UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

FEDERAL TRADE COMMISSION, Plaintiff, v. **THE DEBT ADVOCACY CENTER, LLC,** a Delaware limited liability company, **SMITH, GROMANN & DAVIDSON, P.A.,** **EDWARD J. DAVIDSON,** individually and as Chief Executive Officer of The Debt Advocacy Center, LLC and as an owner of Smith, Gromann & Davidson, P.A., **JOHN W. SMITH,** individually and as an owner of Smith, Gromann & Davidson, P.A., **GLEN E. GROMANN,** individually and as an owner of Smith, Gromann & Davidson, P.A., and **KEVIN MCCORMICK,** individually, Defendants.	**Case No.** **Judge** **Magistrate**

PLAINTIFF'S MEMORANDUM IN SUPPORT OF ITS MOTION FOR TEMPORARY RESTRAINING ORDER WITH ASSET FREEZE AND OTHER EQUITABLE RELIEF AND ORDER TO SHOW CAUSE WHY A PRELIMINARY INJUNCTION SHOULD NOT ISSUE

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

LEGISLATIVE HISTORY

I. INTRODUCTION

Defendants callously take advantage of consumers who are behind on their mortgage payments and facing foreclosure. Defendants attract their victims by misrepresenting their success rate in helping consumers obtain mortgage loan modifications. Defendants promise to obtain mortgage loan modifications and save consumers from foreclosure, typically charging their financially distressed clients fees of $2,000 and more at a time when they have little or no money to spare. Some or all of the money must be paid up front. Defendants' program, however, is often nothing more than a dead end for consumers in financial distress. After taking their clients' money, Defendants do little to help. Many consumers are able to save their homes only through their own efforts. Adding insult to injury, after having failed to deliver on their promise of foreclosure relief, Defendants then fail to honor their refund policy. Defendants' egregious conduct violates Section 5 of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45. This action against Defendants is part of an ongoing coordinated law enforcement effort to stop the expansion of these pernicious home-rescue scams.

To put an immediate stop to Defendants' illegal activities and preserve assets for redress, Plaintiff Federal Trade Commission ("FTC") seeks, under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), issuance of a temporary restraining order ("TRO") with an order to show cause why a preliminary injunction should not issue. The proposed TRO would enjoin Defendants' illegal practices, freeze their individual assets, appoint a receiver over the Defendants' businesses, preserve documents, require Defendants to report promptly certain information regarding their business practices and allow the FTC expedited discovery. These measures are necessary to prevent continued consumer injury, dissipation of assets, and destruction of

evidence, thereby preserving this Court's ability to provide effective final relief to Defendants' victims.

II. THE PARTIES

A. Plaintiff

The FTC is an independent agency of the United States government created by the FTC Act, 15 U.S.C. § 41 *et seq.* The FTC enforces Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), which prohibits unfair or deceptive acts or practices in or affecting commerce. Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), authorizes the FTC, through its own attorneys, to initiate federal district court proceedings to enjoin violations of the FTC Act and secure appropriate equitable relief, including rescission of contracts and restitution, the refund of monies paid, and the disgorgement of ill-gotten gains.

B. Defendants

Defendant The Debt Advocacy Center LLC **(DAC),** is a Delaware limited liability company with offices at 614 Superior Avenue, Suite 815, Cleveland, Ohio. (PX 10 at 6; PX 11 at 8) The company also operates a telephone sales boiler-room at 14000 Military Trail, Suite 200, Delray Beach, Florida. (PX 19 at 4) In addition to its offices, the company also is the owner of the following websites:

thedebtadvocacycenter.com

debtadvocacycenter.com

theconsumeradvocacycenter.com

the consumeradvocacycenter.net

sgandd.com

smithgromanndavidson.com

(PX 19 at 3-13)

Defendant **Smith, Gromann & Davidson, P.A. (SG&D),** purports to be "An Interstate Partnership of Professional Associations." (PX 4 at 18) On information and belief, SG&D has no formal legal status in any state. Its principal place of business is located at 614 Superior Avenue, Suite 815, Cleveland, Ohio. (PX 4 at 18) It also uses 14000 Military Trail, Suite 200, Delray Beach, Florida. (PX 4 at 17) Upon information and belief, SG&D also operates at 2201 Corporate Boulevard, Suite 200, Boca Raton, Florida, and at 1095 N.W. Broken Sound Parkway, Suites 200 and 201, Boca Raton, Florida.

Defendant **Edward J. Davidson** is the CEO of DAC (PX 11 at 4) and he is also the managing partner and CEO of SG&D. (PX 4 at 18) Davidson is also an attorney admitted to practice in Illinois. (PX 11 at 4) He personally supervises DAC's daily operations. (PX 23 at 1) Davidson has previously signed and agreed on behalf of DAC to a Cease and Desist Order brought by the Consumer Protection Section of the Colorado Attorney General's office. (PX 18)[1]

Defendant **John W. Smith** is a licensed Florida attorney and partner in SG&D. (PX 4 at 30)

Defendant **Glen E. Gromann** is a licensed New Jersey attorney and a partner in SG&D. (PX 4 at 30)

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[1] Specifically, it was alleged that DAC had violated the "Colorado Foreclosure Protection Act" §§ 6-1-1101-1120, C.R.S. (2007). The Act forbids foreclosure consultants from accepting any compensation from homeowners until services have been fully performed. DAC agreed to the provisions of the Order in July 2008.

Defendant **Kevin McCormick** is a resident of Florida. He is the supervisor of DAC's Florida boiler room. (PX 13 at 2-3 ¶ 9 and at 11)

III. DEFENDANTS' DECEPTIVE PRACTICES VIOLATE SECTION 5 OF THE FTC ACT

A. This Court Has Jurisdiction over the Defendants and Venue Is Proper in this District.

This Court has subject matter jurisdiction over the Commission's claims pursuant to 15 U.S.C. §§ 45(a) and 53(b), and 28 U.S.C. §§ 1331, 1337(a) and 1345. The FTC Act provides that "process may be served on any person, partnership, or corporation where it may be found." 15 U.S.C. § 53(b). In this provision, Congress authorized worldwide service of process. In the Sixth Circuit, when a federal statute authorizes nationwide (or greater) service of process, a court should determine jurisdiction by asking whether the defendant has "sufficient minimum contacts with the United States" as a whole.[2] Defendants are all United States residents that have conducted substantial business in the United States. (PX 15 at 2) Therefore this Court has jurisdiction over Defendants.

Venue is proper in the Northern District of Ohio. Under the FTC Act, an action may be brought where a corporation or person "resides or transacts business." 15 U.S.C. § 53(b).

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[2] *Med. Mutual of Ohio v. DeSoto*, 245 F.3d 561, 566 (6th Cir. 2001); *Pikas v. Williams Cos.*, 542 F. Supp. 2d 782, 784 (S.D. Ohio 2008); *Blue Cross Blue Shield v. Doctors Med. Ctr. of Modesto*, No. 1:07-CV-180, 2008 U.S. Dist. LEXIS 1191 at *19 (E.D. Tenn. Jan. 8, 2008); *Peacock v. PACE Int'l Union Pension Fund*, No. 3:06-0703, 2007 U.S. Dist. LEXIS 62471 at *25 (M.D. Tenn. Aug. 23, 2007); *Eastman Outdoors, Inc. v. Archery Trade Ass'n*, No. 05-74015, 2006 U.S. Dist LEXIS 42835 at *12 (E.D. Mich. June 6, 2006); *Wuliger v. Bock*, No. 3:04 cv 260, 2006 U.S. Dist LEXIS 2014 at *3-4 (N.D. Ohio Jan. 19, 2006). *See also, United Liberty Life Ins. Co. v. Ryan*, 985 F.2d 1320, 1330 (6th Cir. 1993); Fed. R. Civ. P. 4(k).

Defendant DAC and SG&D has maintained an active office in this district – in fact, it is located only two blocks from the courthouse. (PX 13)

B. A Misrepresentation Violates Section 5 if it is Likely to Mislead Consumers Acting Reasonably under the Circumstances about a Material Fact.

An act or practice is deceptive if: (1) there is a representation; (2) the representation is likely to mislead consumers acting reasonably under the circumstances; and (3) the representation is material.[3]

A representation may be express or implied. Liability attaches for "misleading consumers by innuendo as well as by outright false statements."[4]

A representation is likely to mislead if it is false.[5] In determining whether Defendants have engaged in deception, the Court must consider the net impression Defendants' sales presentation has on consumers.[6]

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[3] *Southwest Sunsites, Inc. v. FTC,* 785 F.2d 1431, 1436 (9th Cir. 1986); *In re Cliffdale Assocs.*, 103 F.T.C. 110, 164-65 (1984), appeal dismissed *sub nom. Koven v. FTC*, No. 84-5337 (11th Cir. 1984); *FTC v. Int'l Computer Concepts, Inc.*, 1994-2 TRADE CAS. (CCH) ¶ 70,798, at 73,402 (N.D. Ohio 1994).

[4] *Kraft, Inc.,* 114 F.T.C. 40, 121 (1991), *aff'd*, 970 F.2d 311 (7th Cir. 1992); *see also* FTC Policy Statement on Deception, appended to *Cliffdale Assocs.*, 103 F.T.C. at 175-77.

[5] *Thompson Med. Co.*, 104 F.T.C. 648, 818-19 (1984), *aff'd*, 791 F.2d 189 (D.C. Cir. 1986).

[6] *FTC v. Atlantex Assocs.*, 1987-2 TRADE CAS. (CCH) ¶ 67,788, at 59,254 (S.D. Fla. 1987), *aff'd*, 872 F.2d 966 (11th Cir. 1989); *Beneficial Corp. v. FTC*, 542 F.2d 611, 617 (3d Cir. 1976).

Consumer reliance upon express claims is presumptively reasonable.[7] In addition, consumers are entitled to interpret reasonably each representation as meaning precisely what it purports to mean, and are under no obligation to doubt the veracity of a claim.[8]

Express claims are presumed to be material.[9] If consumers are likely to have chosen differently but for the deception, then a misrepresentation is material.[10]

C. Conduct is Unfair and Violates Section 5 If: (1) It Causes Substantial Injury; (2) It Is Not Outweighed by Any Countervailing Benefits to Consumers or Competition; and (3) Consumers Could Not Have Reasonably Avoided It.

Section 5(a) of the FTC Act also prohibits unfair acts or practices in or affecting commerce. 15 U.S.C. § 45(a). For an act or practice to be "unfair" it must satisfy a three prong test: (1) it must cause substantial consumer injury; (2) it must be injury that consumers themselves could not reasonably have avoided; and (3) it must not be outweighed by countervailing benefits to consumers or competition. 15 U.S.C. § 45(n).[11] Like its counterpart standard for deception, the unfairness test does not require the court to take into account the

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[7] *FTC v. Int'l Computer Concepts,* 1994-2 TRADE CAS. (CCH) at 73,402.

[8] *Atlantex Assocs.,* 1987-2 TRADE CASES (CCH) at 59,254; *Thompson Med. Co.*, 104 F.T.C. at 788 and n.6, 792.

[9] *Thompson Med. Co.*, 104 F.T.C. at 816; *Int'l Computer Concepts*, 1994-2 TRADE CAS. (CCH) at 73,402.

[10] *Southwest Sunsites, Inc.,* 105 F.T.C. 7, 149 (1985), *aff'd,* 785 F.2d 1431 (9th Cir. 1986); *Cliffdale Assocs.,* 103 F.T.C. at 165; *Int'l Computer Concepts*, 1994-2 TRADE CAS. (CCH) at 73,402.

[11] *See also Orkin Exterminating Co., Inc. v. FTC*, 849 F.2d 1354, 1364 (11th Cir. 1988) (citing FTC's 1980 Policy Statement); *FTC v. J.K. Publ'ns*, 99 F. Supp. 2d 1176, 1201 (C.D. Cal. 2000); *FTC v. Windward Mktg., Ltd.*, No. 1:96-CV-615, 41997 U.S. Dist. LEXIS 17114, at *29-30 (N.D. Ga. Sept. 30, 1997).

mental state of the party accused of a Section 5 violation. A practice may be found unfair to consumers without a showing that the offending party intended to cause consumer injury.[12]

IV. BACKGROUND ON THE MORTGAGE FORECLOSURE CRISIS

Over the past two years, the nation's housing and mortgage markets have suffered an unprecedented downturn. Home sales, housing starts, and home prices have all fallen dramatically. Many of the nation's housing markets are currently experiencing substantial price declines. As a result, many homeowners are now "underwater" - i.e., their house is worth less than the amount owed on their mortgage. At the same time, residential mortgage loan defaults and foreclosures are surging.

"The process of assisting a client facing foreclosure can be time-consuming and complicated." (PX 20 at ¶17) It requires a detailed initial assessment in order to determine whether it is feasible to obtain a loan modification for the client. (PX 20 at ¶¶ 17-19) The fact that many home loans are owned through securitization by an entity other than the servicer complicates matters. The actual owner may not allow any modifications at all or may limit the modifications that can be made. (PX 20 at ¶ 25; PX 21 at ¶¶ 8-15) Securitization of residential first lien mortgages occurs in about 70-75% of all first lien mortgages. (PX 21 at ¶ 7) As of September 2009, only 10% of securitized loans have received loan modifications. (PX 21 at ¶ 7)

Finally, some clients simply do not have the income necessary to support a modification. (PX 20 at ¶¶ 18, 21)

Defendants promise consumers they can modify existing mortgages and save consumers' homes. The problem of "loan modification consultants" who make promises they cannot keep has grown substantially during 2009. (PX 20 at ¶ 27) Some of these collect substantial fees for

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[12] *Orkin*, 849 F.2d at 1368.

doing no work or minimal work. (PX 20 at ¶ 28) Loan modification consultants who collect money up front have little incentive to engage in the difficult and protracted effort necessary to actually obtain a loan modification. (*Id.* at ¶ 29) They also have little incentive to screen out borrowers who cannot afford to keep their homes because of insufficient income. People in this situation are particularly vulnerable to the promises of a fix because they are desperate. (*Id.* at ¶ 30)

The consequences can be devastating for consumers who are caught in a foreclosure rescue scam. "People who are already in extreme financial distress are forced deeper into debt. People who cannot afford to keep their homes are being bilked out of money they need to relocate. People who do have a chance of keeping their home are being steered away from legitimate, free homeowner counseling services or are failing to take any action before it is too late, because they have been assured everything is being taken care of for them already." (*Id.* at ¶ 31)

V. DEFENDANTS' DECEPTIVE BUSINESS PRACTICES

Defendants advertise their loan modification services via the Internet and television. Defendants lure their consumer victims to pay for their services by making material misrepresentations to consumers on their websites, during sales calls, and in the documents they send to consumers. In addition to unsubstantiated claims of their success rate in securing mortgage loan modifications, they make false promises of refunds and money back guarantees, and unfairly debit consumer accounts.

The websites of DAC and SG&D are nearly identical in structure, content and images. The websites ask consumers if they would like a "free foreclosure evaluation." (PX 22 at

¶¶ 7-22) Defendants' websites guarantee that consumers will receive at least $1600 if Defendants are unsuccessful in obtaining the promised loan modification. (PX 22 at 11-14)[13] To make their services sound even sweeter, some of DAC's sales people even promised an extra $200 in addition to the $1600. (PX 15 at 2) Their websites claim that they are successful 90% of the time in securing loan modifications for consumers. (PX 22 at 7-10)

Their claims are then buttressed by "consumer testimonials" relating what a great company they are and how they had succeeded when others had failed. Some of these comments were:

- Thank You so Much for all that you have done for me and my family and for the people that you continue to help. . . I know that if wasn't for you and your company we would have been in a real pickle. . . Again, thank you soooo much and if I know of anyone who got into the same problems that we got into I would be the first to recommend you! (PX 22 at 2)[14]

- I just wanted to take a moment to thank all of you. In particular J.G! It's always nice to know when your *[sic]* down to your last chance to hold onto your house and your *[sic]* kicking and screaming their *[sic]* is a person out their *[sic]* that cares as much as me and my wife do on holding onto it.[15] (PX 22 at 5)

- With a 90% success rate, we're constantly receiving testimonial letters. . . With the new payment, including escrow, **we will be saving over $350 a month!** (emphasis in original). This is great news on top of being in a fixed term, all of

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[13] Defendant DAC also provided a written guarantee stating that at least $1600 would be returned to the consumer if DAC failed to stop a foreclosure or obtain a loan modification reducing the monthly payment and the arrears "to an amount the customer feels is acceptable." (PX 14 at 12 (Defendant Davidson's printed signature exemplar appears on this document))

[14] The same letter appears on both SG&D's and DAC's websites. (PX 22 at 1)

[15] The letter shown here as it appears on SG&D's website bears a date almost five months before SG&D came into existence. Again, it is a duplicate of one which also appeared on the website of DAC. (PX 22 at 6)

the delinquencies erased, and a lower interest rate! We now have peace of mind knowing that we can keep our home! (PX 22 at 7)[16]

Many consumers were initially contacted by Defendants' salespeople, mostly by telephone and sometimes by email. Defendants' salespeople misrepresented Defendants' ability to help solve the dire situations faced by these consumers. The salespeople did everything to convince consumers that they had come to the right company. The following are representations illustrative of the claims made by Defendants' salespeople or claims which they sent to consumers:

- For a fee of $1300 Magali Achille was told she would get a loan modification. (PX 10 at 1, 61)[17]
- For a fee of $2600 DAC assured Candy L. Dihel that she would get a loan modification with her debts consolidated and lower monthly mortgage payments. (PX 11 at 1) She was told the company had a very high success rate and they consulted attorneys.[18]

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[16] The identical letter appears on the website of SG&D. (PX 22 at 9)

[17] Magali Achile agreed to purchase the Defendants' services in December 2008. DAC made an unauthorized charge to her bank account causing her to pay $210 in overdraft fees. For her fee of $1300 DAC sent her a packet of "educational" materials about the foreclosure process and instructions on disputing information on her credit report and a fill-in-the-blanks sample complaint for contesting a foreclosure action. (PX 10 at 6-60) They advised her to stop making payments on her mortgage - which she did. They told her not to worry about her lender sending a foreclosure notice dated March 17, 2009. On April 3, 2009, DAC told her to fill out the fill-in-the-blanks Answer to Complaint for Foreclosure included in her "educational" materials. She asked DAC for her money back because they failed to obtain a loan modification as guaranteed. She was refused. She filed a Chapter 13 bankruptcy and only then was able to save her home from foreclosure. (*Id.* at 1-5)

[18] Mrs. Dihel signed the contract and the same day DAC deducted $1300 from her bank account as a first payment. The next day she and her husband decided they did not want the service and unsuccessfully tried to stop the payment. She called and told Defendant Kevin McCormick that they did not want DAC's service and asked for their money back. He refused, saying it was too late. (PX 11 at 2) For her fee of $1300 she was sent a do-it-yourself complaint form accompanied by a letter from DAC stating that "[s]ome of my other clients have typed up

(continued...)

- Angela Cohill was told by DAC that for $3000 she would be guaranteed a "favorable outcome" and they would be able to save her house in less time than if she paid them a lesser amount. (PX 12 at 3) The salesman said that at that level of payment she would have "more staff" and a "more seasoned" person. This made her feel very confident that DAC would help save her home from foreclosure. (*Id.* at 3)[19]

- Katherine Hart filled out the form on DAC's website and was called by their salesman. He told her that the company had a 99% success rate in securing loan modifications. The operations manager told her the same thing. DAC also told her that if they failed to get her a loan modification they would give all of her money back plus a penalty payment of $200.[20] (PX 14 at 4) DAC's paperwork said that they could not help her if she had a second mortgage. She told them she had one. The salesman assured her that they could still could help her. (PX 14 at 2)

- Ronda Littleton-Johnson was facing foreclosure when she found DAC's website claiming a 90% success rate – which she understood pertained to stopping foreclosures. (PX 16 p. 1) After she filled out the online form to see if she qualified for assistance, DAC called and said they could assist her. (*Id.*) The salesperson never asked for her monthly income, living expenses, or the appraised

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[18](...continued)
letters to the judge, asking for him to delay a ruling . . ." (PX 11 at 1-3, 11) Unfortunately, while she was trying to have their money refunded, her husband died. Even after she told Defendant McCormick her husband had died, he still refused to give her a refund. (PX 11 at 3)

[19] Ms. Cohill was electronically charged $700 on her MasterCard by DAC. One day later she was granted a loan modification upon documents she had independently sent to her lender before any contact with DAC. DAC insisted that she still owed $800 because she had agreed to purchase their "educational packet and initial underwriting." (PX 12 at 5) Even though it had no authority to do so, DAC charged another $550 to her MasterCard. (*Id.* at 7) Ms. Cohill complained to the BBB, and DAC responded by stating that Ms. Cohill owed them $1500 because she had purchased their DIY kit "which informs clients of everything they could possibly do to resolve their foreclosure issues." (*Id.* at 8)

[20] They debited $1000 from her account for her first payment. (PX 14 at 1) Her second payment of $1000 was debited about 10 days later. After several months she was contacted by her lender and told that they were foreclosing and she had to be out of the house by September 18, 2009. DAC's salesman said that he was going to complain to her lender. She lost her home. When she asked for her guaranteed refund and $200 penalty payment because DAC failed to save her home, she was told that they did not give refunds, but they would give her a refund. One month later Defendants told her they had written her the check, but as of November 4, 2009 she had not received a refund. (*Id.* at 3)

value of her home. (*Id.*) On the same call she spoke to the owner of DAC who said they had they best lawyers and that "we make sure people like you get taken care of . . . you're better off doing that than trying to do this on your own." (*Id.*) These statements led her to believe she would be paying them to take over and negotiate her loan modification. She agreed to allow them to debit their fee of $1500 from her account. (*Id.*)[21]

- Lisa Trujillo had not missed any mortgage payments when she saw a DAC television commercial in January 2009. She responded to the ad and quickly after that she received an email from DAC. She did not respond, but soon received another DAC email stating that she should work with them soon so she wouldn't lose her house. (PX 17 at 1) She returned this email with a phone call to DAC, which claimed that DAC had a 90% success rate in helping their clients and guaranteed 100% satisfaction. He also said that attorneys would be working on her case. He said that, because she had not missed any of my mortgage payments, he would have to check to see if DAC could help her. (*Id.* at 1-2) He called her back the next day and said that DAC could help to arrange a forbearance agreement with her lender. She gave them a $700 down payment to begin their services.[22]

- In March 2009, Dr. Mark Hellstern was searching the Internet for help in avoiding his imminent foreclosure. He found DAC and called them later that month. They told him that they had never "lost a house," (PX 24 at 1) and that DAC's lawyers would contact his lender. The DAC representative also told him

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[21] Even though she told DAC to wait until she put the money into her account, they attempted to debit it immediately. (PX 16 at 2) She contacted DAC about the debit and they told her they couldn't understand how this happened and assured her nothing would be debited from her account. Despite their assurance, a week later they did it again. She called DAC several times to complain, but never got a return phone call. (*Id.*) However, she was charged $150 in fees by her bank for these occurrences and had to close her account. (*Id.*)

[22] When she paid DAC this money, she had not given DAC, nor had they asked, any information about her monthly living expenses, monthly gross earnings, or even the amount of her monthly mortgage payment. (PX 17 at 2) What DAC did was tell her to stop paying Countrywide, her lender. After her first payment to DAC they sent her contracts and a payment authorization form. (*Id.* at 2, 5-11) She believed she was contracting with DAC to get a forbearance agreement with her lender. (*Id.* at 2) Two weeks after her payment to DAC she was contacted by her assigned debt negotiator and he told her to stop the next payment because Countrywide did not negotiate forbearance agreements and she should not have been accepted as a client. (*Id.* at 3) She had to close her bank account to make sure DAC could not take out any more money – this was a $30 expense. She spoke with Defendants Davidson and McCormick asking for a refund of her money. Davidson told her she had signed a contract and, therefore, owed the DAC an additional $800. She made six calls to McCormick who told her he would not refund her original $700. (*Id.*)

> to immediately stop making payments to his lender. (*Id.*) He was also told that DAC would most likely lower his interest rate to 4% or 5%. (PX 24 at 2) He said he was interested in their service and wanted to get more information in writing. DAC's representative told him they could only go further if he provided banking information and that this was only so that DAC accounting could see his good faith. (Id.) DAC said he would not be charged anything if he didn't sign and return the contract. He provided his banking information[23]

These practices convinced these desperate homeowners to pay for DAC's services. Their need for help to ensure they didn't lose their homes was assuaged by DAC's false representations about saving their homes. Some victims just lost their money while others lost their money and their homes.

An FTC investigator spoke with SG&D several times, posing as a consumer seeking their help in getting her home loan mortgage modified. These undercover calls were tape recorded and transcribed. (*See* PX 5 through PX 9) These conversations corroborate what the consumers have said. Excerpts of the conversations with DAC follow:

- "We're a national law firm that's helped over 2,000 people with real mortgage solutions. What I mean by that is when people are behind on payments, we're able to get those payments forgiven or at least put on the back of the loan . . . . But not just that, we're able to also reduce the interest rate and reduce the payment." (PX 5 at 4:25-5:6).

- "[W]e're the only law firm, to my knowledge, Lisa, that guarantees our service." (PX 5 at 5:6-8).

- "[M]y firm has dedicated teams at every major lender and servicer in the United States . . . ." (PX 5 at 5:16-18).

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[23] Meanwhile, his lender informed him that it would never restructure or modify a loan. The contract arrived and he neither signed nor sent it back to DAC. Without his knowledge or authorization DAC deducted a total of $1700 from his bank account and cost him an additional $400 in overdraft fees. His last contact with DAC was on June 17, 2009, when he spoke with Defendant McCormick. McCormick told him that he was not going to get any money back because he had a valid contact with DAC because he gave them his bank account information. (PX 24 at 2)

- "My attorneys deal with people around the CEO and general counsel level." (PX 5 at 5:23-24).

- "We have over a 97 percent success rate at achieving modifications." (PX 5 at 19:3-4).

- "The only time we're not successful obtaining what our clients need and want is for two reasons. Either, one, a client has lied to us about their current situation. . . . And then we have another handful of clients, Lisa, who make the decision to let my law firm help them . . . and then they never send in that paperwork. That happens 2 to 3 percent of the time. The other 97 percent of the time, clients are ecstatic with what our law firm achieves here." (PX 5 at 19:6-23)

- "[W]e've been getting modifications as low as 2 percent, 3 percent, 4 percent with Wells Fargo. . . . Can I guarantee that they'll be - get that to happen? No, I can't. You know, but I can definitely guarantee you getting 5 percent. . . . [A]nd the reality is you got a 90 - I'd say a 90 percent chance of it being even low than that." (PX 6 at 7:4-14).

- "[T]ell [your husband] our guarantee is in writing in our contract." (PX 6 at 11:24-25).

SG&D had another series of conversations with this FTC investigator (using the name "Laura Spencer"). (PX 7 through PX 9) Some typical representations follow:

- "Ed Davidson . . . is an attorney and he's a very successful attorney. He works alongside Andrew Cuomo who is currently the Attorney General of New York and the late Jack Kemp who was previously Secretary of HUD. And they - we've done well over 2,000 loan modifications in the last two years." (PX 7 at 7:18-25).

- "[O]ur approach is predatory lending. . . . [I]n every loan, there's at least five to ten violations of predatory lending, especially every loan that's happened within the last 20 to 30 years." (PX 7 at 8:1-9)

- "We don't really take on clients that we know that we can't help." (PX 7 at 10:25-11:1)

- "It would be illegal for me to tell you not to pay your mortgage, okay? But I can tell you the way it works. . . . [T]hey're not going to modify your loan unless you're behind anyway. So, sending a payment is like throwing good money after bad money right now." (PX 7 at 15:22-16:16)

- "Credit doesn't matter because our approach is predatory lending. Remember, we're going after them; we're threatening them. And we've never lost a home to foreclosure. I can tell you that. If we get you - if we get you approved, it's a

guarantee, and it will not take any more than 24 hours for me to let you know." (PX 7 at 16:24-17:4)

- "We have never lost a property to foreclosure ever." (PX 7 at 26:18)
- "We can get you an approval." (PX 8 at 6:17)
- "[O]nce we give them notice that you've retained us, then, you know, it basically jams up the foreclosure process. We've never lost a home to foreclosure." (PX 8 at 11:11-14)
- "[O]kay, we do offer you a money back guarantee." (PX 8 at 13:9-10)
- "We didn't even discuss what they were able to approve you for. A 30-year fixed, okay, at a 5 - I mean, at a 4.5. Now we guarantee the high end . . . [f]or 4.5. . . . I got an approval from underwriting right here." (PX 8 at 14:2-11)
- "[S]o it's written in our retainer agreement and it says that if we cannot get you what you agreed to up-front, then within ten days of that time, we will give you your money back. . . . 100 percent of it." (PX 8 at 15:13-18)
- "[T]hey always send me new emails of loans they just closed and they just got one where they actually had it - they dropped the interest rate to 3 percent. Successful modification dropping interest rate to 3 percent and payment savings of 265." (PX 9 at 10:2-6)

The FTC asked Lisa Sitkin, an attorney with Housing and Economic Rights Advocates who has worked with over 290 homeowners seeking help with a foreclosure or loan modification, to examine and comment upon the representations SG&D made. (PX 20) She pointed out the following:

Even though SG&D represented that their "predatory lending" approach was likely to work because "in every loan, there's at least five to ten violations of predatory lending" (PX 7 at 7:8), they never asked how old Ms. Spencer's loan was. Most Truth in Lending Act violations are covered by a three year statute of limitations. (*See* Sitkin Declaration PX 20 at ¶ 34) Second, it is simply not true that every loan will contain at least five to ten violations of predatory lending that will be sufficiently supported by documentary evidence to be used

effectively as leverage in a loan modification request. (*Id.*) Third, there is no reason to think that Defendants can make high level contact with the investor on the loan, particularly since they do not know who that is. Defendants only know that the servicer is Wells Fargo. (*Id.*)

Based on the information Ms. Spencer provided, it is unlikely that she would qualify for a 30-year fixed rate loan at an interest rate of no more than 4.5% that Defendants promised. (PX 20 ¶ 35; PX 8 at 13:2-16) Given how little Defendants know about the actual circumstance of the loan, the guarantee is a sham. (Sitkin Declaration PX 20 at ¶ 35)

The consumer Declarations and transcripts show that Defendants promised they would help homeowners – often times when the information consumers provided clearly showed they would never qualify for a loan modification. More egregiously, they sometimes promised they could help and took the consumer's money, without asking beforehand basic underwriting criteria like gross monthly income, monthly expenses, amount of monthly mortgage payment, taxes, insurance, and home value.

VI. ARGUMENT

As shown by the foregoing, Defendants make three central misrepresentations to consumers to induce them to enroll in their program. First, Defendants misrepresent to consumers that they will obtain a mortgage loan modification that will make their mortgage payments substantially more affordable. (Complaint Count I ¶¶ 27-29) Second, Defendants misrepresent to consumers that they have a success rate of at least 90% in securing loan modifications for consumers. (Complaint Count II ¶¶ 30-32) Third, Defendants misrepresent to consumers that they will grant a refund if they fail to arrange a loan modification or other foreclosure relief for a consumer. (Complaint Count III ¶¶ 33-35) Finally, it is unfair and a violation of Section 5 of the FTC Act when Defendants withdraw funds from consumers' bank

accounts or charge consumers' credit cards without first obtaining the consumers' agreement to purchase and pay for Defendants' services. (Complaint Count IV ¶¶ 36-39)

A. The Temporary and Preliminary Relief Requested Is Appropriate Under Section 13(b) of the FTC Act.

1. This Court Has the Authority to Grant the Relief Requested.

Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), authorizes the FTC to bring suit in federal district court when it has reason to believe that a party is violating, or is about to violate, "any provision of law" enforced by the FTC, *e.g.*, Section 5(a) of the FTC Act. The second proviso of Section 13(b),[24] under which this action is brought, provides that, "in proper cases[25] the FTC may seek, and after proper proof, the court may issue, a permanent injunction." Once the FTC has invoked the equitable power of a federal court, the full breadth of the court's authority is available, including such ancillary final relief as rescission of contracts and restitution.[26] Further, the court may grant a preliminary injunction and temporary restraining order, and whatever additional preliminary relief is necessary to preserve the possibility of final

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[24] 15 U.S.C. § 53(b). Because the FTC proceeds under the second proviso of Section 13(b), the conditions set forth in the first proviso of Section 13(b) for the issuance of preliminary injunctions in the aid of administrative proceedings do not apply to this case. *See FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1111 (9th Cir. 1982) (routine fraud cases may be brought under the second proviso, without being subject to first proviso requirement that the FTC institute an administrative proceeding); *FTC v. U.S. Oil & Gas Corp.*, 748 F.2d 1431, 1434 (11th Cir. 1984) ("Congress did not limit the court's powers under the [second and] final proviso of 13(b).").

[25] A case such as this one qualifies as a "proper case" under the second proviso of Section 13(b). Courts have consistently held that it is appropriate to invoke the remedies of Section 13(b) in cases where there is evidence of routine fraud or a straightforward deceptive practice. *FTC v. World Travel Vacation Brokers*, 861 F.2d 1020 (7th Cir. 1988).

[26] *H.N. Singer*, 668 F.2d at 1113.

effective ultimate relief.[27] Indeed, "a district court's equitable powers are even broader and more flexible when the public interest is involved."[28] These broad powers include the ability to enjoin deceptive practices, preliminarily freeze assets, and order expedited discovery.[29] Such an order can be entered *ex parte*.[30]

When amending the FTC Act in 1994, Congress reemphasized the FTC's authority to obtain *ex parte* relief: "Section 13 of the FTC Act authorizes the FTC to file suit to enjoin any violation of the FTC [Act]. The FTC can go into court *ex parte* to obtain an order freezing assets, and is also able to obtain consumer redress." S. Rep. No. 103-130, at 15-16 (1993), *reprinted in* 1994 U.S.C.C.A.N. 1776, 1790-91.

2. The FTC Meets the Applicable Legal Standard for the Issuance of a Temporary Restraining Order.

When the FTC brings suit to enforce the FTC Act, it is acting to prevent a violation of federal law and, therefore, litigates "not as an ordinary citizen, but as a statutory guardian safeguarding public interest in enforcing" the law.[31] Accordingly, to obtain a temporary restraining order, the FTC need only show that it is likely to succeed on the merits of its case and

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[27] *Id.* at 1111-13; *FTC v. Renaissance Fine Arts, Ltd.*, 1994-2 TRADE CAS. (CCH) ¶ 70,703, at 72,817 (N.D. Ohio 1994) (citing *FTC v. Southwest Sunsites, Inc.*, 665 F.2d 711, 718 (5th Cir. 1982)); *FTC v. Sec. Rare Coin & Bullion Corp.*, 931 F.2d 1312, 1314 (8th Cir. 1991).

[28] *United States v. Universal Mgmt. Servs.*, 191 F.3d 750, 761 (6th Cir. 1999) (quoting *Mitchell v. Robert De Mario Jewelry, Inc.*, 361 U.S. 288, 291 (1960)).

[29] *See, e.g.*, *Renaissance Fine Arts*, 1994-2 TRADE CAS. (CCH) at 72,817; *FTC v. Gem Merch. Corp.*, 87 F.3d 466, 469 (11th Cir. 1996); *H.N. Singer*, 668 F.2d at 1113-14.

[30] *See* Affidavit of Plaintiff's Counsel, ¶ 14; *Granny Goose Foods v. Teamsters*, 415 U.S. 423, 439 (1974); *In re Vuitton et Fils, S.A.* 606 F.2d 1, 4 (2d Cir. 1979). The most recent grant of an *ex parte* temporary restraining order in this district was *FTC v. 6253547 Canada, Inc., et al.*, No.1:09CV1211 (N.D. Ohio June 2, 2009) (Judge Gwin), attached as PX 25.

[31] *SEC v. Mgmt. Dynamics*, 515 F.2d 801, 808 (2d Cir. 1975).

that the equities favor the granting of preliminary relief.[32] Harm to the public is presumed[33] and the FTC "need not prove irreparable injury."[34]

The evidence demonstrates that Defendants have been operating a systematic and well-orchestrated fraud; thus the FTC is likely to succeed in showing violations of the FTC Act. A misrepresentation violates Section 5 of the FTC Act if it is likely to mislead consumers acting reasonably under the circumstances about a material fact. Defendants made three such misrepresentations. First, Defendants claimed they would make successful loan modifications that would lower consumers' mortgage payments in all or virtually all instances. The attached consumer Declarations clearly demonstrate this is false. Second, Defendants stated they had a 90% success rate in obtaining loan modifications for their customers. The attached expert declarations show this is clearly false. Further, homeowners were in dire situations facing the possibility of foreclosure. They were a likely catch when defendants said they had a 90% success rate, and Defendants must have known the statement was merely bait to hook new customers. Third, Defendants state that their customers are guaranteed to have their money

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[32] *See FTC v. World Wide Factors, Ltd.*, 882 F.2d 344, 346 (9th Cir. 1989) ("Pursuant to 15 U.S.C. § 53(b), the district court is required (i) to weigh equities; and (ii) to consider the FTC's likelihood of ultimate success before entering a preliminary injunction."). *See also FTC v. Solar Michigan, Inc.*, 1988-2 TRADE CAS. (CCH) ¶ 68,339, at 59,916 (E.D Mich.1988) ("There does not appear to be any doubt that the more lenient public interest test applies to preliminary injunctive relief for future statutory violations."); *SEC v. Youmans*, 729 F.2d 413, 415 (6th Cir. 1984) ("the standards of the public interest not the requirements of private litigation measure the propriety and the need for injunctive relief"); *FTC v. Bass Bros. Enters., Inc.*, 1984-1 TRADE CAS. (CCH) ¶ 66,041, at 68,619 (N.D. Ohio 1984) ("Section 13(b) establishes 'the public interest' as the standard of proof").

[33] *See Envtl. Def. Fund, Inc., v. Lamphier*, 714 F.2d 331, 338 (4th Cir. 1983); *World Wide Factors*, 882 F.2d at 346.

[34] *Int'l Computer Concepts*, 1994-2 TRADE CAS. (CCH) at 73,402 (quoting *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 903 (7th Cir. 1989)).

returned if they fail to obtain a loan modification for consumers. The attached consumer declarations show they did not.

It is also a violation of Section 5 if an act or practice is unfair. For an act or practice to be "unfair" it must satisfy a three prong test: (1) it must cause substantial consumer injury; (2) it must be injury that consumers themselves could not reasonably have avoided; and (3) it must not be outweighed by countervailing benefits to consumers or competition. 15 U.S.C. § 45(n).[35] Defendants' practices in taking consumers' money without their approval satisfy this standard. Consumers who are charged without their authorization suffer substantial injury, particularly given the difficult financial situation that these consumers are facing. Consumers who have not authorized the debiting of their accounts cannot reasonably have avoided the unauthorized debits, and Defendants' practices in billing consumers without the consumers' authorization offer not the slightest countervailing benefit to consumers or competition. The FTC has demonstrated a likelihood of successfully showing that all of the elements of unfairness have been satisfied. *See, e.g.*, PX 10, PX 17, PX 24.

In weighing the equities between the public interest in preventing further violations of law and Defendants' interest in continuing to operate their business unabated, the public equities are accorded much heavier weight.[36] This is particularly true where the evidence demonstrates that a defendant's business is rooted in deception.[37]

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[35] *See also Orkin Exterminating Co., Inc. v. FTC*, 849 F.2d 1354, 1364 (11th Cir. 1988) (citing FTC's 1980 Policy Statement); *FTC v. J.K. Publ'ns*, 99 F. Supp. 2d 1176, 1201 (C.D. Cal. 2000); *FTC v. Windward Mktg., Ltd.*, No. 1:96-CV-615, 41997 U.S. Dist. LEXIS 17114, at *29-30 (N.D. Ga. Sept. 30, 1997).

[36] *World Wide Factors*, 882 F.2d at 346-47.

[37] A "court of equity is under no duty 'to protect illegitimate profits or advance business
(continued...)

A temporary restraining order should be entered. First, the clear evidence of deceptive practices demonstrates a strong likelihood that the FTC will succeed on the merits. Second, Defendants' violations of the FTC Act are continuing and are likely to continue unless and until Defendants are compelled to cease and desist. Third, because Defendants' business is grounded in fraud, the equities weigh heavily in favor of granting the requested relief.

3. The Individual Defendants Are Liable for Injunctive and Monetary Relief.

In addition to DAC a limited liability company defendant, individual Defendants Davidson, Smith, Gromann, and McCormick are liable for injunctive and monetary relief for law violations committed by DAC and by the unregistered entity, Defendant SG&D. To obtain an injunction against an individual, the FTC must show that the individual (1) directly participated in the violative acts, (2) played a role in controlling, directing, or formulating the policies and practices which resulted in violative acts, or (3) had the authority to control the unlawful activities or participated directly in them. *FTC v. Check Investors, Inc.*, 2003 U.S. Dist. LEXIS 26941 (D.N.J. Jul. 30, 2003); *In re Nat'l Credit Mgmt.*, 21 F. Supp. 2d at 424, 461 (D.N.J. 1998); *see also Affordable Media*, 179 F.3d at 1234; *Gem Merch.*, 87 F.3d at 470; *Amy Travel*, 875 F.2d at 573-74. In general, an individual's status as a corporate officer gives rise to a presumption of liability to control a small, closely held corporation. *Standard Educators, Inc. v. FTC*, 475 F.2d 401, 403 (D.C. Cir.), *cert. denied*, 414 U.S. 828 (1973). More particularly, assuming the duties of a corporate officer is probative of an individual's participation or authority. *Amy Travel*,

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[37](...continued)
which is conducted [illegally].'" *CFTC v. British Am. Commodity Options Corp.*, 560 F.2d 135, 143 (2d Cir. 1977) (quoting *FTC v. Thomsen-King & Co.*, 109 F.2d 516, 519 (7th Cir. 1940)).

875 F.2d at 573; *Check Investors*, 2003 U.S. Dist. LEXIS 26941 at *44; *Five-Star Auto Club*, 97 F. Supp. 2d at 538.

An individual may be held liable for monetary redress for corporate practices if the individual had, or should have had, knowledge or awareness of the corporate defendants' misrepresentations. *Affordable Media*, 179 F.3d at 1231; *Gem Merch.*, 87 F.3d at 470; *Amy Travel*, 875 F.2d at 574. This knowledge element, however, need not rise to the level of subjective intent to defraud consumers. *Affordable Media*, 179 F.3d at 1234; *Amy Travel*, 875 F.2d 574. Instead, the FTC need only demonstrate that the individual had actual knowledge of material misrepresentations, reckless indifference to the truth or falsity of such representations, or an awareness of a high probability of fraud, coupled with the intentional avoidance of the truth. *Affordable Media*, 179 F.2d at 1234; *Amy Travel*, 875 F.2d at 574; *Check Investors*, 2003 U.S. Dist. LEXIS 26941 at *44-45. Participation in corporate affairs is probative of knowledge. *Affordable Media*, 179 F.3d at 1235; *Amy Travel*, 875 F.2d 564; *Check Investors*, 2003 U.S. Dist. LEXIS 26941 at *45.

As discussed above, Davidson is the CEO of DAC and is involved in its daily operation. He signs letters as "Chief Executive Officer" and signed the Colorado cease-and-desist order on its behalf. He speaks directly with consumers and his name appears as a signatory on the so-called "refund guarantee." In short, he clearly has the authority to control and does control Defendants' operations. He had direct contact with the states, he was informed of the complaints consumers made about DAC to the BBB, and he was informed by the FTC that some of DAC's practices may be in violation of Section 5. There can be little doubt that Davidson is aware of the company's wrongful acts, participates in them, and has the ability to control them. Accordingly,

he should be enjoined from violating the FTC Act, and held liable for consumer redress or other monetary relief.

Individual Defendants Smith, Gromann, and McCormick are also liable because of their status as either owners, supervisors, or both. Smith and Gromann are partners with Davidson in a new iteration of DAC. They use testimonial letters on their website which were never sent to them and their website uses pages which are identical with those of DAC. They either had the knowledge of the acts and practices of the business or had a reckless disregard of the practices. Thus, preliminary relief is appropriate against these individual Defendants. Individual Defendant McCormick actively participated in the business. He spoke directly with consumers and told them he would not honor the refund guarantee. He told one consumer, who never signed a contract nor authorized a debit to his account, that providing banking information meant there was a DAC contract and denied the consumer a refund.

4. This Court Has the Authority to Grant an Order Freezing Assets Pending a Determination on the Merits.

A district court's authority to enter orders to preserve the Defendants' assets is ancillary to its equitable authority to order consumer redress. Where business operations are permeated by deception, there is a strong likelihood that assets may be dissipated during the pendency of the legal proceedings. Mindful of this, courts have ordered such relief solely on the basis of pervasive deceptive activities such as those found in this case.[38]

Indeed, these individual Defendants present compelling evidence that their assets will be dissipated unless they are frozen. The Defendants have used addresses other than their own to

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[38] *See SEC v. Manor Nursing Ctrs.*, 458 F.2d 1082, 1106 (2d Cir. 1972); *SEC v. R.J. Allen & Assocs.*, 386 F. Supp. 866, 881 (S.D. Fla. 1974). *See also H.N. Singer*, 668 F.2d at 1113.

conceal their true location from consumers. Defendants rejected the FTC investigator's request for their address when she attempted to mail a money order to them. There is no logical reason for a business and especially for a law firm to conceal their true address. Defendants have also shown a willingness to make unauthorized withdrawals from consumers' accounts. A freeze of the assets of the individual Defendants is warranted because they control the activities of the companies and have actual or constructive knowledge of the illegal practices.[39] An immediate freeze of assets granted *ex parte* and under seal will permit Plaintiff to serve the order on persons and financial institutions in this country that hold assets of the individual Defendants and prevent those assets from either being dissipated or from leaving the country.[40]

5. The Temporary Restraining Order Should Be Issued *Ex Parte*.

Due to the substantial risk of immediate asset dissipation and document destruction, Plaintiff seeks an *ex parte* restraining order. The issuance of an *ex parte* order is appropriate where the evidence demonstrates the likelihood that providing notice to Defendants would render the order fruitless.[41]

This matter is a proper case for the granting of an *ex parte* order. The fraudulent nature of Defendants' scheme, the fact that Defendants hide their identity behind false addresses and the

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[39] *See Amy Travel*, 875 F.2d at 573-76; *World Travel Vacation Brokers*, 861 F.2d at 1031.

[40] The Commission also seeks expedited discovery in order to locate assets obtained from defrauded consumers and preserve records of the Defendants' activities. Expedited discovery will protect evidence from concealment or destruction, and is necessary to prepare for the anticipated preliminary injunction hearing. Federal Rules of Civil Procedure 1, 26, 30, 34, and 45 contemplate the courts' traditional ability to depart from usual discovery procedures and fashion discovery by order so as to meet discovery needs in particular cases.

[41] *See* Affidavit of Plaintiff's Counsel, ¶¶ 14-17; *In re Vuitton et Fils*, 606 F.2d at 1; *cf. Am. Can Co. v. Mansukhani*, 742 F.2d 314 (7th Cir. 1984).

likelihood that Defendants will conceal assets or business records absent *ex parte* relief, justify dispensing with notice to the Defendants until the Court has had the opportunity to ensure the possibility that effective permanent relief will be available if the FTC is ultimately successful.

VII. CONCLUSION

For the foregoing reasons, the FTC requests that the Court issue the requested *ex parte* Temporary Restraining Order. A proposed Order is included in the materials with this filing.

Date: 11/18/09

Respectfully submitted,

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