No. 15-55510

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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IN RE: CHARLES F. GUGLIUZZA II, Debtor;

FEDERAL TRADE COMMISSION,
Plaintiff-Appellee,

v.

CHARLES F. GUGLIUZZA II,
Defendant-Appellant,

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On Appeal From the United States District Court
for the Central District of California
No. 8:14-bk-22893-CJC (Hon. Cormac J. Carney, D.J.)

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# BRIEF OF THE FEDERAL TRADE COMMISSION

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**[CORRECTED VERSION]**

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## INTRODUCTION

The fraud exception of the Bankruptcy Code forbids discharge of a debt that results from "false pretenses, false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A). Charles Gugliuzza owes an $18 million debt to the FTC that arose from a judgment in an FTC enforcement action against him for defrauding half a million consumers through a deceptive marketing scheme over a two-year period.

The district court held that under the principles of collateral estoppel, the underlying judgment precluded Gugliuzza from challenging four of the five factors used to apply the fraud exception. The court remanded to the bankruptcy court for additional fact-finding on the remaining factor.

This Court should dismiss this appeal for lack of jurisdiction because the district court's remand order left the parties' dispute unsettled and therefore the order is not final. If the Court reaches the merits, it should affirm that the principle of collateral estoppel precludes Gugliuzza from challenging the findings in the underlying enforcement case that (i) Gugliuzza deceived consumers, who (ii) relied on his deceptions, and (iii) suffered harm as a result. Those elements were conclusively determined in the prior litigation under identical legal standards. Gugliuzza should not be allowed to take advantage of relief that Congress intended for honest debtors and not for dishonest ones.

## JURISDICTION

The bankruptcy court had jurisdiction over the bankruptcy case and the adversary proceeding pursuant to 28 U.S.C. §§ 157(a), 157(b)(1), (b)(2)(I) and (b)(2)(J). The district court had jurisdiction over the appeal from the bankruptcy court's final summary judgment order pursuant to 28 U.S.C. § 158(a)(1). On April 1, 2015, Gugliuzza filed a timely notice of appeal of the district court's March 12, 2015, order affirming in part and remanding in part. This Court has jurisdiction over appeals from final district court orders in bankruptcy cases under 28 U.S.C. § 158(d)(1), but it lacks jurisdiction over this case because the order on review is not final. *See* Argument I, *infra.*

## QUESTIONS PRESENTED

1. Whether the Court has jurisdiction to review a district court order that affirmed a bankruptcy court's order in part, reversed it in part, and remanded for further fact-finding proceedings, thus leaving unresolved the ultimate question whether the fraud exception precludes discharge of the debt.

2. Whether principles of collateral estoppel prevent Gugliuzza from relitigating rulings in the prior enforcement case establishing that (1) he deceived consumers by misrepresenting and omitting material facts about his company's services, (2) consumers relied on his misrepresentations, and (3) they were harmed as a result.

Applicable statutes are contained in an Addendum at the end of this Brief.

## STATEMENT OF THE CASE

### A. Gugliuzza's Deceptive Marketing Scheme

Gugliuzza and his company, Commerce Planet, Inc., ran a deceptive Internet marketing scheme called "OnlineSupplier." Their website promoted a purportedly free e-commerce kit to consumers, but concealed that consumers who ordered the kit were automatically enrolled in a "membership" plan that placed fees of up to $60 per month on their credit cards. *See FTC v. Commerce Planet, Inc.*, 878 F. Supp. 2d 1048, 1057 (C.D. Cal. 2012) ("Enforcement Ruling"), appeal pending No. 12-57064 (9th Cir.) (argued Feb. 9, 2015).[1]

Gugliuzza had broad control over the marketing of OnlineSupplier. He oversaw the development of the company's website and reviewed and approved its design and content. 878 F. Supp. 2d at 1057, 1059-61. At his direction, Commerce Planet marketed OnlineSupplier on the Internet through ads touting a free "Online Auction Starter Kit" that purportedly would help consumers learn how to turn a profit buying and selling products on auction websites. *Id.* at 1054, 1057, 1064. The ads prominently featured the eBay logo, despite the lack of any affiliation with eBay. *Id.* at 1064-66.

[1] This factual summary is based on the district court's findings in the Enforcement Ruling. In his appeal of that order Gugliuzza disputes some of the court's findings, but their validity is not at issue in this bankruptcy appeal.

Consumers who clicked an ad to learn more about this offer were directed to a "landing page" on the OnlineSupplier website. This page did not mention a membership program or a monthly fee. Instead, it presented a sales pitch to induce consumers to order the "free" kit. Consumers who clicked a prominent button labeled "Ship My Kit!" were directed to a "billing page" with a form for submitting their mailing addresses and credit card information, ostensibly to pay a nominal fee (ranging from $1.95 to $7.95) for shipping and handling of the kit. *Id*. at 1064-65. After submitting the form, consumers were directed to a page offering additional products and services, and from there, to a final page confirming the transaction. *Id.* at 1057-58.

In fact, consumers who supplied their billing information were not only charged the initial fee, but also were enrolled in a "membership" program with automatic billing each month. The web pages concealed these recurring charges. The information provided about them was unclear and incomplete and displayed near the bottom of the pages in a tiny, difficult-to-read font. *Id.* at 1065. Consumers could obtain additional information about the charges and cancelation requirements only if they scrolled to the very bottom of those pages and clicked on a small link to a "Terms of Membership" page. That link called up fine-print terms, written in dense legalese, that did not make clear that Commerce Planet would charge consumers the recurring fee. *Id.* at 1067-68.

Ultimately, over 500,000 consumers clicked the button to order the kit. *Id.* at 1054. Thousands of them later complained to Commerce Planet that they neither knew about nor agreed to an automatic billing program; they demanded that the company refund the unauthorized charges. Numerous consumers asked their credit card issuers to reverse these charges, and thousands submitted complaints to Better Business Bureaus and state and federal consumer protection agencies. *Id.* at 1059, 1073-74. Gugliuzza knew of these consumer complaints and the high rates of credit card charge reversals, but he personally rejected any effort to provide clearer disclosures, which would have reduced consumer sign-ups. *Id.* at 1072-76, 1082. For example, he vetoed a proposal to send post-transaction emails to consumers because he believed they would have led to greater cancelations. *Id.* at 1082.

**B. The $18.2 Million Judgment Against Gugliuzza**

In 2009, the FTC sued Gugliuzza, Commerce Planet, and two other officers of the company for engaging in deceptive and unfair practices, in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a). Gugliuzza's co-defendants settled by agreeing to the entry of stipulated injunctions and payment of monetary judgments. Gugliuzza chose to litigate. 878 F. Supp. 2d at 1062.

At a 16-day bench trial, the district court reviewed more than 300 exhibits and heard testimony from 22 fact and expert witnesses. It found Gugliuzza

individually liable for consumer harm and entered both an injunction and an $18.2 million equitable monetary judgment against him. Specifically, the court held that (1) Gugliuzza made material misrepresentations on the website; (2) he knew the representations were false or deceptive; (3) consumers actually and reasonably relied on his misrepresentations and were misled by them; and (4) Gugliuzza's deceptive marketing was the direct cause of consumer injury in the amount of at least $18.2 million. *See id*. at 1081-83, 1091-92. The district court thus entered judgment against Gugliuzza in that amount for the FTC to use to provide restitution to victims of the fraud.

### C. Gugliuzza's Attempt to Escape the Judgment Through Bankruptcy

Gugliuzza filed a Chapter 7 bankruptcy petition and sought discharge of the FTC's judgment against him. The FTC opposed that attempt on the ground that Gugliuzza's judgment debt is excepted from discharge under the Bankruptcy Code's fraud exception, which bars discharge of debts "to the extent obtained by false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A).

The FTC moved for summary judgment on the ground that the Enforcement Ruling had already resolved each of the factors necessary to prove that a debt falls within the fraud exception: (1) "misrepresentation, fraudulent omission or deceptive conduct by the debtor"; (2) "knowledge of the falsity or deceptiveness of his statement or conduct"; (3) "an intent to deceive"; (4) "justifiable reliance by the

creditor on the debtor's statement or conduct"; and (5) "damage to the creditor proximately caused by its reliance on the debtor's statement or conduct." *Turtle Rock Homeowners Ass'n v. Slyman* (*In re Slyman*), 234 F.3d 1081, 1085 (9th Cir. 2000); *accord Dietz v. Ford* (*In re Deitz*), 760 F.3d 1038, 1050 (9th Cir. 2014).

The bankruptcy court granted the FTC's motion, concluding that the Enforcement Ruling established all of those elements. The bankruptcy court held that the same legal standards that governed the underlying case also govern the fraud exception and that the holdings in the Enforcement Ruling were necessary in determining Gugliuzza's liability. Bankr. Ct. Order at 3-7 [ER 242-246]. Under the doctrine of collateral estoppel, the court held, the parties had already litigated each element of the fraud exception, and Gugliuzza therefore was precluded from litigating them again.

### D. The District Court Order on Review

On appeal, the district court (the same judge who had issued the comprehensive Enforcement Ruling) affirmed the bankruptcy court's holding that the Enforcement Ruling satisfied four of the five elements of the fraud exception. The court reversed the decision on the remaining factor (intent to deceive) and remanded to the bankruptcy court for additional findings. Dist. Ct. Op. [ER 1-12] (published at *FTC v. Gugliuzza* (*In re Gugliuzza*), 527 B.R. 370 (C.D. Cal. 2015)).

In particular, the district court found that the Enforcement Ruling precluded relitigation in the bankruptcy case on the questions whether: (a) Gugliuzza engaged in "misrepresentation, fraudulent omission or deceptive conduct" (Dist. Ct. Op. 6-7) [ER 6-7]; (b) he knew his statements were false or deceptive (*id.* at 7); (c) consumers "justifiably relied" on them (*id.* at 9-11); and (d) Gugliuzza's misconduct was the "proximate cause" of the consumer losses (*id.* at 11-12). But the district court reasoned that, because Section 5(a) of the FTC Act does not require a showing of intent, the prior litigation had not resolved the question whether Gugliuzza intended to deceive consumers. *Id.* at 8-9.

Gugliuzza appeals the district court's order. He does not dispute the district court's conclusion that collateral estoppel precludes him from challenging the earlier ruling on the knowledge element. He seeks review only of the district court's finding of preclusion on the three remaining factors: deception, justifiable reliance, and damages.

## SUMMARY OF ARGUMENT

1. The Court lacks jurisdiction because the district court's order is not final. The district court did not resolve the central question of whether Gugliuzza's judgment debt to the FTC is exempt from discharge, but reversed one aspect of the bankruptcy court's decision and remanded for additional fact finding. Such an order is non-final under the Supreme Court's decision in *Bullard v. Blue Hills*

*Bank*, 135 S. Ct. 1686 (2015), this Court's decision in *Sahagun v. Landmark Fence Co., Inc.* (*In re Landmark Fence Co., Inc.*), 801 F.3d 1099 (9th Cir. 2015), and this Court's "flexible finality" test.

2. In any event, the district court correctly held that the underlying Enforcement Ruling resolved the three elements of the fraud exception at issue here and that collateral estoppel principles bar Gugliuzza from challenging them.

a. To satisfy the first element of the fraud discharge test, a creditor must demonstrate "misrepresentation, fraudulent omission or deceptive conduct by the debtor." *Slyman*, 234 F.3d at 1085. The FTC proved deception under the FTC Act using a substantively identical standard. Gugliuzza is wrong that the Court's decision in *Slyman* stated the law incorrectly and that the fraud exception requires an affirmative false statement. Such a requirement is inconsistent with other decisions of this Court as well as the statutory language and policy. The fraud exception was meant to protect *honest* debtors, a description that does not apply to Gugliuzza.

b. Gugliuzza is wrong that the reliance element of the fraud exception requires the FTC to show each consumer's individual and actual reliance on his misrepresentations. Such a standard has no basis in the statute or precedent and would be impossible to meet in the context of government enforcement actions against large-scale deception schemes. Indeed, this Court has found that the FTC

establishes "actual reliance" when it submits unrebutted evidence of wide dissemination of materially misleading information. The fraud exception requires no more. In a closely analogous decision, *SEC v. Bilzerian* (*In re Bilzerian*), 153 F.3d 1278 (11th Cir. 1998), the court held that an enforcement agency's unrebutted showing of widespread material deception satisfies the fraud exception. Any other outcome would allow fraud perpetrators to avoid the consequences of their misconduct by seeking discharge in bankruptcy, thereby subverting the basic purpose of the fraud exception.

Gugliuzza is wrong that the FTC did not prove "justifiable reliance" in the underlying case because some consumers could have figured out his scam and therefore did not rely on the misinformation on his website. In the underlying case, the FTC proved "reasonable reliance," a higher hurdle than justifiable reliance. Consumer reliance on a misrepresentation is justifiable unless a consumer would recognize immediately that it is false, which was not the case with Gugliuzza's website. A consumer need not conduct an investigation to uncover the falsity.

c. Gugliuzza's claim that the fraud exception requires the FTC to show individualized harm fails for the same reasons as his argument that the FTC must show individualized reliance.

## STANDARD OF REVIEW

The applicability of the fraud exception "presents mixed issues of law and fact and is reviewed *de novo*." *Dietz*, 760 F.3d at 1043. In addition, "[t]he preclusive effect of a judgment in a prior case presents a mixed question of law and fact in which the legal issues predominate" and is also reviewed *de novo*. *Robi v. Five Platters, Inc.*, 838 F.2d 318, 321 (9th Cir. 1988).

## ARGUMENT

### I. THIS COURT LACKS JURISDICTION BECAUSE THE DISTRICT COURT'S ORDER IS NOT FINAL.

Congress granted this Court jurisdiction to hear appeals from "final decisions, judgments, orders, and decrees" of district courts on review of bankruptcy court decisions. 28 U.S.C. § 158(d)(1). Here, the Court lacks jurisdiction because the district court order on review is not final.

The Supreme Court recently made clear that an order in a bankruptcy case is "final" under Section 158 only if it "finally dispose[s] of [a] discrete dispute[]" and "alters the legal relationships among the parties." *Bullard v. Blue Hills Bank*, 135 S. Ct. 1686, 1692, 1695 (2015) (citation omitted). The Court found that the same criteria governing finality in any other civil case also govern finality in a bankruptcy proceeding. For example, an "order granting a motion for summary judgment is final [but] an order denying such a motion is not." *Id.* at 1694.

The Court acknowledged that the rules governing finality for purposes of appeal are "different in bankruptcy" than in other civil cases, as illustrated by the differences between the wording in the statute governing bankruptcy appeals (28 U.S.C. § 158) and that governing other appeals (28 U.S.C. § 1291). *Bullard*, 135 S. Ct. at 1692. This difference arises not because "finality" means something different in bankruptcy than elsewhere. Rather, it is because in bankruptcy cases, a single proceeding may contain multiple "individual controversies" between the debtor and one or more other parties. Orders in such proceedings—like final orders in "stand-alone lawsuits"—may "finally dispose of discrete disputes" even if they do not conclude the bankruptcy case as a whole. *Id.* For any given dispute, however, an order is not final unless it "alters the status quo and fixes the rights and obligations of the parties." *Id.*

Under *Bullard*, the district court order at issue here is not final. The district court neither left Gugliuzza "free and clear of [the FTC's] claim" nor conclusively "doom[ed] the possibility of a discharge." *Id.* Instead, by affirming the bankruptcy court's summary judgment order on four of the five fraud exception factors, but reversing and remanding for additional fact-finding proceedings with respect to the remaining factor, the district court left "unsettled" the ultimate question of whether or not Gugliuzza's judgment debt is dischargeable. As in *Bullard*, the district court's order leaves both parties free to press their cases on the

remanded issue. As a result, the parties' rights and obligations will not be resolved until the bankruptcy court completes its new fact-finding proceeding and decides the issue on remand.

Before *Bullard* was decided, this Court typically assessed finality in bankruptcy cases using a multi-factor "flexible" finality standard. *See, e.g.*, *DeMarah v. United States* (*In re DeMarah*), 62 F.3d 1248, 1250 (9th Cir. 1995); *Bonner Mall P'ship v. U.S. Bancorp Mortgage Co.* (*In re Bonner Mall P'ship*), 2 F.3d 899, 904 (9th Cir. 1993). In *Sahagun v. Landmark Fence Co., Inc.* (*In re Landmark Fence Co., Inc.*), 801 F.3d 1099 (9th Cir. 2015), the Court acknowledged (but did not resolve) the tension between the flexible finality concept and the Supreme Court's holding in *Bullard*. *Id.* at 1102 n.1. But *Landmark Fence* demonstrates that even under the flexible finality approach, the order in this case is not final. The Court held that its "flexible approach is stretched beyond its breaking point by this appeal from a district court order that includes a remand to the bankruptcy court with explicit instructions to engage in 'further fact-finding.'" *Id*. at 1101. Such an order is "not final for purposes of appeal." *Id*. That is precisely the posture of this case. *See also Vylene Enters., Inc. v. Naugles, Inc.*, (*In re Vylene Enters., Inc.*), 968 F.2d 887, 895 (9th Cir. 1992) (where district court "remands for factual determinations on a central issue, its order is not final") (citations omitted).

Moreover, even if *Bullard* and *Landmark Fence* had never been decided, the district court's order still would not be final under the "flexible finality" factors often used in past cases: (1) the need to avoid piecemeal litigation; (2) judicial efficiency; (3) the systemic interest in preserving the bankruptcy court's role as the finder of fact; and (4) whether delaying review would cause either party irreparable harm. *See Stanley v. Crossland* (*In re Lakeshore Village Resort*), 81 F.3d 103, 106 (9th Cir. 1996). Taking up the merits of this dispute now would create a risk of piecemeal litigation and judicial inefficiency. If the Court were to determine the merits of the pending appeal, one of the parties likely would take yet another appeal from a future final judgment conclusively determining the status of Gugliuzza's debt. A single appeal that presents all issues in the case would prevent multiple "climb[s] up the appellate ladder," which is "precisely the reason for a rule of finality." *Bullard*, 135 S. Ct. at 1693. And Gugliuzza has no genuine claim that a decision in this case is necessary to avoid irreparable harm.[2]

[2] In his one-paragraph Statement of Jurisdiction, Gugliuzza relies on the Ninth Circuit's pre-*Bullard* decision in *Price v. Lehtinen* (*In re Lehtinen*), 564 F.3d 1052, 1057 (9th Cir. 2009), for the proposition that courts of appeals have jurisdiction whenever "the issues presented are pure legal questions." Br. 4. That proposition contradicts *Bullard*, *Landmark Fence*, and this Court's traditional flexible finality analysis. Indeed, because many appeals present only "legal questions," Gugliuzza's proposed standard would justify appellate jurisdiction over a range of orders that would not be "final" under any plausible approach to appellate jurisdiction.

## II. THE ENFORCEMENT RULING RESOLVED THE ISSUES OF DECEPTION, RELIANCE, AND HARM UNDER STANDARDS IDENTICAL TO THOSE OF THE FRAUD EXCEPTION.

When a bankruptcy court determines whether a debt established in a prior judgment was obtained by "false pretenses, a false representation, or actual fraud," 11 U.S.C. § 523(a)(2)(A), it should "give collateral estoppel effect to those elements of the claim" that (1) "are identical to the elements required for discharge," (2) were "actually litigated and determined in the prior action," and (3) were "a critical and necessary part of the judgment in the earlier action." *Grogan v. Garner*, 498 U.S. 279, 284 (1991); *Clark v. Bear Stearns & Co.*, 966 F.2d 1318, 1320 (9th Cir. 1992). The district court correctly determined that collateral estoppel precludes Gugliuzza from relitigating the three elements of the fraud exception he now challenges. Dist. Ct. Op. 6-7, 9-12 [ER 6-7, 9-12].

### A. Gugliuzza Cannot Relitigate Whether He Engaged in Deception.

The Enforcement Ruling found that the evidence "abundantly establishe[d]" that Gugliuzza was responsible for deceptively marketing what he touted as a "free" online kit affiliated with eBay, when in fact he charged consumers a monthly fee and the kit had no such affiliation. 878 F. Supp. 2d at 1064-1068, 1079-1082. Gugliuzza contends that he may relitigate whether he made misrepresentations and engaged in deceptive conduct because in the underlying case the district court held only that his website created a false "net impression"

whereas the fraud exception requires proof of an "affirmatively false representation." Br. 24. He also claims that "there is no argument here that [he] made a false representation or material omission." Br. 25. Gugliuzza is wrong on the law and the facts.

### 1. The Deception Standard of the FTC Act is Identical to the First Element of the Fraud Exception.

To satisfy the first element of the fraud discharge exception, a creditor must demonstrate "misrepresentation, fraudulent omission or deceptive conduct by the debtor." *Slyman*, 234 F.3d at 1085; *Dietz*, 760 F.3d at 1050. To prove deception under the FTC Act, the FTC must show that a defendant engaged in a "representation, omission, or practice" that is "likely to mislead consumers acting reasonably under the circumstances," and is "material." *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1095 (9th Cir. 1994) (quoting *Cliffdale Assocs.*, 103 F.T.C. 110, 164-65 (1984)). Those standards are substantively identical. Therefore, as the district court correctly concluded, the Enforcement Ruling's finding that "the marketing of OnlineSupplier was deceptive" also meets the first element of the fraud exception test. Dist. Ct. Op. 6 [ER 6].

Contrary to Gugliuzza's claim, a deceptive "net impression" meets the standard of the fraud exception because it *is* a false representation, even if some aspect of it is literally true. Its overall falsity induces consumers to draw incorrect conclusions just as would a wholly false statement. Deceptive conduct thus fits

comfortably within the fraud exception's requirements of "false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A). Like deception under Section 5 of the FTC Act, a "debtor's silence or concealment of a material fact can create a false impression which constitutes a misrepresentation" under the fraud exception. *Tallant v. Kaufman* (*In re Tallant*), 218 B.R. 58, 66 (9th Cir. BAP 1998); *accord Apte v. Japra* (*In re Apte*), 96 F.3d 1319, 1323-24 (9th Cir. 1996) (a failure to disclose material facts can constitute a false representation) (citing Restatement (Second) of Torts § 551 (1976)). Numerous courts have determined that proof of deception under the FTC Act satisfies the fraud exception.[3]

Gugliuzza argues that his website disclosed, however obscurely, the truth about his product and that the fraud exception is satisfied only by a representation that is false in every respect. He contends that the exception is not satisfied by a statement that is partially true even if, in its totality, it conveys a falsehood. That narrow conception of the fraud exception flatly contradicts the common law principles adopted by this Court and the Supreme Court. *See, e.g., Citibank (South Dakota), N.A. v. Eashai* (*In re Eashai*), 87 F.3d 1082, 1089 (9th Cir. 1996); *Field v. Mans*, 516 U.S. 59, 69-70 (1995). The Restatement of Torts, for example,

[3] *See, e.g., FTC v. Abeyta* (*In re Abeyta*), 387 B.R. 846, 854-55 (Bankr. D.N.M. 2008); *FTC v. Porcelli* (*In re Porcelli*), 325 B.R. 868 (Bankr. M.D. Fla. 2005); *FTC v. Lederman* (*In re Lederman*), No. SV 94-22688 AG, 1995 WL 792072, at *5-6 (Bankr. C.D. Cal. June 26, 1995); *FTC v. Austin* (*In re Austin*), 138 B.R. 898, 907-08 (Bankr. N.D. Ill. 1992).

defines fraud to mean not only affirmative misrepresentations, but also "any other conduct that amounts to an assertion not in accordance with the truth." Restatement (Second) of Torts § 525 comment b (1977). Such conduct can include an ambiguous statement—*i.e.*, one that is literally true but can be interpreted in both true and false ways—if it is made with "reckless indifference as to how it will be understood" or "with the intention that it be understood in the sense in which it is false." *Id*. § 527. Thus, a "statement containing a half-truth may be as misleading as a statement wholly false." *Id.* § 529. These authorities draw upon the simple, common sense idea that deceptive conduct is at the root of whether a debt arises from "false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A). Similarly, the Court has described fraud as "any deceit, artifice, trick or design involving direct and active operation of the mind, used to circumvent and cheat another." *Eashai*, 87 F.3d at 1089 (quoting *RecoverEdge L.P. v. Pentecost*, 44 F.3d 1284, 1293 (5th Cir. 1995)).

Gugliuzza acknowledges that this Court stated in *Slyman* that the first element "could be met by showing a 'misrepresentation, fraudulent omission *or deceptive conduct* by the debtor.'" Br. 26-27 (quoting *Slyman*, 234 F.3d at 1085) (emphasis added). But he contends that this description of the standard contradicts "previous clear law from this Court requiring a false representation" as opposed to "mere decept[ion]" as established by a "net impression." *Id.* 26. That is incorrect.

The pre-*Slyman* cases that Gugliuzza cites do not support his position because the debtors in those cases made specific false representations, and the Court thus did not need to use the broader "deception" concept when reciting the legal standard. *See, e.g.*, *Britton v. Price* (*In re Britton*), 950 F.2d 602, 603-05 (9th Cir. 1991) (debtor lied about being a doctor to induce the victim to undergo surgery). He cites no case in which the Court ordered the discharge of a debt despite the fraud exception because the debt stemmed from deceitful conduct and not a false statement.

Indeed, this Court's pre-*Slyman* cases affirmatively contradict Gugliuzza's position. For example, in *Eashai*, 87 F.3d 1082 (cited at Br. 24, 26, 27, 28), this Court applied the fraud exception even though the debtor made no direct representation but created only a false impression through his conduct. The debtor had run up large credit card bills while making minimum payments each month. The payments misleadingly created a "façade" of good standing and the "appearance of an honest debtor." *Id.* at 1088. This Court held that the misleading impression created by the debtor's deceptive conduct—as opposed to any specific, literally false representation—sufficed to bar discharge of the debt. Similarly, in *American Express Travel Related Servs. Co., Inc. v. Hashemi* (*In re Hashemi*),

104 F.3d 1122 (9th Cir. 1996) (cited at Br. 23, 24, 26, 27, 28, 34), the Court ruled that "deceptive conduct" is tantamount to a "misrepresentation." *Id*. at 1126.[4]

Finally, Gugliuzza's absolute falsity rule would be unmoored not only from the Court's precedents and the language of the fraud exception, but its underlying policies as well. The exception is meant to ensure that dishonest debtors do not "benefit from [their] wrongdoing," *Eashai*, 87 F.3d at 1086; *accord Slyman*, 234 F.3d at 1085, yet that is precisely what Gugliuzza is trying to do here. The Supreme Court has recognized that the need to "protect[] victims," including their "interest in recovering full payment" of debts incurred as a result of dishonest acts "outweigh[s] the . . . interest in giving perpetrators of fraud a fresh start." *Grogan*, 498 U.S. at 287.

[4] Gugliuzza cites bankruptcy court decisions involving state statutes similar to the FTC Act for the proposition that judgments under those statutes do not have collateral estoppel effect in proceedings under the fraud exception. *See* Br. 31-32 n.6 (citing *Harb v. Toscano* (*In re Toscano*), 23 B.R. 736 (Bankr. D. Mass 1982), *Morgan v. Kanak* (*In re Kanak*), 85 B.R. 483 (Bankr. N.D. Ill. 1988), and *Rivers Edge Condominium Homeowners Assoc. v. Cohen (In re Cohen)*, 370 B.R. 26 (Bankr. D.N.H. 2007)). *Toscano* and *Cohen* involved judgment debts stemming from prior state court decisions that did *not* make preclusive findings of liability under the state-law counterparts to the FTC Act. *Toscano* involved liability for breach of contract, *see* 23 B.R. at 740-41. *Cohen* concerned a default judgment in which the court made no legal or factual findings, *see* 370 B.R. at 30. In *Kanak*, the bankruptcy court found that the state statute "renders even innocent misrepresentations actionable," 85 B.R. at 487, a more lenient standard than the fraud exception.

### 2. Gugliuzza Concealed and Omitted Material Facts.

In any event, Gugliuzza concedes that for purposes of the fraud exception "a false representation may include the concealment or omission of a material fact." Br. 24 (citing *Apte*, 96 F.3d at 1323-24. The Enforcement Ruling conclusively established that he concealed and omitted material facts, and that determination alone satisfies the fraud exception.

In the underlying proceeding, the FTC proved that Gugliuzza went out of his way to ensure that consumers would *not* find out the true nature of his product. He designed the automatic billing enrollment program "not [to] be clear and conspicuous, but rather to mask information" about the true nature of the program. Enforcement Ruling, 878 F. Supp. 2d at 1068. As a result, the district court found, Gugliuzza's website "conceal[ed], obscure[ed], and suppress[ed] the very information [the disclosure] purport[ed] to convey." *Id*. The website promised a "free" trial kit but hid the recurring charge imposed on its victims. The information about those charges was truncated, ambiguous, and, at least initially, shown "in the smallest text size on the page and in blue font against a slightly lighter blue background at the very end of the disclosure." *Id.* at 1067. Even if a consumer located the disclosure, it was "buried with other densely packed information and legalese, making it unlikely that the average consumer [would] wade through the material and understand" the bargain. *Id*. at 1065.

The record thus plainly contradicts Gugliuzza's assertion that "there is no argument here that [he] made a false representation or material omission." Br. 25. That description applies precisely to his conduct, no matter what verbal formulation he might prefer. For purposes of the fraud exception, his extensive attempts to conceal the true nature of his product make him no different from the debtor deemed ineligible for a discharge in *Apte*—a tenant who tried to sublet his premises without revealing to the prospective sublessee that the landlord was in the process of evicting him. *Apte*, 96 F.3d at 1321. .

### B. Gugliuzza Cannot Relitigate the Holding in the Enforcement Ruling That Consumers Justifiably Relied on His Deception.

The district court held that the Enforcement Ruling "necessarily concluded that the consumers actually and reasonably relied on Gugliuzza's misleading conduct." Dist. Ct. Op. 9 [ER 9] (citing Enforcement Ruling, 878 F. Supp. 2d at 1089-92). The court thus precluded Gugliuzza from litigating consumers' "justifiable reliance" for purposes of the fraud exception. Dist. Ct. Op. 9 [ER 9]; *see Slyman*, 234 F.3d at 1085. Indeed, justifiable reliance is a "less demanding" standard for the FTC to meet than "reasonable reliance" under the FTC Act. *Field*, 516 U.S. at 61, 70-71. Gugliuzza's challenges to the district court's disposition of that issue are meritless.

### 1. Proof of Actual Reliance Under the FTC Act Satisfies the Reliance Element of the Fraud Exception.

Gugliuzza claims that the Enforcement Ruling cannot preclude him from litigating reliance because the FTC Act does not require "proof of subjective reliance by each individual consumer," Br. 29 (citing Enforcement Ruling, 878 F. Supp. 2d at 1091), whereas the fraud exception does require such proof. Br. 28. The gist of his argument is that, to invoke the fraud exception, the FTC must provide evidence that every single consumer was individually deceived. That position is untenable.

Both the FTC Act and the fraud exception require proof of reliance. In FTC Act cases, this Court has held that "actual reliance" has been proven when the FTC introduces evidence showing that a merchant's misrepresentations were "widely disseminated" and "material," and the merchant does not rebut that evidence. *FTC v. Figgie Int'l, Inc.*, 994 F.2d 595, 605-06 (9th Cir. 1993).

The Tenth Circuit took the same approach in *FTC v. Freecom Communications, Inc.*, 401 F.3d 1192 (10th Cir. 2005), holding that "proof of consumer reliance" is "necessary to establish a right to consumer redress" under the FTC Act. The court found that the FTC "is not required . . . to show any particular purchaser actually relied on or was injured by the unlawful misrepresentations." *Id*. at 1205. Rather, the FTC shows that "consumers actually

relied" on a material misrepresentation when it was widely disseminated. *Id*. at 1203, 1206.

Gugliuzza takes the rigid stance that the FTC can prove actual reliance only if it "provides *individualized* proof of reliance . . . by each purchasing customer"—*i.e.*, if brings every single deceived consumer to court to testify about their behavior. Br. 34. Courts have sensibly rejected that obviously impractical approach in favor of the one adopted by this Court in *Figgie* and the Tenth Circuit in *Freecom*. *Figgie* held that "[r]equiring proof of subjective reliance by each individual consumer would thwart effective prosecutions of large consumer redress actions." 994 F.2d at 605; *accord Freecom*, 401 F.3d at 1205. The same consideration applies to reliance under the fraud exception.

For the same reason, the Supreme Court held in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), that in the analogous context of securities fraud, plaintiffs need not prove "direct reliance" in cases involving large numbers of investors operating in an open market. The Court observed that mass-market transactions "differ from the face-to-face transactions contemplated by [traditional] fraud cases." *Id.* at 243-244. Thus, while it acknowledged that "reliance is an element of a [securities fraud] cause of action," the "reliance of individual plaintiffs . . . may be presumed" upon a showing of "any public material misrepresentations" or "the hiding and secreting of important information" that distorts the market prices that investors

rely on when buying or selling securities. *Id*. at 246-47. Defendants can "rebut [this] presumption of reliance by making a "showing that severs the link between the alleged misrepresentation" and the prices paid or received by the plaintiffs. *Id.* at 248.

Gugliuzza wrongly suggests that allowing the FTC to demonstrate consumers' actual reliance using a rebuttable presumption results in a "shift in the burden or persuasion" to the defendant. Not so. The rebuttable presumption used to establish a *prima facie* case of reliance in FTC Act deception cases—as in securities fraud class actions—does not eliminate plaintiffs' burden of demonstrating reliance. As the Supreme Court explained in *Basic,* such rebuttable presumptions simply provide an "indirect[]" means for plaintiffs to satisfy that burden of proof "in circumstances where direct proof . . . is . . . difficult." *Id.* at 245. The presumption acknowledges the reality that requiring direct proof in all cases "would place an unnecessarily unrealistic evidentiary burden" on plaintiffs in cases involving thousands or millions of market transactions. *Id.*

Gugliuzza cites no persuasive authority for his contrary premise that the fraud-discharge exception requires direct proof of "individualized" reliance in government enforcement cases. He relies (Br. 29, 34) on *Ghomeshi v. Sabban* (*In re Sabban*), 600 F.3d 1219, 1222 (9th Cir. 2010), *Field*, 516 U.S. at 66, and *Hashemi*, 104 F.3d at 1125, but those cases involved a single deceived creditor, not

a large group of deceived consumers. Very different considerations are at play in a case brought by a government enforcement agency against a person who engaged in large-scale deceit against numerous consumers. This case, for example, involved more than 500,000 victims. 878 F. Supp. 2d at 1054.

In a closely analogous case, the Eleventh Circuit rejected the position now taken by Gugliuzza and held instead that a government enforcement agency's proof in an underlying case that the debtor's deception was "material" satisfied the actual reliance element of the fraud exception. *SEC v. Bilzerian* (*In re Bilzerian*), 153 F.3d 1278, 1282 (11th Cir. 1998). In a bankruptcy proceeding, Bilzerian sought discharge of a debt that resulted from an SEC judgment against him for deceptive securities practices. Like the FTC here, the SEC asserted that the fraud exception barred discharge of the debt and that the underlying judgment precluded Bilzerian from relitigating the elements of the exception. Like Gugliuzza here, Bilzerian argued that the underlying judgment did not prove "reliance" because the court in the earlier case had not found that any specific investors "actually relied" on his misrepresentations.

The Eleventh Circuit rejected that argument. The determination in the underlying case that Bilzerian's deception was "material," the court held, precluded him from relitigating the reliance element of the fraud exception in the bankruptcy proceeding. The SEC was not required to have shown individualized

proof that specific investors had actually relied on Bilzerian's deceptive statements. *Id.* at 1282-83. The court explained that both common law fraud and securities fraud require proof that the defendant's conduct caused losses to victims. To establish causation, "reliance is [a necessary] element." *Id*. at 1282 & n.17 (quoting *Basic*, 485 U.S. at 243). But "requiring proof of direct reliance" in securities fraud cases involving large numbers of investors operating in an open market is impracticable. 153 F.3d at 1282 n.19. The court therefore held that in such cases the "causation requirement of 'materiality' . . . satisfies the requirement for actual reliance necessary to apply collateral estoppel" under the fraud exception. *Id*. at 1282. "Any other decision," the court explained, "would conflict with the general principles behind § 523(a)(2)(A)" and would undermine Congress's intent to ensure that "the malefic debtor may not hoist the Bankruptcy Code as protection from the full consequences of fraudulent conduct." *Id.*[5]

Here, just as in *Bilzerian*, Gugliuzza's approach to reliance would enable the perpetrator of a scheme that defrauded thousands of victims to avoid the consequences of his deception—and leave his victims without any remedy. That

[5] Gugliuzza does not challenge the finding in the Enforcement Ruling that his deceptions were material. There, the court found that his misrepresentations "involve[d] information that is important to consumers and, hence, likely to affect their choice of, or conduct regarding, a product." 878 F. Supp. 2d. at 1063 (quoting *FTC v. Cyberspace.com, LLC*, 453 F.3d 1196, 1201 (9th Cir. 2006)). Gugliuzza's misrepresentations were "undoubtedly material because the information about a free kit goes to the cost of the product, an important factor in a consumer's decision on whether or not to purchase a product." *Id*. at 1068.

outcome would radically undermine the fraud exception. When it "exclude[d] from the general policy of discharge certain categories of debts such as . . . liabilities for fraud," *Grogan*, 498 U.S. at 287, Congress concluded that "the interest in protecting victims of fraud" and their "interest in recovering full payment" of debts incurred as a result of fraud "outweigh[] the . . . interest in giving perpetrators of fraud a fresh start." *Id*. In large-scale deception cases, Gugliuzza's actual reliance approach would subvert Congress's intent "to prevent a debtor from retaining the benefits of property obtained by fraudulent means and to ensure that the relief intended for honest debtors does not go to dishonest debtors." *Sabban*, 600 F.3d at 1222 (citing *Slyman*, 234 F.3d at 1085); *see also Eashai*, 87 F.3d at 1086 (exception ensures that dishonest debtors do not "benefit from [their] wrongdoing").[6]

Gugliuzza's approach also would thwart the objectives of the FTC Act. As the district court noted, the FTC Act "'serves a public purpose by authorizing the [agency] to seek redress on behalf of injured consumers' and preventing widespread consumer fraud." Dist. Ct. Op. 10 [ER 10] (citing *Figgie Int'l*, 994

[6] Gugliuzza's heavy reliance (Br. 30-31) on *In re Varrasso*, 194 B.R. 537 (Bankr. D. Mass. 1996), is misplaced. To start with, the portion of the opinion relied on by Gugliuzza is dictum because the court first decided that a default judgment could not estop litigation of the merits, which fully resolved the case. And because the matter involved a default judgment, the record of the underlying case (unlike this one) did not necessarily contain overwhelming evidence and a judicial determination of reliance. Most significantly, the matter involved a single fraud victim and thus has no bearing on the large-scale fraud at issue here.

F.2d at 605). Under Gugliuzza's position, FTC Act violators could avoid judgments against them—and thus deny restitution to their victims—by declaring bankruptcy and faulting the FTC for failing to prove individual reliance for every victim, even if the class of victims runs into the tens or (as here) hundreds of thousands. That position "would undermine the FTC Act's purpose of preventing widespread consumer fraud," Dist. Ct. Op. 10 [ER 10], and would place FTC consumer redress judgments at risk of nullification in bankruptcy in nearly any individual defendant's case.

### 2. The Enforcement Ruling Found "Reasonable Reliance," a More Stringent Standard Than "Justifiable Reliance."

As Gugliuzza acknowledges, the Enforcement Ruling found that his misrepresentations were "of a kind usually relied upon by reasonable prudent people." Br. 32 (citing Dist. Ct. Op. 10 [ER 10]). That determination of "reasonable reliance" under the FTC Act satisfies the less demanding "justifiable reliance" required by the fraud exception. *Field*, 516 U.S. at 61, 70-71, 77; Dist. Ct. Op. 9 [ER 9]. Gugliuzza nonetheless contends there was no showing of reliance at all because some consumers may have learned the truth about his product before they purchased it, and such informed consumers "could not possibly prove . . . justifiable reliance." Br. 33. The argument is untenable.

Under the fraud exception, reliance on a misrepresentation is "justifiable" even if other, accurate information is available unless a consumer "would at once

recognize at first glance" that the statement was false. *Field*, 516 U.S. at 71-72 (citations omitted). Consumers are "entitled to rely upon representations" corresponding to their ordinary understanding, and the FTC need not prove that they went out of their way to conduct "some kind of investigation or examination . . . to discover their falsity" to establish that their reliance on the representations was "justifiable." *Id*. (quotation marks and citation omitted). Thus, even if some consumers theoretically might have been able to derive from Gugliuzza's website that it was a scam, their reliance was justifiable so long as the deceit was not apparent.

The deceit was not apparent. Gugliuzza designed the "disclosure" of the automatic billing enrollment program "not [to] be clear and conspicuous, but rather to mask information" about the true nature of the program. Enforcement Ruling, 878 F. Supp. 2d at 1068. As a result, the disclosure "conceal[ed], obscure[d] and suppresse[d] the very information it purport[ed] to convey." *Id*.; *see* pp. 20-21, *supra*. Because most consumers who wound up enrolling in Gugliuzza's program would have needed to conduct an "investigation or examination . . . to discover the[] falsity" of Gugliuzza's misleading website, *Field*, 516 U.S. at 72 (citation omitted), their reliance on the representations on the website was justifiable.

### C. Gugliuzza Cannot Relitigate Whether His Deceptive Conduct Caused Consumer Harm.

The fraud exception requires a creditor to show damage "proximately caused by its reliance on the debtor's statement or conduct." *Slyman*, 234 F. 3d at 1085. Similarly, in order to obtain an equitable monetary remedy under the FTC Act, the FTC was required to prove that consumers suffered harm as a result of Gugliuzza's violation. *FTC v. Network Servs. Depot, Inc.*, 617 F.3d 1127, 1138 (9th Cir. 2010). In fact, the Enforcement Ruling found that hundreds of thousands of consumers suffered harm as a result of Gugliuzza's deceptive marketing. Enforcement Ruling, 878 F. Supp. 2d at 1074-75, 1088-93. Gugliuzza nevertheless argues that the fraud exception requires a showing of *individualized* monetary harm traced to specific victims. Br. 37-39.

The argument is closely akin to Gugliuzza's claim that the fraud exception requires a demonstration of individualized reliance, and it fails for the same reasons. As with reliance, Gugliuzza cites no authority for his contention that the fraud exception applies the same way in large-scale government enforcement cases that it does in individual cases. That approach suffers from all the same flaws as the reliance argument, and it makes no more sense from a statutory or policy perspective. *See* pp. 23-29, *supra*.

Finally, Gugliuzza contends that "to obtain an actual damages award" (as opposed to the equitable monetary remedy at issue here), the FTC would have been

required to meet the standards for such damages under section 19 of the FTC Act," which he claims are "more stringent" than those under Section 13 of the Act. By "opt[ing] against seeking damages under Section 19," he asserts, "the FTC should not now be able to claim it actually litigated the damages element of nondischargeability." Br. 38-39.

Gugliuzza did not make this argument below, and he may not raise it for the first time on appeal. *Smith v. Marsh*, 194 F.3d 1045, 1052 (9th Cir. 1999). Moreover, the question whether the FTC was required to proceed under Section 19 is currently before the Court in Gugliuzza's other appeal, *see* n.1, *supra*, and there is no good reason for the Court to take up the issue here.

The argument is baseless in any event. The fifth element of the fraud discharge exception does not turn on the provision of the FTC Act on which a judgment was based. A creditor can satisfy that element by showing "actual loss" or "actual harm as a result of [debtor's] misrepresentation." *Sabban*, 600 F.3d at 1223-24. *Cf. Cohen v. de la Cruz*, 523 U.S. 213, 215 (1998) (fraud exception "prevents the discharge of all liability arising from fraud"); *Sabban*, 600 F.3d at 1222-23 (fraud exception bars discharge of a debt even where the debtor did not receive "a direct or indirect benefit from . . . fraudulent activity"). In the enforcement proceeding, the FTC was required to prove, and did prove, that consumers were harmed by Gugliuzza's actions. The fraud exception requirement

also requires proof of harm resulting from his actions. The matter was actually litigated, and was a necessary part of the court's monetary judgment. The finding of harm therefore satisfies all the criteria for collateral estoppel.

## CONCLUSION

For the foregoing reasons, the Court should dismiss this appeal for lack of jurisdiction. If the Court reaches the merits, it should affirm the judgment of the district court.

Respectfully submitted,

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November 5, 2015

## STATEMENT OF A RELATED CASE

A related case is pending before this Court that concerns the same underlying transactions and events as the present appeal and raises legal issues related to those in this case. *Federal Trade Commission v. Charles Gugliuzza*, No. 12-57064 (oral argument held Feb. 9, 2015). Case No. 12-57064 is Gugliuzza's appeal of the district court order holding him individually liable for violations of the Federal Trade Commission Act and imposing an $18.2 million judgment. *Commerce Planet, Inc.*, 878 F. Supp. 2d 1048 (C.D. Cal. 2012) ("Enforcement Ruling"). The instant case presents the question of whether Gugliuzza's obligation to satisfy that judgment is a debt that, under 11 U.S.C. § 523(a)(2)(A), cannot be discharged in bankruptcy.

## STATUTORY ADDENDUM

TITLE 11—BANKRUPTCY

### § 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

* * * * *

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

* * * * *

TITLE 28—JUDICIARY AND JUDICIAL PROCEDURE

### § 158. Appeals

(a) The district courts of the United States shall have jurisdiction to hear appeals—

(1) from final judgments, orders, and decrees;

(2) from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and

(3) with leave of the court, from other interlocutory orders and decrees; of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.

* * * * *

(d)(1) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.

**Certificate of Compliance With Type-Volume Limitation, Typeface Requirements, and Type Style Requirements**

I certify as follows:

1. This Corrected Version of the Brief of the Federal Trade Commission complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 7,741 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This Corrected Version of the Brief of the Federal Trade Commission complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface, using Microsoft Word 2010, in 14-point Times New Roman font.

November 10, 2015

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## Certificate of Service

I certify that I filed the foregoing Corrected Version of the Brief of the Federal Trade Commission with the Court's Appellate CM-ECF System on this date. The CM-ECF system will transmit this document electronically to counsel for all parties in this case.

November 10, 2015

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## Certificate for Brief in Paper Format

I, David L. Sieradzki, certify that this Corrected Version of the Opposition Brief of the Federal Trade Commission in Case No. 15-55510 in paper format is identical to the brief submitted electronically on November 10, 2015.

I further certify that this Corrected Version of the Opposition Brief of the Federal Trade Commission is identical to the original version of the Opposition Brief of the Federal Trade Commission submitted electronically on November 5, 2015, with the exception of the changes listed in the Errata submitted on November 10, 2015.

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