attorney General, Charities Division
Office of the Minnesota Attorney General
1200 Bremer Tower
445 Minnesota Street
St. Paul, MN 55101-2130
Telephone: (651) 296-3854
Facsimile: (651) 296-7438
E-mail: shannon.harmon@state.mn.us
Attorney for Plaintiff State of Minnesota