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**UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA**

<p><b>Federal Trade Commission,</b></p> <p style="text-align: center;">Plaintiff,</p> <p style="text-align: center;">v.</p> <p><b>Dennis Connelly, et al.,</b></p> <p style="text-align: center;">Defendants.</p>	}
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Case No.

**MEMORANDUM OF POINTS AND  
AUTHORITIES IN SUPPORT OF  
PLAINTIFF'S EX PARTE  
APPLICATION FOR TEMPORARY  
RESTRAINING ORDER, ETC.**

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1 **I. INTRODUCTION**

2 The Federal Trade Commission ("Commission" or "FTC") seeks to halt the  
3 practices of a blatantly deceptive debt-negotiation scheme and to preserve assets for  
4 victimized consumers. Since 2001, Defendants have misrepresented to consumers  
5 throughout the United States that Defendants will negotiate settlements with  
6 consumers' creditors that will allow consumers to pay off their unsecured debt for  
7 substantially lower amounts than consumers owe their creditors. According to  
8 Defendants, after consumers complete Defendants' program, consumers will have  
9 good credit and will be able to go on with their lives.

10 But, after paying substantial fees, consumers discover that Defendants'  
11 representations are false. Defendants negotiate few if any settlements for their  
12 clients; in many instances, Defendants never contact consumers' creditors. Because  
13 consumers are advised to stop making payments to their creditors, their accounts are  
14 frequently placed in collection, and many consumers are sued by their creditors and  
15 find their wages garnished. Many consumers discover that their financial situation  
16 has deteriorated to the point where they can no longer make even the minimum  
17 payments on their credit cards, they are ineligible for traditional credit counseling  
18 services, and they have no alternative but to file for bankruptcy. As a result of  
19 Defendants' scheme, thousands of victims nationwide have sustained millions of  
20 dollars in monetary losses.

21 Pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"),  
22 15 U.S.C. § 53(b), the Commission sues to stop Defendants' fraudulent practices and  
23 seeks a Temporary Restraining Order with Asset Freeze and Orders Appointing a  
24 Temporary Receiver, Authorizing Expedited Discovery and to Show Cause Why a  
25 Preliminary Injunction Should Not Issue ("TRO"). The proposed TRO prohibits  
26 Defendants from making further misrepresentations, prevents Defendants' banks  
27 from transferring funds to Defendants, and freezes Defendants' assets so that  
28 Defendants' ill-gotten gains cannot be dissipated or removed from the country. It

1 will also provide the FTC with the authority to propound expedited discovery in  
2 order to locate additional assets which might be used to provide redress to  
3 consumers should Plaintiff prevail on the merits.

## 4 **II. PARTIES**

### 5 **A. Plaintiff**

6 Plaintiff **Federal Trade Commission** is an independent agency of the United  
7 States government created by the FTC Act, 15 U.S.C. § 41 *et seq.* The Commission  
8 is charged, *inter alia*, with enforcement of Section 5(a) of the FTC Act, 15 U.S.C.  
9 § 45(a), which prohibits unfair or deceptive acts or practices in or affecting  
10 commerce. The Commission is authorized to initiate federal district court  
11 proceedings against individuals and corporations, by its own attorneys, to enjoin  
12 violations of these federal laws and to secure such equitable relief as may be  
13 appropriate in each case, including restitution for injured consumers.<sup>1</sup>

### 14 **B. Defendants**<sup>2</sup>

#### 15 1. Overview

16 Defendants **Dennis Connelly** and **Wade Torkelson** launched Defendants'  
17 debt-negotiation operation in the fall of 2001 when they founded Defendant  
18 **Homeland Financial Services** ("Homeland"), based in Santa Ana, California.<sup>3</sup> For  
19 its first two to three years of operation, Homeland was largely a vertically integrated  
20 operation that conducted both sales and "back-end" services, including negotiations  
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23 <sup>1</sup> 15 U.S.C. §§ 45, 53(b).

24 <sup>2</sup> Plaintiff's evidence, filed concurrently herewith, consists of three volumes  
25 of consumer declarations; the declarations of two former insiders, Sarah  
26 Szkudlarek and Michael Real; declarations from five FTC investigators, which  
27 include transcripts of numerous sales pitches received during undercover  
28 telephone calls; and records from previous court cases involving the Defendants,  
which are included as exhibits to the declaration of FTC attorney John Jacobs.

<sup>3</sup> Real ¶¶ 8-10, 32; Szkudlarek ¶¶ 29, 39.

1 with creditors and customer service.<sup>4</sup> Homeland also obtained customers through  
2 contracts with various sales offices.<sup>5</sup>

3 In August 2004, Homeland reorganized its operation. The reorganization  
4 consisted primarily of two components. First, Connelly and Torkelson formed  
5 Defendant **United Debt Recovery, LLC** ("United"), and transferred Homeland's in-  
6 house sales operation to United.<sup>6</sup> Second, Connelly and Torkelson formed  
7 Defendant **National Support Services, LLC** ("NSS"), which took over the  
8 processing and servicing of new debt-negotiation clients.<sup>7</sup> Homeland management  
9 explained that they were restructuring the company because the "biggest obstacle" to  
10 future expansion of sales was the ever increasing number of complaints that had  
11 been lodged against Homeland with the Better Business Bureau of the Southland  
12 ("BBB").<sup>8</sup> The reorganization solved the problem by eliminating Homeland from  
13 both sales and service. Because Homeland's name would no longer be connected to  
14 the transaction, Homeland's negative history would no longer be an issue.

15 The change was thus largely cosmetic. Indeed, Homeland's management  
16 assured its sales offices at the time of the reorganization that "[n]othing will change  
17 from the way we do business."<sup>9</sup>

18 Under the new structure, NSS began outsourcing its sales operation entirely to  
19 third-party sales offices, in an effort to create a buffer zone between NSS and  
20 consumer complaints, and also to avoid the attention of law enforcement.<sup>10</sup> While  
21 NSS continued to provide scripts and training to these offices, NSS characterized its  
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23 <sup>4</sup> Szkudlarek ¶¶ 39-41; Real ¶¶ 33-37, 62.

24 <sup>5</sup> Szkudlarek ¶ 12; Real ¶¶ 33-34, 70-73.

25 <sup>6</sup> Szkudlarek ¶¶ 9, 15-19.

26 <sup>7</sup> Szkudlarek ¶¶ 9, 15-19; Ex. 30 (¶ 219).

27 <sup>8</sup> Szkudlarek Ex. 30 (¶ 219), ¶ 229.

28 <sup>9</sup> Szkudlarek Ex. 30 (top of p. 255) (¶ 219); *see also* Ex. 4 (¶ 16).

<sup>10</sup> Szkudlarek ¶ 19; Real ¶ 40.



1 role as providing these sales offices with "back-end support"—i.e., everything  
2 involved in providing a debt-negotiation program except the sales.<sup>11</sup> Following a  
3 consumer's enrollment, the sales office would then pass the contract on to NSS for  
4 servicing. NSS, through another company owned by Connelly and Torkelson,  
5 would then pay the sales office a percentage of the fee received from the client.<sup>12</sup>

6 These sales offices include not only Defendant United, but also Defendants  
7 **Prosper Financial Solutions** ("Prosper") (a d/b/a for Defendant **Joanne Garneau**),  
8 **Freedom First Financial** ("Freedom First"), and **USA Debt Co, LLC** ("USA  
9 Debt"), a/k/a UsaDebtCo.com.<sup>13</sup> NSS (and Homeland before it) has had at least as  
10 many as 26 sales offices selling the company's debt-negotiation program.<sup>14</sup>

11 It appears that within the past few months, NSS has transferred its operation  
12 to Nationwide Support Services ("Nationwide"). Consumers report receiving letters  
13 from Nationwide stating that the consumer's account with the Defendants "is now  
14 being serviced" by Nationwide.<sup>15</sup> The BBB lists Theresa Schumann, who was the  
15 C.O.O. of NSS, as the BBB's contact at Nationwide.<sup>16</sup> Nationwide is integrally  
16 related not only to NSS, but also to other Defendants. Corporate records show that  
17 Defendant Joanne Garneau is the Chief Executive Officer of Nationwide, and that  
18 the company has an address that is the same as Defendant Prosper's address.<sup>17</sup> In  
19 addition, the sign on the door of an office that previously belonged to Defendant  
20 United now reads "Nationwide Support Services."<sup>18</sup>

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22 <sup>11</sup> Szkudlarek ¶ 66; Ex. 30 (top of pg.255).

23 <sup>12</sup> Szkudlarek ¶¶ 22, 81, 90; Jacobs ¶ 15d at pg.11:18 - 12:3, Ex. 24.

24 <sup>13</sup> Szkudlarek ¶ 26-27, Ex. 6 (¶ 25).

25 <sup>14</sup> Szkudlarek ¶ 19; see also Ex. 6 (¶ 26) (19 sales offices as of Jan. 2005.)

26 <sup>15</sup> Consumer Gorski ¶ 24, Ex. 4; Gale ¶ 142, Ex. 34 at pg.354 (cf. Gorski).

27 <sup>16</sup> Gale ¶ 141, Ex. 33; Szkudlarek ¶ 15 (Schumann COO of NSS).

28 <sup>17</sup> Gale ¶¶ 43-45, Ex. 6; see also ¶ 140 (BBB report).

<sup>18</sup> Gale ¶ 22.

1 Defendants' debt-negotiation program has generated substantial revenues.  
2 Between 2002 and 2004, Homeland's and NSS's gross revenues ranged from roughly  
3 \$200,000 to close to \$1 million per week.<sup>19</sup> Net sales in 2003 and 2004 generally  
4 fluctuated between \$1.5 million and \$2.5 million per month.<sup>20</sup> Connelly and  
5 Torkelson boasted that they had a "50 million-dollar-a-year company."<sup>21</sup>

## 6 2. The Individual Defendants

7 **Defendant Dennis Connelly**, together with Defendant Torkelson, has owned  
8 and operated Defendants Homeland, NSS, and United; he also has owned Defendant  
9 Freedom First, and possibly Defendant USA Debt.<sup>22</sup> Connelly has also served as the  
10 Secretary and as a director of Homeland.<sup>23</sup>

11 While Connelly and Torkelson attempted to hide their ownership and control  
12 of their companies, these two Defendants were in charge of the debt-negotiation  
13 business, operating as a team, supervising the sales room, making all the significant  
14 decisions and receiving the biggest share of the profits.<sup>24</sup>

15 Prior to starting Homeland, Connelly had been a defendant in both criminal  
16 and civil law-enforcement actions stemming from a fraudulent telemarketing scam  
17 involving the sale of copier toner. A grand jury in this district indicted Connelly in  
18 1995 for mail fraud, wire fraud and money laundering; in 1997, Connelly pled guilty  
19 to charges of money laundering and was sentenced to serve 33 months in prison and  
20 three years thereafter on supervised release.<sup>25</sup> Connelly was then twice found to  
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23 <sup>19</sup> Real ¶¶ 58-61.

24 <sup>20</sup> Szkudlarek ¶ 42.

25 <sup>21</sup> Szkudlarek ¶ 42.

26 <sup>22</sup> Szkudlarek ¶¶ 26, 29-30, 34, 38; Real ¶¶ 8-10.

27 <sup>23</sup> Gale Ex. 2 (¶ 34).

28 <sup>24</sup> Szkudlarek ¶¶ 28, 30-34, 38; Real ¶¶ 43-44, 47-48.

<sup>25</sup> Jacobs ¶ 6c.

1 have violated the terms of his supervised release.<sup>26</sup> One of the violations involved  
2 associating with five different convicted felons, apparently in connection with  
3 another telemarketing scam, which resulted in Connelly's re-incarceration and a  
4 prohibition on telemarketing during the ensuing supervised release, which remained  
5 in effect at least through April 2003.<sup>27</sup>

6 In March 1996, the FTC filed civil charges against Connelly in connection  
7 with the toner scam discussed above.<sup>28</sup> On August 8, 1996, a Stipulated Final  
8 Judgment and Order for Permanent Injunction was entered against Defendant  
9 Connelly (Final Order). The Final Order prohibits Connelly, *inter alia*, from  
10 misrepresenting any material facts in connection with the telemarketing of any  
11 goods or services.<sup>29</sup>

12 **Defendant Richard Wade Torkelson**, also known as Wade Torkelson,  
13 founded or helped to found Defendants Homeland, NSS, and United.<sup>30</sup> Torkelson is  
14 or has been the Chief Executive Officer, the Chief Financial Officer, and a director  
15 of Homeland.<sup>31</sup>

16 **Defendant Joanne Garneau**, also known as Joanne Torkelson, is an  
17 individual who has conducted business as **Prosper Financial Solutions**<sup>32</sup> out of  
18 offices located at 1031 Calle Recodo Suite D, San Clemente, California.<sup>33</sup> Garneau  
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22 <sup>26</sup> *Id.* at ¶ 6e and g.

23 <sup>27</sup> *Id.* at 6h, Ex. 9.

24 <sup>28</sup> *Id.* at ¶ 7.

25 <sup>29</sup> *Id.* at ¶ 9, Ex. 16 (pg.163:19-27).

26 <sup>30</sup> Szkudlarek ¶ 29; Real ¶¶ 8-10.

27 <sup>31</sup> Gale Ex. 2 (¶ 34).

28 <sup>32</sup> Szkudlarek ¶ 27.

<sup>33</sup> Gale Ex. 4 (¶ 38); ¶ 28; Ex. 16 (¶ 76).

1 is also the Chief Executive Officer and a director of Nationwide.<sup>34</sup> Garneau is the  
2 mother of Defendant Wade Torkelson.<sup>35</sup>

3           3.     The Corporate Defendants

4           **Defendant Homeland Financial Services** is a California corporation which  
5 is last known to have operated out of offices located at 2850 Red Hill Avenue, Suite  
6 220, Santa Ana, California.<sup>36</sup> The majority owners of Homeland were Defendants  
7 Connelly and Torkelson, each with a 45% interest.<sup>37</sup> As explained above, Homeland  
8 operated a debt-negotiation program through July 2004; Homeland stopped  
9 accepting new clients in August 2004. Homeland continued, however, to maintain a  
10 website and referred inquirers to United or one of NSS's other sales offices.<sup>38</sup>

11           **Defendant National Support Services, LLC** is a California limited liability  
12 company whose last known principal place of business was 2850 Hill Avenue, Suite  
13 220, Santa Ana, California.<sup>39</sup> As explained above, NSS was last known to be owned  
14 by Defendants Connelly and Torkelson. National took over Homeland's debt-  
15 negotiation business in 2004, contracting out the sales function to third-party sales  
16 offices. It appears NSS transferred its operation to Nationwide Support Services in  
17 April 2006.

18           **Defendant United Debt Recovery, LLC** is a Nevada limited liability  
19 company whose last known principal place of business was 2151 Michelson Drive,  
20 Suite 170, Irvine, California.<sup>40</sup> United was last known to be owned by Defendants  
21 Connelly and Torkelson. United was a sales office that sold Defendant NSS's debt-

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23           <sup>34</sup> Gale ¶ 45, Ex. 6.

24           <sup>35</sup> Szkudlarek ¶ 27.

25           <sup>36</sup> Gale Ex. 2 (¶ 34); Szkudlarek ¶ 40.

26           <sup>37</sup> Jacobs at p.12:21-26, Ex. 23 at 249:9-12; Szkudlarek ¶ 29; Real ¶ 14.

27           <sup>38</sup> Szkudlarek ¶ 47.

28           <sup>39</sup> Gale Ex. 1 (¶ 33); ¶¶ 6, 13, 15; Jacobs ¶ 11a, Ex. 17.

<sup>40</sup> Gale Ex. 3 (¶ 35); ¶¶ 7, 12; Szkudlarek ¶ 41; Ex. 6 (top of pg.72)(¶ 25).

1 negotiation program. According to documents that the company filed with the  
2 California Secretary of State, United's records are maintained at NSS's address.<sup>41</sup>  
3 United began operating in August 2004.

4 **Defendant Freedom First Financial, LLC** is a Wyoming limited liability  
5 company whose last known principal place of business was 1274 Center Court  
6 Drive, Suite 107, Covina, California.<sup>42</sup> Freedom First was last known to be owned  
7 by Defendant Connelly. Freedom First was a sales office for Defendant NSS.  
8 Freedom First began operating in or about 2004.

9 **Defendant USA Debt Co, LLC**, also known as UsaDebtCo.com, appears to  
10 be a successor to Defendant Freedom First. Like Freedom First, USA Debt is a  
11 Wyoming limited liability company.<sup>43</sup> USA Debt maintained an office at 1274  
12 Center Court Drive, Suite 107, Covina, California, following the apparent departure  
13 from that address of Freedom First.<sup>44</sup> USA Debt also maintained a website that was  
14 virtually identical to that of Freedom First.<sup>45</sup> The BBB lists the same contact people  
15 for USA Debt as were listed for Freedom First.<sup>46</sup> USA Debt was also a sales office  
16 for NSS.

17 ///

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22 <sup>41</sup> Gale Ex. 3 (¶ 35).

23 <sup>42</sup> Gale Ex. 10 (¶¶ 57-58); Ex. 18 (¶ 76d).

24 <sup>43</sup> Gale ¶ 60, Ex. 11.

25 <sup>44</sup> Gale ¶¶ 8, 10; Szkudlarek Ex. 6 (at bottom of pg.72) (¶ 25).

26 <sup>45</sup> Cf. Gale Ex. 20 (¶ 78) and Ex. 18 (¶ 76d). In addition, the domain names  
27 for USA Debt and Freedom First are both registered to the same name (with the  
28 same e-mail address). Gale ¶ 69f and j.

<sup>46</sup> Gale ¶ 136.

1 **III. DEFENDANTS' FRAUDULENT SCHEME**

2 **A. Defendants' Debt-Negotiation Program**

3 1. Defendants' Solicitations Begin With Elaborate Websites

4 Defendants promote their program to prospective purchasers primarily  
5 through Internet websites.<sup>47</sup> Consumers find these websites while searching on the  
6 Internet for information about debt reduction or avoiding bankruptcy.<sup>48</sup> Former  
7 insiders report that Defendants Connelly and Torkelson were responsible for the text  
8 that appeared on the websites and that they used companies called Overture and  
9 Engine Ready to help ensure that a link to Homeland's website appeared at or near  
10 the top of the list of search results.<sup>49</sup> After the reorganization, NSS provided the  
11 independent sales offices with a template, based on the Homeland website, to use in  
12 setting up their own websites.<sup>50</sup> Each of the websites promotes debt-negotiation  
13 services under the sales office's own name without any reference to NSS.

14 The dominant theme of Defendants' websites is that consumers can rely on  
15 Defendants to improve the consumer's financial situation and to relieve consumers  
16 of the stress of dealing with creditors.<sup>51</sup> Each website includes claims such as "We  
17 can help you find the best alternative for dealing with your debt,"<sup>52</sup> "We have a great  
18  
19

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20 <sup>47</sup> Defendants Homeland and Prosper have multiple websites in both  
21 English and Spanish. *See* Gale ¶¶ 63, 74-83; Gale Ex. 15 (¶ 76a) [Homeland], Ex.  
22 16 (¶ 76b) [Prosper], Ex. 17 (¶ 76c) [United], Ex. 18 (¶ 76d) [Freedom First], Ex.  
23 19 (¶ 77) [Prosper], Ex. 20 (¶ 78) [USA Debt], Ex. 22 (¶ 82a) [Prosper Spanish],  
Ex. 23 (¶ 82b) [Homeland Spanish]; Real ¶¶ 77-78; Szkudlarek ¶ 52.

24 <sup>48</sup> *See e.g.* Bond ¶ 5; Evans¶ 2; Gorski ¶ 5; Rangel ¶ 3; Real ¶ 80; Robinson  
25 ¶ 4; Spezzacatena ¶ 6; Washington ¶¶ 3-4.

26 <sup>49</sup> Real ¶¶ 77-81; Szkudlarek ¶¶ 46, 48

27 <sup>50</sup> Real ¶ 81; Szkudlarek ¶¶ 45, 50-52.

28 <sup>51</sup> *See e.g.* Gale Ex. 15, pg. 134-35 (¶ 76a); Ex. 18, pg. 177 (¶ 76d).

<sup>52</sup> *See e.g.* Gale Ex. 17, pg. 165 (¶ 76c); Ex. 18, pg. 177 (¶ 76d).

1 track record with creditors and clients,"<sup>53</sup> and, "Our main goal is to get you out of  
2 debt,"<sup>54</sup> and also includes "testimonials" that purport to be from satisfied  
3 customers.<sup>55</sup>

4 The websites claim Defendants will improve consumers' financial situations  
5 by lowering their debt. They make claims such as "We can help you find the best  
6 alternative for dealing with your debt,"<sup>56</sup> "Reduce your debt by 40-60% of the  
7 current total" and "[H]elping good people like you every day by reducing your debt  
8 up to 50% and getting you debt free forever."<sup>57</sup> The claims found on Prosper's  
9 website are typical. The Prosper homepage assures consumers in large bold letters  
10 that "DEBT RELIEF is finally available," and claims that they will "reduce pay-off  
11 time by 70%, cut monthly payments by as much as 60%, reduce or eliminate interest  
12 rates."<sup>58</sup> Similarly, the United website claims: "Your current level of unsecured debt  
13 will be skillfully negotiated for you. Our average monthly settlements range from  
14 45-62% of the total debt, which means that essentially you will be paying only a  
15 portion of your debt."<sup>59</sup>

16 Most consumers simply glance at the first page of whichever website they  
17 visit and come away with the impression that the Defendants can settle a variety of  
18 unsecured debt, including credit cards, unsecured loans, and medical bills, for  
19 pennies on the dollar.<sup>60</sup> Defendants' websites encourage consumers to request a free  
20 analysis of their financial situation either by calling Defendants' toll-free numbers or  
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22 <sup>53</sup> See e.g. Gale Ex. 15, pg.145 (¶ 76a), Gale Ex. 16, pg. 162 (¶ 76b).

23 <sup>54</sup> See e.g. Gale Ex. 20, pg. 207 (¶ 78).

24 <sup>55</sup> See e.g. Gale Ex. 19, 156-57 (¶ 77); Ex. 20, pg. 219-20 (¶ 78).

25 <sup>56</sup> See e.g. Gale Ex. 17, pg. 165 (¶ 76c); Ex. 18, pg. 177 (¶ 76d).

26 <sup>57</sup> See e.g. Gale Ex. 18, pg. 180 (¶ 76d); Ex. 20, pg. 206 (¶ 78).

27 <sup>58</sup> See e.g. Gale Ex. 16, pg. 158 (¶ 76b); Ex. 19, pg. 196 (¶ 77).

28 <sup>59</sup> See e.g. Gale Ex. 17, pg. 168 (¶ 76c), Gale Ex. 18, pg. 180 (¶ 76d).

<sup>60</sup> See e.g. Robinson ¶ 4; Washington ¶ 4.

1 by completing and submitting an online form requesting more information.<sup>61</sup>  
2 Whether consumers complete Defendants' on-line form for more information, or call  
3 Defendants' toll free number, they soon find themselves connected with one of  
4 Defendants' sales persons.<sup>62</sup>

## 5 2. Interview with a Financial Consultant

6 The telephone interview with a "debt" or "financial" consultant is the second  
7 step in the enrollment process. But instead of actual advice, counseling or training  
8 about budgets, consumers get only a hard sell to enroll in Defendants' debt  
9 negotiation program.<sup>63</sup> Based on their discussions with Defendants' sales  
10 representative, consumers believe that participation in Defendants' program lacks  
11 any down side.

12 The essence of the pitch is that Defendants have a procedure to negotiate  
13 down any unsecured debt so that the consumer will be able to pay off debts sooner  
14 for a substantially lower amount and have more cash in hand. More specifically,  
15 they claim that Defendants will persuade creditors to settle consumers' accounts for  
16 as little as 40% of the current outstanding balance. To pay off the settlement, the  
17 consumer will make monthly payments—typically substantially less than the  
18 consumer's current minimum monthly payments—into a separate account or to  
19 Defendants.<sup>64</sup> Defendants tell consumers directly or indirectly that they need to stop  
20 paying their creditors before creditors will negotiate a favorable settlement.<sup>65</sup> Thus,  
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23 <sup>61</sup> Eby ¶ 3; Davila ¶ 3; Szkudlarlek ¶ 53.

24 <sup>62</sup> See e.g. Chiarolanza ¶¶ 5-6; Bond ¶ 6; Evans ¶ 4; Robinson 4-5;  
25 Spezzacatena ¶ 8; Szkudlarek ¶ 59; Washington ¶¶ 5-6.

26 <sup>63</sup> Gorski ¶ 13; Rangel ¶ 10; Spezzacatena ¶¶ 14-15.

27 <sup>64</sup> See e.g. Drayton ¶ 6; Eby ¶¶ 6-7; Evans ¶ 6; Hadenfeldt ¶ 11; Gorski ¶ 9.

28 <sup>65</sup> Szkudlarek ¶ 74; See also e.g. Bresnahan Ex. 4, pg. 100 (¶ 15); Drayton  
¶ 8; Robinson ¶ 14; Washington ¶ 10.



1 Even those who are current when they enter the program soon find themselves in  
2 arrears.<sup>66</sup>

3 Consumers are assured that creditors regularly accept the types of settlements  
4 proposed by the Defendants.<sup>67</sup> They are told that the Defendants have considerable  
5 experience at effectively negotiating settlements on behalf of their clients<sup>68</sup> and that  
6 Defendants can achieve substantially better results than a consumer could expect if  
7 they tried their own negotiations. Consumer Chiarolanza, for example, was told by  
8 the Prosper sales representative that he could negotiate with his creditors on his own  
9 but that his chances of being successful were small.<sup>69</sup>

10 Regardless of their circumstances, every declarant and every Commission  
11 investigator was advised that the solution to their financial difficulties was to enroll  
12 in Defendants' debt negotiation program.<sup>70</sup>

13 a. Defendants Represent that They Can and Will Negotiate  
14 Settlements and Reduce Consumers' Total Debt

15 The telemarketer tells the consumers that under the company's program, they  
16 will no longer have to deal with their creditors, that they will pay off their debt by  
17 paying only a fraction of their outstanding balance, and that they will enjoy more  
18 affordable monthly payments.<sup>71</sup>

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20 <sup>66</sup> See e.g. Eby ¶ 2; Davila ¶ 2; Drayton ¶ 3; Young ¶ 3.

21 <sup>67</sup> See e.g. Bond ¶ 8; Evans ¶ 4; Stetson ¶ 4; Szkudlarek ¶ 201.

22 <sup>68</sup> See e.g. Eby ¶ 5; Bresnahan Ex. 1, pg. 27(¶ 5), Ex. 2, pgs. 60-61 (¶ 9),  
23 Ex. 3, pg. 84 (¶ 12), Ex. 4, pg. 113 (¶ 15). See also Gale Ex. 17, pg. 173 (76c).

24 <sup>69</sup> Chiarolanza ¶ 8.

25 <sup>70</sup> See e.g. Bond ¶ 8; Bresnahan Ex. 1, pgs.11-14 (¶ 5); Ex. 2, pgs. 42, 48-50  
26 (¶ 9), Ex. 3, pgs. 70-72 (¶ 12); Evans ¶¶ 4-5; Feagin ¶ 5; Gale ¶¶ 106-116;  
Kaufman Ex. 1, pg. 16; (¶ 8 ); Washington ¶ 6.

27 <sup>71</sup> See e.g. Bresnahan Ex. 1, pg. 14 (¶ 5); Baronowski ¶ 5; Bond ¶ 9;  
28 Chiarolanza ¶¶ 7, 14; ¶ 5; Evans ¶¶ 5-6; Hadenfeldt ¶ 11-12; Kraus Ex. 1, pg. 26  
(¶ 5) ("we are here to take the brunt of it").

1 Consumers report being told that they will be able to pay off their debts for 40  
2 to 60% of what they presently owe.<sup>72</sup> For example, Consumer Feagin owed \$20,528  
3 on her credit cards. The Homeland representative told her that Homeland could  
4 settle her accounts for half of the original balance.<sup>73</sup> Consumer Evans was told by a  
5 United sales representative that if she enrolled in United's program, she would pay  
6 off the \$17,000 in credit card debt for about \$9,000, including the fees to United.<sup>74</sup>  
7 A United representative told Consumer Spezzacatena that he and his wife could pay  
8 off their total debt of \$40,496 for approximately \$16,198 plus fees of \$5,669.<sup>75</sup>

9 These same representations were made to FTC investigators who placed  
10 undercover calls to the Defendants. For example, in two separate calls, an  
11 investigator was informed by representatives from USA Debt and Freedom First that  
12 she would be able to settle \$32,000 of debt for a total of \$17,280, including the  
13 company's service fees.<sup>76</sup> USA Debt further said that her monthly payment would be  
14 \$471 for thirty-six months (down from her current estimated monthly payment of  
15 approximately \$650), while Freedom First said that her monthly payment would be  
16 \$501 for thirty-four months.<sup>77</sup> A Freedom First representative informed another  
17 investigator that they would be able to negotiate \$41,000 in debt down to a total of  
18 \$22,140, including fees, and lower her monthly payments down from \$825 to  
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21 <sup>72</sup> See e.g. Bresnahan, Ex.1, pg. 14 (¶ 5), Ex. 2, pg. 50 (¶ 9), Ex. 3, pg. 71  
22 (¶ 12), Ex. 4, pgs. 100, 102 (¶ 15); Davila ¶ 5; Drayton ¶ 5; Duez ¶ 8; Eby ¶ 4;  
23 Feagin ¶ 5; Gosha Ex. 1, pg. 19-20 (¶ 9), Ex. 2, pg. 35 (¶ 10), Ex. 3, pg. 63-64  
24 (¶ 15), Ex. 4, pg. 74 (¶ 16), Ex. 11, pg. 138, 140 (¶ 32); Kraus Ex. 1, pgs. 20-21  
(¶ 5), Ex. 3, pgs. 65-66 (¶ 8).

25 <sup>73</sup> Feagin ¶ 4.

26 <sup>74</sup> Evans ¶¶ 2, 5-6.

27 <sup>75</sup> Spezzacatena ¶¶ 3-4, 11.

28 <sup>76</sup> Bresnahan Ex. 1, pg. 16 (¶ 5), Ex. 3, pg. 73-74 (¶ 12)

<sup>77</sup> Id.

1 \$622.69.<sup>78</sup> A Prosper telemarketer claimed that the Defendants could lower our  
2 investigator's total debt from \$31,000 to \$18,600 and his monthly payment from  
3 \$1,000 down to \$639.

4 Both of the former insiders state that they made these types of representations  
5 or heard them being made to prospective consumers.<sup>79</sup> A script provided by an  
6 insider is consistent with our undercover transcripts and consumer interviews. It  
7 promises that Defendants will "immediately contact your creditors and collectors . .  
8 . and inform them that we are now representing you on your behalf. You'll no  
9 longer deal with them directly at all." The script goes on to say that Defendants will  
10 "negotiate your debt down 40% - 60% of what you owe," leaving the consumer with  
11 a single monthly payment and debt free in as little as 3 years.<sup>80</sup>

12 Any expression of skepticism by consumers is met by assurances that the  
13 program actually works. Consumers report that telemarketers left no doubt in their  
14 minds that if they enrolled in the program, all of their credit-card debts would be  
15 negotiated down to a substantially lesser amount.<sup>81</sup> Statements made to undercover  
16 investigators corroborate what the consumers reported. For example, when an  
17 investigator asked a Freedom First representative about its success rate, the sales  
18 representative claimed that "the success rate is high."<sup>82</sup> In another undercover call,  
19 an investigator asked: "And are people generally -- people that do this program, are  
20 they generally successful in getting out of debt?" The Prosper representative  
21 asserted: "Actually, we've got one of the highest completion rates in the industry."<sup>83</sup>  
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23 <sup>78</sup> Kraus Ex. 1, pg. 8 (¶ 5).

24 <sup>79</sup> Real ¶¶ 88-89, 92-93; Szkudlarek ¶ 69.

25 <sup>80</sup> Szkudlarek ¶¶ 63-72, Ex. 11, pgs. 139 (¶ 63); *see also* Ex. 9, pgs. 96, 100  
26 (¶ 60) [Marketer's Guide: "52% or less"].

27 <sup>81</sup> Spezzacatena ¶ 11.

28 <sup>82</sup> Bresnahan Ex. 1, pgs. 27-28 (¶ 5)

<sup>83</sup> Bresnahan Ex. 2, pgs. 60-61 (¶ 9)

1 In response to a similar question, a USA Debt representative replied: "I know that  
2 we haven't had anyone not have their debt settled. . . . And that's even including  
3 people that have like \$124,000."<sup>84</sup>

4 b. Defendants Represent They Have Special Relationships  
5 with Creditors and A High Success Rate

6 Defendants' telemarketers claim that Defendants have special expertise in  
7 dealing with creditors.<sup>85</sup> While some sales representatives may concede that  
8 consumers can negotiate their debts on their own, they discourage consumers from  
9 doing so, emphasizing that the Defendants can get a better deal because they have  
10 "skills and knowledge of how your creditors negotiate" coupled with leverage  
11 resulting from the volume of accounts they deal with and "many years of experience  
12 negotiating the largest debt reductions."<sup>86</sup> After one consumer listed her creditors,  
13 the sales representative replied that her creditors "were good to work with" and that  
14 Prosper had dealt with them before.<sup>87</sup> Prosper told another consumer that they could  
15 work with all of the consumer's creditors.<sup>88</sup>

16 A Prosper sales representative told a Commission investigator that "we're  
17 going to be using our leverage. We've enrolled over 40,000 clients. So, we're not  
18 just going at them with one credit card, one account, we're going at them with  
19 hundreds of accounts at a time."<sup>89</sup> Similar representations were made to another  
20 investigator who was told that one reason Prosper could help him was that "you are  
21  
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23 <sup>84</sup> Washington ¶ 6.

24 <sup>85</sup> See e.g. Barnowski ¶ 5; Chiarolanza ¶ 7; Rangel ¶¶ 7-8; Gorski ¶ 7.

25 <sup>86</sup> Gale Ex. 15, pg. 139 (¶ 76a), Ex. 17, pg. 173 (¶ 76c), Ex. 19, pg. 198 (¶ 77).

26 <sup>87</sup> Bond ¶ 8.

27 <sup>88</sup> Washington ¶ 7.

28 <sup>89</sup> Bresnahan Ex. 2, pg. 58 (¶ 9) [Investigator placed call to Homeland and  
was transferred to Prosper].

1 not just Craig Stone against MBNA and Providian, it's Craig Stone and about 900  
2 other people that we're settling the same accounts with."<sup>90</sup>

3 Sales representatives are also unequivocal in their assurances that the  
4 Defendants can work successfully with all credit-card issuers.<sup>91</sup> In a conversation  
5 with a USA Debt representative, for example, an investigator specifically said: "I  
6 was just curious if you were going to say there were certain credit cards -- you  
7 know, credit-card companies that you didn't work with or something like that." The  
8 representative responded unequivocally: "Oh, no, no, no, no."<sup>92</sup> According to our  
9 former insiders, the Defendants were reluctant to decline any of a consumer's  
10 accounts in large part because the consumer's fees are based on the total amount of  
11 debt the consumer submits into the program.<sup>93</sup>

12 c. Defendants Represent the Program's Effect on Consumers'  
13 Credit Rating is Limited and Temporary

14 One common question from consumers considering enrollment in the program  
15 is how participation will affect their credit rating.<sup>94</sup> Sales personnel use a scripted  
16 response, downplaying any negative impact and even claiming that creditors will  
17 remove any derogatory information at the end of the program.<sup>95</sup>

18 Corroborating the information from the insiders and the actual script, the  
19 consumers we interviewed believed that the worst thing that could happen by  
20 enrolling in the Defendants' program was that their credit rating might decline  
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22 <sup>90</sup> Kaufman Ex. 1, pg. 16 (¶ 8).

23 <sup>91</sup> See e.g. Bond 8; Bresnahan, Ex. 1, pg. 27 (¶ 5); Kaufman Ex. 1, pgs. 9-12  
24 (¶ 8); Kraus, Ex. 1, pg. 31 (¶ 5); Real ¶¶ 99-100.

25 <sup>92</sup> Bresnahan Ex. 1, pg. 14 (¶ 5)

26 <sup>93</sup> Real ¶¶ 98-100; Szkudlarek ¶¶ 203-04.

27 <sup>94</sup> Real ¶ 96.

28 <sup>95</sup> Real ¶¶ 96-97; Szkudlarek ¶ 193; see also Bresnahan Ex. 1, pg. 25 (¶ 5),  
Ex. 2, pg. 59(¶ 9), Ex. 3, pg. 86(¶ 12), Ex. 4, pgs. 105- 106(¶ 15).

1 somewhat, but only until their debts were all paid off.<sup>96</sup> Our undercover  
2 investigators had similar experiences. For example, one Prosper telemarketer told  
3 an investigator: "It's going to show some late pays on your credit report until we get  
4 it settled. They'll show up as a 90-day late. Once we get it settled and paid in full,  
5 those will fall off."<sup>97</sup> A USA Debt telemarketer said that the investigator would see  
6 "some late payments or slow reported to your credit report. . . . But we're not just  
7 negotiating on the dollar amount that you owe the creditor, we're negotiating on the  
8 entire account. So, when we reached [sic] a settlement with your creditors, part of  
9 our negotiations is that we request that they remove any derogatory information that  
10 they might have reported while you were in our program."<sup>98</sup>

## 11 **B. Enrollment**

12 Consumers "pre-enroll" by providing Defendants with a list of their creditors,  
13 or copies of recent statements, so that the Defendants can confirm that a consumer is  
14 "qualified" for the program.<sup>99</sup> So long as none of the debt at issue is related to  
15 military, student, or government loans virtually all consumers are "qualified" for the  
16 program. The former insiders report that, in their pursuit of profits, initially  
17 Connelly and Torkelson were reticent to exclude any potential client.<sup>100</sup> Later,  
18 Defendants began to avoid smaller creditors, like small stores or credit unions, only  
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21 <sup>96</sup> See e.g. Bresnahan Ex. 1, pg. 29(¶ 5), Ex. 2, pg. 60(¶ 9), Ex. 4, pgs. 105-  
22 106 (¶ 15); Chiarolanza ¶ 12; Davila ¶ 6; Feagin ¶ 5; Kraus Ex. 1, pg. 21 (¶ 5);  
23 Malone pg. 14; Robinson ¶ 16; Stetson ¶ 6.

24 <sup>97</sup> Kaufman Ex. 1, pg. 22 (¶ 8 ).

25 <sup>98</sup> See e.g. Bresnahan Ex.1, pg. 25 (¶ 5). See also Gale Ex. 1 pg. 8 (¶ 5);  
26 Kraus Ex. 1, pg. 21 (¶ 5); Washington ¶ 6.

27 <sup>99</sup> See e.g. Bresnahan Ex. 1. pgs 14-15 (¶ 5); Evans ¶ 5; Hadenfeldt ¶ 10;  
28 Gorski ¶ 4; Kraus Ex. 1, pg. 29 (¶ 5), Ex. 5, pg. 70 (¶ 8); Szkudlarek ¶ 72.

<sup>100</sup> Real ¶ 100; Szkudlarek ¶¶ 201-04 [Citibank accounts were accepted  
even though Defendants knew Citibank would not deal with debt negotiators].

1 because smaller creditors typically launch collection activities so quickly that fewer  
2 fees are collected before the consumer quits the program.<sup>101</sup>

3 Once a consumer is "pre-qualified," the sales representative sends the  
4 consumer, by facsimile or e-mail, copies of account opening documents. Defendants  
5 all use a standard contract, which typically identifies the independent sales office as  
6 the provider of the debt-negotiation service.<sup>102</sup> The contract provides that the  
7 company's services include negotiating with clients' creditors "for reduction of  
8 unsecured debt and formulation of a payment plan."<sup>103</sup> The company further  
9 promises to use its "best efforts" to settle the client's debt. The contract assures  
10 clients that the Defendants will commence their service "[a]t such time as [the  
11 company] has received the first payment."<sup>104</sup>

12 After consumers return the account opening documents, the sales office  
13 submits them to NSS's compliance department. An NSS representative then calls  
14 the consumer to confirm that the consumer understands the parameters of the debt-  
15 negotiation program and to review payment information. Typically within ten days,  
16 the compliance department sends the consumer a Welcome Packet. By that time, the  
17 first payment has often already been withdrawn from the consumer's account.

18 **C. Ultimately, Consumers Discover That All of Defendants'**  
19 **Representations are False**

20 Only after enrolling in Defendants' debt-negotiation programs and  
21 participating for a number of months do consumers learn the truth about the  
22 program. Unfortunately, by the time they learn the truth, they have already paid the  
23 Defendants significant amounts of money, their debt situation has worsened, rather  
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26 <sup>101</sup> Real ¶ 48.

27 <sup>102</sup> Baronowski ¶ 10 [Exh. 1]; Robinson ¶ 22 [Exh. 1]; Szkudlarek ¶¶ 76-78.

28 <sup>103</sup> Kraus Ex. 2, pg. 50 (¶ 6); Szkudlarek Ex. 12, pgs. 144, 147, 150 (¶ 78).

<sup>104</sup> Kraus Ex. 2, pg. 50 (¶ 6).

1 than improved, and their credit has been destroyed. Many consumers find they have  
2 no alternative but to declare bankruptcy.<sup>105</sup>

3 1. The Negotiations Department Fails to Contact Creditors

4 Despite prominent representations on their websites and in their contract as  
5 well as oral assurances that they will immediately contact a consumer's creditors<sup>106</sup>  
6 in fact Defendants do not immediately, and in some cases, never, contact the  
7 consumers' creditors to begin negotiations.<sup>107</sup> Instead, based on the experience of  
8 the consumer victims as confirmed by the statements of the insiders, Defendants  
9 wait until after the consumer has paid most of the fees, before even contacting a  
10 creditor.<sup>108</sup> In contrast to the language in the contract, according to the insiders,  
11 even if a client's creditors called the Defendants, they would not begin negotiations  
12 before at least 40% of the down payment had been received and not simply the first  
13 payment.<sup>109</sup>

14 2. Defendants Do Not Provide the Promised Negotiation Services

15 Many consumers report that Defendants failed to negotiate any sort of  
16 settlement with their creditors.<sup>110</sup> Over the course of three months, consumer  
17 Robinson and her husband paid Prosper \$2,800 in fees but Defendants failed to  
18 negotiate with any of their creditors.<sup>111</sup> Consumer Washington paid \$2,500 in fees  
19 and, instead of obtaining a settlement with her creditors, was sued and had her  
20  
21

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22 <sup>105</sup> See e.g. Duez ¶ 44; Drayton ¶ 19; Feagin ¶ 32.

23 <sup>106</sup> See e.g. Gale Ex. 16, pg. 152 (¶ 76b); Ex. 17, pg. 168 (¶ 76c), Ex. 18, pg.  
24 180 (¶ 76d); Kraus Ex. 1, pg. 32 (¶ 5), Ex. 2, pg. 50 (¶ 6); Ex. 3, pg. 65 (¶ 8).

25 <sup>107</sup> Szkudlarek ¶¶ 104, 213.

26 <sup>108</sup> Szkudlarek ¶ 213.

27 <sup>109</sup> Szkudlarek ¶ 213.

28 <sup>110</sup> Bond ¶¶ 36-37.

<sup>111</sup> Robinson ¶¶ 36-44.



1 wages garnished.<sup>112</sup> None of these stories are surprising considering the Defendants'  
2 operation is focused merely on increasing sales. Sales figures were posted in the  
3 main offices, those numbers were updated twice a day and Defendants Connelly and  
4 Torkelson frequently stated that their goal was to have one million in sales each  
5 week.<sup>113</sup> Sales managers stayed on the job only as long as sales were up.<sup>114</sup> When  
6 the sales staff complained to Connelly and Torkelson that the Compliance  
7 Department was causing sales to decline because what they said to consumers was  
8 less positive than the script, the Compliance department had to change what they  
9 said.<sup>115</sup> Not less than 18 offices of salespeople feed consumers to a single  
10 Negotiations Department at times staffed by less than 20 people.<sup>116</sup> According to  
11 Defendants' own documents the average consumer enters the program with at least 7  
12 credit cards.<sup>117</sup> Yet despite enrolling hundreds of persons with thousands of  
13 accounts into their program each month, by August 2004, the most settlements the  
14 Negotiations Department concluded in a single month was 556.<sup>118</sup> For example,  
15 between March 2004 and November 2004, the number of settlements per month  
16 ranged from 366 to 556.<sup>119</sup> Concurrently the average number of new accounts  
17 accepted into the program was roughly 3,500 per month.<sup>120</sup>

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21 <sup>112</sup> Washington ¶ 27.

22 <sup>113</sup> Real ¶¶ 58-61.

23 <sup>114</sup> Real ¶¶ 37, 64-66, 85-86.

24 <sup>115</sup> Real ¶¶ 66-69.

25 <sup>116</sup> Szkudlarek ¶ 155.

26 <sup>117</sup> Szkudlarek ¶¶ 122, 138.

27 <sup>118</sup> Szkudlarek ¶ 133.

28 <sup>119</sup> Szkudlarek ¶ 132.

<sup>120</sup> Szkudlarek ¶ 130.

1 Even consumers who save enough funds to settle accounts cannot get the  
2 Negotiations Department to act on their behalf.<sup>121</sup> Consumer Davila was told that  
3 Homeland could settle her accounts for 50% of what she owed. She saved the  
4 necessary funds and contacted Defendants to request that they begin to settle her  
5 accounts.

6 Defendants told her that it was impossible and in the end, Davila negotiated her  
7 own settlements.<sup>122</sup> Both of the former insiders confirm that even consumers with  
8 ample funds who made specific requests that their accounts be settled, could not get  
9 their accounts settled.<sup>123</sup>

### 10 3. Consumers Must Deal with Collection Efforts and Lawsuits

11 When consumers fail to make regular monthly payments, creditors frequently  
12 launch aggressive collection efforts. Consumers who enroll in Defendants' program  
13 and fail to make their regular monthly payments to their creditors are inundated with  
14 calls from creditors seeking to collect on legitimate debts.<sup>124</sup> For consumers who  
15 were not receiving collection calls before, these calls are often traumatic.<sup>125</sup> If the  
16 accounts are sufficiently in arrears, creditors may sue or threaten to sue to collect on  
17 the debt.<sup>126</sup> Following Defendants' instructions, consumer Washington stopped  
18 making her monthly payments and sent the money to Prosper instead. When her  
19 creditor threatened her with legal action, Prosper representatives told her it was an  
20 "empty threat." The so-called "empty threat" became a judgment against her for

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21  
22 <sup>121</sup> Davila ¶ 13; Real ¶¶ 102-106, 109-110; Szkudlarek ¶ 129.

23 <sup>122</sup> Davila ¶¶ 13, 18.

24 <sup>123</sup> Real ¶¶ 102-106; Szkudlarek ¶ 128.

25 <sup>124</sup> Binzel ¶¶ 7-8; Davila ¶ 11; Drayton ¶ 13; Duez ¶¶ 26-35; Eby ¶¶ 13-14;  
26 Feagin ¶¶ 16, 19-22; Young ¶ 11.

27 <sup>125</sup> Bond ¶¶ 19-20, 23-26.

28 <sup>126</sup> Szkudlarek ¶¶ 114, 161-62 (consumers sued even though they had  
directed Defendants to negotiate with the creditor), 207d (daily stack of lawsuits),  
207e (up to 80 lawsuits per day against clients); Young ¶ 25.

1 \$5,000 and a wage garnishment.<sup>127</sup> Consumer Evans had a joint bank account with  
2 her son. One of her creditors sued her, obtained a judgment against her and  
3 garnished the joint account.<sup>128</sup> Eventually, the pressure from creditors is  
4 overwhelming and most consumers leave the program after having paid Defendants  
5 considerable fees.<sup>129</sup>

6 4. Consumers' Financial Situation Declines, Often Precipitously

7 During the months that consumers are paying Defendants' fees, their accounts  
8 go unpaid. As the accounts go unpaid, the balances on their cards are constantly  
9 increasing due to the fees, penalties and interest, pushing the consumer further into  
10 debt. Depending on the terms of the individual's credit agreement, creditors may  
11 also raise the interest rates applicable to the consumer's account because he has  
12 missed making his minimum monthly payments. Many consumers report that,  
13 because penalties and interest were accruing while they were on the program, by the  
14 time they quit the program they owed significantly more money to their creditors  
15 than they owed when they first enrolled.<sup>130</sup>

16 In complaint after complaint, consumers report that while they were on the  
17 program their debt had increased and their credit had been worsened.<sup>131</sup> Some  
18 consumers reported entering Defendants' program with good credit, but a lot of debt,  
19 and leaving the program having paid thousands in fees and facing bankruptcy  
20 because their accounts fell so far behind and their debt increased so substantially.<sup>132</sup>

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23 <sup>127</sup> Washington ¶¶ 19-25.

24 <sup>128</sup> Evans ¶¶ 10-12.

25 <sup>129</sup> Bond ¶¶ 33-35; Duez ¶¶ 35-36, 39; Evans ¶ 13.

26 <sup>130</sup> See e.g. Baronowski ¶ 16; Bond ¶¶ 37-38; Davila ¶ 18; Gorski ¶ 21;  
27 Evans ¶ 16; Stetson ¶ 28; Washington ¶ 25. See also Szkudlarek ¶ 144.

28 <sup>131</sup> See e.g. Chiarolanza ¶ 41; Hadenfeldt ¶ 49; Spezzacatena ¶ 28.

<sup>132</sup> See e.g. Baronowski ¶ 16; Evans ¶ 16; Gorski ¶ 21; Spezzacatena ¶ 26.

1 Instead of being an easy fix for their financial problems, Defendants' programs put  
2 consumers in a significantly worse position than when they started.<sup>133</sup>

3 Consumers who leave the program and attempt to obtain a full refund of their  
4 fees are inevitably unsuccessful.<sup>134</sup> Defendants tell consumers that all of the pre-  
5 paid fees for the services are non-refundable, leaving the consumer in an even worse  
6 position because now, in addition to owing more on their debt, they have also lost  
7 the fees paid to Defendants.<sup>135</sup> Consumers state that if they had known the truth  
8 before enrolling in Defendants' programs, they would have refused to do business  
9 with the Defendants.<sup>136</sup>

#### 10 **IV. DEFENDANTS' KNOWLEDGE.**

##### 11 **A. Awareness of Representations Being Made To Consumers**

12 Defendants Connelly, Torkelson, Garneau, Homeland and NSS are aware of  
13 the representations being made to consumers, in large part because the  
14 representations originate with them. Connelly drafted the original scripts used by  
15 the sales representatives and approved all modifications to the script.<sup>137</sup> Connelly  
16 and Torkelson supervised the in-house sales office, conducted training of the sales  
17 representatives, and required those representatives to memorize and use the script.<sup>138</sup>  
18 Connelly and Torkelson provided the same scripts used by the in-house sales  
19 representatives to their independent sales offices and strongly encouraged those  
20 offices to use the script.<sup>139</sup> Connelly and Torkelson also created the Homeland  
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22 <sup>133</sup> See e.g. Bond ¶ ; Chiarolanza ¶¶ 35, 41-42; Evans ¶¶ 12, 16; Hadenfeldt  
23 ¶ 49; Washington ¶¶ 25, 31.

24 <sup>134</sup> See e.g. Evans ¶ 15; Hadenfeldt ¶ 44; Robinson ¶ 41; Washington ¶ 27.

25 <sup>135</sup> See e.g. Baronowski ¶ 15; Bond ¶ ; Gorski ¶ 20; Rangel ¶¶ 23-24.

26 <sup>136</sup> See e.g. Bond ¶ 41; Chiarolanza ¶ 42; Evans ¶ 12.

27 <sup>137</sup> Real ¶ 90; Szkudlarek ¶ 64.

28 <sup>138</sup> Real ¶¶ 37, 47, 49, 65, 87; Szkudlarek ¶¶ 32, 34, 65.

<sup>139</sup> Real ¶¶ 70, 73, 76, 91; Szkudlarek ¶ 66.

1 website and provided a template of that website to the independent sales offices for  
2 use in developing their own websites.<sup>140</sup>

3 Garneau sent her sales representatives to be trained in the main office and  
4 provided copies of the standard sales script to her sales staff.<sup>141</sup> She spoke with  
5 Customer Service on a regular basis about customer complaints.<sup>142</sup> Garneau has  
6 even solicited consumers directly to enroll in the program.<sup>143</sup> As the active owner of  
7 a small company, she would also be aware of the content of her company's website,  
8 which used the template NSS provided to all its sales offices.<sup>144</sup>

9 Collectively, these Defendants also set and enforced policies that ensured that  
10 consumers received inaccurate and incomplete information. For example, Connelly  
11 had a general policy that sales representatives were supposed to disclose as little as  
12 possible about the possible negative consequences of enrolling in the company's  
13 debt-negotiation program to clients, whether prospective or already enrolled.<sup>145</sup> The  
14 transcripts of undercover conversations with different sales representatives from  
15 different sales rooms confirms the insiders' claim that negatives were always to be  
16 downplayed.<sup>146</sup> Another example of the climate of misinformation is how  
17 Defendants characterized their ability to settle accounts. While the script has always  
18 claimed that Defendants could settle any and all accounts, it was well-known  
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20  
21 <sup>140</sup> Real ¶ 77; Szkudlarek ¶¶ 46, 50-52.

22 <sup>141</sup> Real ¶¶ 73-74.

23 <sup>142</sup> Szkudlarek ¶ 127.

24 <sup>143</sup> Kraus Ex. 1, pgs. 4-40 (¶ 5); Szkudlarek ¶ 27.

25 <sup>144</sup> Real ¶¶ 73-74; Szkudlarek ¶ 52; *cf.* Prosper website (Gale Exs. 16  
26 (¶ 76b), 19 (¶ 77), 22 (¶ 82a) [Prosper Spanish]) with other Defendants' websites  
(Gale Exs. 15-20).

27 <sup>145</sup> Szkudlarek ¶ 192.

28 <sup>146</sup> Gale Ex. 28, pg. 300 (¶ 100); Kaufman Ex. 1, pgs. 15-16, 18-19 (¶ 8);  
Kraus Ex. 1, pg. 27 (¶ 5); Real ¶¶ 66-69, 99-100.

1 amongst the sales representatives and the management that they were not able to  
2 settle accounts with Citibank.<sup>147</sup>

3 **B. Awareness of Deception**

4 1. Knowledge of Poor Record In Negotiating Settlements

5 Defendants Connelly, Torkelson, Garneau, Homeland and NSS are fully  
6 aware of all of the problems with their debt negotiation operation and that the sales  
7 representatives' claims are a fantasy.

8 Most concretely, they are familiar with company data showing that only a  
9 small percentage of their clients' accounts are settled. In September 2004,  
10 Defendants published their first monthly newsletter, which showed that in the  
11 previous month, Defendants had enrolled 613 new clients but had settled only 556  
12 individual credit accounts. Defendants' former Customer Service Manager, Sarah  
13 Szkudlarek, realized that these numbers were cause for concern.<sup>148</sup> She knew that  
14 new clients on average brought seven new accounts into the program. Thus, in the  
15 previous month, while the company had settled 556 accounts, it had actually  
16 accepted approximately 4,300 new accounts into the program.<sup>149</sup> After Torkelson  
17 brushed off her concern, Szkudlarek developed and, with management's approval,  
18 implemented a tracking system.<sup>150</sup> The tracking system allowed the company to  
19 keep track of progress on client accounts when clients called to inform the company  
20 that they had saved up sufficient funds to begin negotiations with one or more  
21 creditors.<sup>151</sup>

22 Szkudlarek's tracking log revealed that, consistent with the numbers in the  
23 newsletter, the number of settlements that the company was negotiating for clients

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24  
25 <sup>147</sup> Szkudlarek ¶¶ 201-204.

26 <sup>148</sup> Szkudlarek ¶ 122.

27 <sup>149</sup> Id.

28 <sup>150</sup> Id. ¶¶ 123-26.

<sup>151</sup> Id. ¶ 127.

1 who had requested settlements was *de minimis*. For example, in November 2004,  
2 the company received requests to settle 597 accounts. However, only 14% of these  
3 accounts had been settled as of January 10, 2005.<sup>152</sup>

4 Szkudlarek repeatedly informed Connelly and Torkelson, as well as Garneau,  
5 of the data showing the company's poor performance.<sup>153</sup> While feigning concern,  
6 they failed to act.<sup>154</sup> Connelly's lack of response is unsurprising given that he and  
7 Schumann told Szkudlarek on a number of occasions that they felt she and her staff  
8 spent too much time talking to clients to try to help them.<sup>155</sup> After Szkudlarek  
9 continued to press the issue, Connelly fired her.<sup>156</sup>

## 10 2. Knowledge of Client Dissatisfaction

11 Defendants have always been fully aware that consumers who enroll in their  
12 debt-negotiation program are dissatisfied with the performance of the program and  
13 that most consumers who enroll eventually quit.<sup>157</sup> The Customer Service  
14 department regularly provided Defendants' management, including Connelly and  
15 Torkelson, with a report of recent customer cancellations that included the reason  
16 for the cancellation.<sup>158</sup> According to these reports, consumers leave the program  
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20 <sup>152</sup> Id. ¶ 129. According to Szkudlarek, the average client bringing in seven  
21 accounts could expect to have only one of those accounts settled, and on average  
22 could expect the settlement amount on that one account to be 64% of the original  
23 balance (while often settlements were for *more* than the original balance because  
of late fees, penalties and interest). ¶¶ 144-46.

24 <sup>153</sup> Id. ¶¶ 173-75. *See also* Real ¶ 113-16.

25 <sup>154</sup> Szkudlarek ¶¶ 175-77.

26 <sup>155</sup> Id. ¶ 187.

27 <sup>156</sup> Id. ¶¶ 2, 11, 190.

28 <sup>157</sup> Id. ¶¶ 54, 56, 119, 120, 157, 182-184.

<sup>158</sup> Id. ¶¶ 118, 180; *see also* ¶¶ 166-169.

1 because they do not receive the services that they were promised.<sup>159</sup> Management  
2 was also aware of the high number of complaints being made to the BBB.<sup>160</sup>

3 But when the complaints against Homeland became too numerous and sales  
4 began to stagnate, instead of correcting the problems, Defendants simply  
5 reorganized, launching new companies under different company names so that  
6 consumers would not uncover Homeland's negative performance rating with the  
7 BBB or find out about all the complaints that had been made to the BBB. In pre-  
8 reorganization planning meetings, Connelly, Torkelson and the rest of management  
9 made sure that all employees were made aware that the old company, Homeland,  
10 and the new company, United, were never to be linked together<sup>161</sup> so that consumers  
11 would not discover the deception.

#### 12 **IV. ARGUMENT: THE COURT SHOULD ENTER THE REQUESTED** 13 **RELIEF**

##### 14 **A. The Court is Authorized to Grant the Requested Relief**

15 As final relief in this matter, the Commission seeks a permanent injunction  
16 against Defendants. The Commission also seeks ancillary equitable relief including  
17 consumer redress, rescission and restitution, and/or disgorgement. To preserve the  
18 possibility of effective final relief, the Commission, by this application, seeks  
19 preliminary relief in the form of a temporary restraining order and preliminary  
20 injunction, the appointment of a receiver, and an asset freeze. The Court has the  
21 authority under Sections 13(b) of the FTC Act to grant all the requested relief.

22 Section 13(b) expressly authorizes the issuance of a permanent injunction.  
23 The second proviso of Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), states that  
24 "in proper cases the Commission may seek, and, after proper proof, the court may  
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26  
27 <sup>159</sup> Id. ¶¶ 116, 118, 180.

28 <sup>160</sup> Id. ¶ 184.

<sup>161</sup> Szkudlarek ¶¶ 222-24.



1 issue, a permanent injunction."<sup>162</sup> A routine fraud case such as this one, replete with  
2 misrepresentations of material facts in violation of Section 5(a) of the FTC Act,  
3 qualifies as a "proper case" for injunctive relief under Section 13(b). FTC v. H.N.  
4 Singer, Inc., 668 F.2d 1107, 1111-13 (9th Cir. 1982). The Court therefore has the  
5 authority to issue a permanent injunction.

6 The authority to issue a permanent injunction includes the authority to grant  
7 ancillary and preliminary equitable relief. The Court may exercise the full breadth  
8 of its equitable authority in a Section 13(b) action because Congress "did not limit  
9 that traditional equitable power" when it invoked that power in passing the FTC Act.  
10 Singer, 668 F.2d at 1113. Thus, under Section 13(b), the Court may order ancillary  
11 equitable remedies, such as rescission of contracts and restitution, as well as  
12 whatever additional temporary or preliminary relief is necessary to preserve the  
13 possibility of effective final relief. Id. at 1113-14. Preliminary relief may include an  
14 order freezing assets, a temporary restraining order enjoining practices and  
15 permitting expedited discovery, and an order appointing a receiver to ensure that  
16 assets are protected from dissipation. See, e.g., Singer, 668 F.2d at 1113-1114; FTC  
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21 <sup>162</sup> Section 13(b) of the FTC Act authorizes the issuance of injunctive relief  
22 in two different situations. Section 13(b) first addresses the issuance of injunctive  
23 relief when the Commission seeks to bring a halt to a defendant's conduct while  
24 administrative proceedings are pending. After setting forth the standard for  
25 obtaining a TRO or preliminary injunction in that context, Section 13(b) then,  
26 under the so-called "second proviso," authorizes the issuance of injunctive relief in  
27 a second situation—when the Commission has decided to litigate the merits of a  
28 case in district court rather than administratively. Because the Commission  
proceeds here under the second proviso of Section 13(b), the standard set forth for  
the issuance of temporary relief in aid of administrative proceedings does not  
apply. FTC v. H.N. Singer, Inc., 668 F.2d 1107, 1111 (9th Cir. 1982); FTC v.  
U.S. Oil & Gas Corp., 748 F.2d 1431, 1434 (11th Cir. 1984).

1 v. U.S. Oil & Gas Corp., 748 F.2d 1431, 1432 (11th Cir. 1984);<sup>163</sup> see also S. Rep.  
2 103-130, 103d Cong., 1st Sess. (1993), *reprinted in* U.S.C.C.A.N. (1994) at 1790-91  
3 ("Section 13 of the FTC Act authorizes the FTC to file suit to enjoin any violation of  
4 the FTC [Act]. The FTC can go into court *ex parte* to obtain an order freezing  
5 assets, and is also able to obtain consumer redress"). District courts are also  
6 authorized to depart from normal discovery procedures and to fashion discovery by  
7 order to meet discovery needs in particular cases. F.R.Civ.P. 1, 26(b)(2), 30(a),  
8 34(b).

9 The exercise of this broad, equitable authority is particularly appropriate  
10 where, as here, the public interest is at stake. Porter v. Warner Holding Co., 328  
11 U.S. 395, 398, 66 S.Ct. 1086, 90 L.Ed. 1332 (1946); U.S. v. Laerdal Mfg., 73 F.3d  
12 852, 857 (9th Cir. 1995); FTC v. World Wide Factors, Ltd., 882 F.2d 344, 347 (9th  
13 Cir. 1989).

14 **B. The Evidence Presented Meets the Standard For Entry of a**  
15 **Preliminary Injunction**

16 1. The Standard

17 Traditionally, a plaintiff may obtain a preliminary injunction if it shows  
18 either: (1) a combination of probable success on the merits and the possibility of  
19 irreparable injury, or (2) that serious questions are raised and the balance of  
20 hardships tips in its favor. United States v. Odessa Union Warehouse Co-op, 833  
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22 <sup>163</sup> In fact, in many previous routine Section 13(b) cases in this district,  
23 including cases involving debt-negotiation programs, this Court has entered  
24 temporary restraining orders *ex parte* and without notice granting the full panoply  
25 of relief requested here. See Certification and Declaration of Plaintiff's Counsel,  
26 listing, *inter alia*, the following examples: Debt-negotiation cases: FTC v. National  
27 Consumer Council, SACV-04-0474-CJC (April 23, 2004), and FTC v. Jubilee Fin.  
28 Servs., Inc., CV-02-6468-ABC (Aug. 20, 2002). Other cases: FTC v. Universal  
Premium Services, Inc., CV-06-0849-SJO (Feb. 21, 2006); FTC v. Unicyber  
Tech., Inc., CV-04-1569-LGB (Mar. 12, 2004); FTC v. Trek Alliance, Inc.,  
CV-02-9270-DSF (Dec. 6, 2002).

1 F.2d 172, 174 (9th Cir. 1987). These are not two separate tests: "These two  
2 formulations represent two points on a sliding scale in which the required degree of  
3 irreparable harm increases as the probability of success decreases." Id.

4 Under the first of these formulations, where the government moves for  
5 injunctive relief in a statutory enforcement action, it need not show irreparable  
6 injury if it shows a likelihood of success on the merits, in which case harm to the  
7 public interest is presumed. Id.; World Wide Factors, 882 F.2d at 347 ("the district  
8 court need only to find some chance of probable success on the merits," citing  
9 Odessa Union); and FTC v. Affordable Media, LLC, 179 F.3d 1228, 1233 (9th Cir.  
10 1999).<sup>164</sup> Thus, a preliminary injunction may be granted if the district court  
11 determines that the FTC has a likelihood of success on the merits.

12 Under the second formulation of the sliding-scale test, a district court may  
13 grant a preliminary injunction even absent a showing of a likelihood of success on  
14 the merits if the moving party shows "that his cause presents serious questions of  
15 law worthy of litigation." Topanga Press, Inc. v. City of Los Angeles, 989 F.2d  
16 1524, 1528 (9th Cir. 1993). In weighing the public and private equities, the public  
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23 <sup>164</sup> In discussing the standard for preliminary relief, the court in Affordable  
24 Media quoted the standard for obtaining temporary relief under Section 13(b)  
25 pending administrative proceedings, and in support thereof cited a case (FTC v.  
26 Warner Communications, Inc.) in which the Commission was in fact proceeding  
27 under this provision. While this statutory standard is substantially similar to the  
28 test in the 9th Circuit for obtaining preliminary relief, it should be noted, as  
discussed in the preceding section, that the standard which Congress specified in  
Section 13(b) applies only to instances in which the Commission seeks temporary  
relief pending administrative proceedings.

1 interest should receive greater weight. World Wide Factors, Ltd., 882 F.2d at 347.<sup>165</sup>

2 2. Plaintiff is Likely to Succeed on the Merits

3 Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), prohibits "unfair or deceptive  
4 acts or practices in or affecting commerce." A violation of Section 5(a) is properly  
5 found upon a showing that "first, there is a representation, omission, or practice that,  
6 second, is likely to mislead consumers acting reasonably under the circumstances,  
7 and third, the representation, omission, or practice is material." FTC v. Pantron I  
8 Corp., 33 F.3d 1088, 1095 (9th Cir. 1994). See also Resort Car Rental System v.  
9 FTC, 518 F.2d 962, 964 (9th Cir.), cert. denied, 423 U.S. 827 (1975) (advertising  
10 that induces consumer response through deception violates FTC Act).

11 It is likely that the FTC will ultimately prove, by a preponderance of the  
12 evidence, that Defendants have violated Section 5(a) by making material  
13 misrepresentations and failing to disclose material information as alleged in the  
14 Complaint.

15 a. Defendants Have Violated Section 5 By Misrepresenting  
16 They Will Negotiate Substantial Reductions in Consumers  
17 Debt

18 Count I of the Complaint alleges that Defendants have misrepresented that,  
19 by enrolling in Defendants' debt-negotiation program, consumers will be able to pay  
20 off their credit-card and other unsecured debts for a substantially reduced amount,  
21 such as 40 to 60 percent of the total amount owed to their creditors.

22 As described above in Section III.A. above, this representation is the  
23 centerpiece of Defendants' efforts to solicit consumers. Defendants market their  
24

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25 <sup>165</sup> This is particularly true where the evidence demonstrates that a  
26 defendant's business is rooted in deception, for a "court of equity is under no duty  
27 to protect illegitimate profits or advance business which is conducted [illegally]."  
28 CFTC v. British American Commodity Options Corp., 560 F.2d 135, 143 (2d Cir.  
1977), cert. denied, 438 U.S. 905 (1978), quoting FTC v. Thomsen-King & Co.,  
109 F.2d 516, 519 (7th Cir. 1940).

1 debt-negotiation program to consumers who are looking to reduce their debt.  
2 Defendants make this representation on their websites ("Our average monthly  
3 settlements range from 45-62% of the total debt, which means that essentially you  
4 will be paying only a portion of your debt"; "Pay back HALF of what you currently  
5 owe"). And they make it in their telephone sales pitches ("We negotiate your debt  
6 down 40%-60% of what you owe, so essentially you'll end up paying a fraction of  
7 the amount that you currently owe"). This representation has been made  
8 continuously since Homeland's inception in 2001.

9 As discussed above in Section III.C, the representation that Defendants will  
10 negotiate favorable settlements and save their clients 40% to 60% of their total  
11 balances is misleading. Defendants give little priority to negotiating settlements and  
12 high priority to generating sales. (Szkudlarek ¶¶ 155-56.) All that the Defendants  
13 really care about "is the fees." (Szkudlarek ¶ 181.) Thus, month after month,  
14 Defendants negotiate settlements on only a few hundred accounts while promising  
15 settlements on thousands of new accounts for hundreds of new clients. And the  
16 relatively few settlements that Defendants have negotiated have brought little if any  
17 savings for their clients. Because clients are required to pay Defendants a service  
18 fee of 15% of the total amount of their debt—regardless of whether any of their  
19 accounts are actually settled—clients are highly unlikely to realize any net savings  
20 at all.

21 Defendants' failure to deliver on their promises is reflected in the profound  
22 dissatisfaction voiced by their clients. Defendants have received a constant stream  
23 of complaints from their clients that their accounts are not being negotiated, that  
24 their creditors have not been contacted, and that the company "wasn't doing  
25 anything." Defendants themselves had difficulty finding a single happy client to  
26 quote on their websites. (Szkudlarek ¶ 56.)

27 Defendants' abysmal failure to deliver on their promises is most clearly  
28 reflected in the fact that after three years, all but 129 clients had dropped out of

1 Defendants' program early. (Szkudlarek ¶ 147.) The reasons clients give for  
2 dropping out revolve around one central point: that Defendants have failed to  
3 negotiate the settlements that Defendants have promised.

4 Defendants' deceptive representation as to their ability to perform the service  
5 they promise is also material. A claim is material if it involves information that is  
6 important to consumers and thus likely to influence their decision of whether to  
7 purchase a product. Kraft, Inc. v. FTC, 970 F.2d 311 (7th Cir. 1992), cert. denied,  
8 507 U.S. 909 (1993). Express claims are presumed to be material. Pantron I, 33 F.  
9 3d at 1095-96. In this case, as discussed in Section III.A above, the claim that  
10 Defendants would substantially reduce consumers' debt is express and is important  
11 to consumers' decisions to enroll in Defendants' program.

12 Finally, to the extent this misrepresentation has been made by independent  
13 sales offices, Homeland and NSS are nonetheless liable because they provided their  
14 sales offices with a Marketer's Guide, scripts and websites that incorporated this  
15 claim, and they encouraged their sales offices to use these materials. See Goodman  
16 v. FTC, 244 F.2d 584, 591-93 (9th Cir. 1957) (finding principal liable under Section  
17 5 for sales practices of independent contractors acting within scope of their  
18 authority); see also FTC v. Figgie Int'l, Inc., 994 F.2d 595, 599, n.1 (9th Cir. 1993)  
19 (imputing to defendant the representations made by its independent distributors  
20 when defendant prepared and provided to its distributors the main elements of their  
21 sales presentations, trained the distributors, and encouraged them to use the  
22 defendant's sales methods); and National Housewares, Inc., 90 .F.T.C. 512, 590-91,  
23 1977 FTC LEXIS 20, at \*167-69 (1977) (holding respondent liable for independent  
24 salesmen's deceptive sales practices where respondent had developed the sales  
25 method and promoted its adoption by salesmen).

26 Accordingly, the FTC is likely to succeed in proving that Defendants have  
27 violated Section 5 by misrepresenting that they will negotiate substantial reductions  
28 in consumers' debt.

1                   b.     Plaintiff is Also Likely to Succeed in Establishing Counts  
2                             II-IV of the Complaint

3             In addition to misrepresenting that they will substantially reduce consumers'  
4 debt, Defendants have violated Section 5 by misleading consumers about other  
5 central aspects of their debt-negotiation program.

6             Defendants have advised consumers that they should stop paying their  
7 creditors to achieve more favorable settlements (see Section III.A.2 above).  
8 However, Defendants fail to inform consumers that by following Defendants'  
9 advice, consumers are walking off a cliff. First, Defendants fail to adequately  
10 disclose that when consumers stop paying their creditors, there is a substantial  
11 likelihood that one or more of their creditors will sue the consumer (see Section  
12 III.C.3 above). Instead, Defendants' sales reps are told first not to raise the issue of  
13 lawsuits by creditors, and second to downplay the likelihood, with the assurance that  
14 creditors would rather settle than sue. In an FAQ section not likely to be read by  
15 consumers, Defendants' websites similarly downplay the need to worry about being  
16 sued, assuring consumers that "[i]n our experience, most creditors would rather not  
17 go to the expense of suing and simply try to negotiate a settlement." This tepid  
18 disclaimer does little to overcome Defendants' assurances that consumers will no  
19 longer have to worry about dealing with their creditors.

20             Second, Defendants fail to adequately disclose that the balances on their  
21 credit accounts will increase as a result of interest accruing on their accounts,  
22 increases to their interest rate, and the imposition of late fees and other charges (see  
23 Section III.C.4). Consumers simply trust Defendants' assurances that they will deal  
24 with consumers' creditors and that consumers need not worry about the effects on  
25 their balances since the settlements will take any such increases into account. By  
26 the time consumers realize that Defendants are not negotiating the promised  
27 settlements, they cannot simply back out and suffer only the loss of their service fee.  
28

1 Instead, they find that they debts they owe their creditors have substantially  
2 increased.

3 By failing to disclose these important facts to consumers, Defendants have  
4 violated Section 5.

5 In addition, Defendants have also violated Section 5 by representing that  
6 negative information that appears on a consumer's credit report as a result of  
7 participating in Defendants' program will be removed upon completion of the  
8 program (see Section III.A.2.c above). This representation is misleading since,  
9 pursuant to the Fair Credit Reporting Act ("FCRA"), credit reporting agencies are  
10 permitted to report accurate negative information such as late payments, charge-offs,  
11 collections, judgments and garnishments for seven years. 15 U.S.C. § 1681c. The  
12 FCRA also prohibits creditors from knowingly reporting false information (15  
13 U.S.C. § 1681s-2(a)(1)), and thus prohibits creditors from changing accurate  
14 information they have previously reported. It's also misleading because Defendants  
15 claim that under the settlements they negotiate, creditors remove any derogatory  
16 information that they might have reported while the consumer was in their program.  
17 But Defendants do not even attempt to negotiate such a provision. (Szkudlarek ¶¶  
18 197-98.)

19 While the FAQ section of Defendants' websites states that consumers' credit  
20 scores will decline due to entering the program (see, e.g., Gale at pg.172), this  
21 disclaimer, appearing in a section of their website that consumers are unlikely to  
22 review, is insufficient. Defendants' response equivocates as to the extent and  
23 duration of the negative impact. For example, Defendants' state that "[a]fter all the  
24 debts have been settled and paid, the credit score should begin to improve since the  
25 negative items have been resolved." This statement is misleading since it implies  
26 that an account's negative payment history will no longer be reported. In any event,  
27 the disclaimer must be viewed in light of the clear representation in the telephone  
28 sales pitches that the negative impact of participating in the Defendants' program



1 will last only as long as the consumer is in the program. "Representations violate  
2 Section 5 if the FTC proves that, based on a common sense net impression of the  
3 representations as a whole, the representations are likely to mislead reasonable  
4 customers to their detriment." FTC v. Tashman, 318 F.3d 1273, 1283 (11th Cir.  
5 2003). *Accord*, FTC v. Gill, 265 F.3d 944, 956 (9th Cir. 2001).

6 Thus, the FTC is likely to succeed in proving Counts II-IV of the Complaint.

7 c. Injunctive Relief is Not Moot

8 As discussed above, Defendants NSS, United, Freedom First and USA Debt  
9 may no longer be operating. The requested temporary injunctive relief is  
10 nonetheless appropriate because there remains a possibility that the deceptive acts  
11 may recur. *See* FTC v. Freecom Communications, Inc., 401 F.3d 1192, 1204 (10th  
12 Cir. 2005). Without an injunction, "the defendant is free to return to his old ways."  
13 United States v. W.T. Grant, 345 U.S. 629, 632, 97 L.Ed. 1303, 73 S. Ct. 894  
14 (1953). A court should be more willing to find a possibility of recurrence "[w]hen  
15 the violation has been founded on systematic wrongdoing, rather than an isolated  
16 occurrence." CFTC v. Hunt, 591 F.2d 1211, 1220 (7th Cir. 1979).

17 In this case, just as they have done in the past, any of the Defendants listed  
18 above may have simply transferred their assets and business records to a successor  
19 company also owned by one or more of the individual Defendants. If so, unless a  
20 TRO is entered against these Defendants and any successors or affiliates, these  
21 Defendants' records and their assets could be lost. Moreover, just like squeezing a  
22 balloon, if the Court were to enter a TRO that applied only to the other Defendants,  
23 there is no reason to believe that the individual Defendants would not simply  
24 transfer operations back to these dormant shells. The harm that could result from  
25 not granting a TRO could be significant. If, on the other hand, the businesses are  
26 truly defunct, the harm of entering a TRO against them would be insignificant.

27 Thus, especially in light of the systematic nature of these Defendants'  
28 fraudulent business activity, the requested temporary relief is appropriate.

1 d. The Individual Defendants are Personally Liable for  
2 Injunctive and Monetary Relief

3 The Commission is also likely to succeed in demonstrating that the individual  
4 Defendants are personally liable for both injunctive and monetary relief for the  
5 corporate Defendants' deceptive practices.

6 (1) Injunctive Relief

7 If a business is liable for violating Section 5, an individual defendant may be  
8 held liable for injunctive relief if the FTC shows that the individual defendants  
9 participated directly in the practices or acts or had authority to control them. FTC v.  
10 Publishing Clearing House, 104 F.3d 1168, 1170 (9th Cir. 1997); FTC v. Amy  
11 Travel Service, Inc., 875 F.2d 564, 573 (7th Cir.), cert. denied, 493 U.S. 954, 107 L.  
12 Ed. 2d 352, 110 S. Ct. 366 (1989); FTC v. Freecom Communications, Inc., 401 F.3d  
13 at 1204. "Authority to control the company can be evidenced by active involvement  
14 in business affairs and the making of corporate policy, including assuming the duties  
15 of a corporate officer." Amy Travel at 573. Authority to control is evidenced by the  
16 authority to sign documents on behalf of a company. Publishing Clearing House at  
17 1171.

18 Connelly, Torkelson and Garneau have participated directly in representing  
19 that Defendants would substantially reduce consumers' debt. As discussed above in  
20 Section III.A, Connelly drafted all the language in the scripts, and Connelly and  
21 Torkelson drafted the language on the Defendants' websites. Garneau has  
22 personally made the misrepresentation in telephone sales pitches. (Kraus at 20-21.)

23 Connelly, Torkelson and Garneau have also had the authority to control the  
24 Defendant companies and the representations being made to consumers. As  
25 discussed above in Section II.B, Connelly and Torkelson owned and controlled  
26 Homeland, NSS and United and made all the important decisions. Connelly did in  
27 fact control the representations made by Homeland sales reps, and also controlled  
28 Theresa Schumann, the only officer of Homeland and NSS. Torkelson also assumed

1 control of Homeland's sales room and signed checks for Homeland and NSS. They  
2 were also actively involved in the business affairs of their companies.

3 As the sole owner of Prosper, Garneau has the authority to control the  
4 representations made by Prosper's sales reps. She is also very active in running her  
5 business. (Real ¶¶ 73-74.)

## 6 (2) Monetary Relief

7 An individual who is liable for injunctive relief under Section 13(b) of the  
8 FTC Act is additionally liable for monetary relief if the individual had sufficient  
9 "knowledge" of the deception. Publishing Clearing House, 104 F.3d at 1171;  
10 Freecom at 1207; Amy Travel at 573-74.

11 In addition to showing knowledge, the FTC must also show reliance.  
12 However, proof of subjective reliance is not required, since such a requirement  
13 "would thwart effective prosecutions of large consumer redress actions and frustrate  
14 the statutory goals of the section." FTC v. Figgie Internat'l, Inc., 994 F.2d at 605.  
15 Instead, "a presumption of actual reliance arises once the Commission has proved  
16 that the defendant made material misrepresentations, that they were widely  
17 disseminated, and that consumers purchased the defendant's product." Id. at 605-06  
18 (citing FTC v. Kitco of Nevada, Inc., 612 F. Supp. 1282 1293 (D. Minn. 1985), and  
19 FTC v. Internat'l Diamond Corp., 1983-2 Trade Cas. (CCH) P65,725 at 69,709  
20 (N.D. Ca. 1983)).

## 21 (a) Knowledge

22 The requisite degree of knowledge can be demonstrated by showing actual  
23 knowledge of material misrepresentations, reckless indifference to the truth or  
24 falsity of the misrepresentations, or an awareness of a high probability of fraud  
25 along with an intentional avoidance of the truth; the Commission need not show  
26 intent to defraud. Publishing Clearing House at 1171. In short, the issue is whether  
27 the individual Defendants "knew or should have known of the entity's  
28 misrepresentations." Freecom at 1203.

1           The individual Defendants have or had the requisite knowledge to establish  
2 monetary liability. First, they certainly had actual knowledge that Defendants and  
3 their sales reps were claiming they would negotiate substantial reductions in their  
4 clients debts. Connelly and Torkelson drafted the text of the websites that made this  
5 claim, and the claim was expressly included in the script that they required sales  
6 reps to use and which they watched sales reps use. As noted above, Garneau  
7 personally made this representation to prospective clients. She also received and  
8 used Connelly's scripts and sent her sales reps to be trained at Homeland, was very  
9 active in running her small office, and always "wanted to know the 'truth' about what  
10 was happening." (Real ¶¶ 73-74.) This claim that Defendants would negotiate  
11 substantial reductions in consumers debt was the centerpiece of the Defendants'  
12 debt-negotiation program. Only through willful ignorance could the individual  
13 Defendants have failed to know this claim was being made.

14           The individual Defendants also knew or should have known that the claim  
15 was false. Homeland and NSS kept detailed records of their clients' accounts and  
16 the settlements they negotiated. It was readily apparent from these records that the  
17 number of accounts that the company was accepting into the program far exceeded  
18 the number of accounts that were being settled. The company's lack of performance  
19 was also readily apparent from the continual stream of client complaints and the fact  
20 that the vast majority of the company's clients dropped out of the program—  
21 information which Connelly and Torkelson regularly monitored. Connelly and  
22 Torkelson received conclusive evidence of their company's failure to negotiate  
23 settlements in November 2004, when NSS's Customer Service Manager provided  
24 Connelly and Torkelson with records showing that the vast majority of their clients'  
25 requests to settle accounts were neglected.

26           While Connelly and Torkelson knew about this fact, they just didn't care. Far  
27 from being concerned about the voluminous cancellations and the continual  
28 complaints about the Negotiations Department's lack of performance, Connelly and

1 Torkelson embraced the cancellations as a key to increased profitability. As they  
2 said on more than one occasion, they were interested only in obtaining their clients'  
3 fees; servicing clients who had paid their fees was a waste of time and money. As a  
4 matter of policy Homeland and NSS refrained from doing any work on their clients'  
5 accounts during the several-month period after enrollment when clients were making  
6 their down payments and then saving money for settlements, while at the same time  
7 Connelly and Torkelson knew that most of their clients would quit the program  
8 shortly thereafter.

9 Garneau also has had the knowledge necessary for monetary liability. At the  
10 very least, Garneau should have known that the clients whom Prosper enrolled were  
11 not receiving what they bargained for, particularly in light of her keen interest in the  
12 complaints that Prosper clients generated (Szkudlarek ¶ 27) and the fact that she  
13 always "wanted to know the truth" about what was happening. The records showing  
14 that NSS has been failing to deliver the reduction in debt that has been promised to  
15 clients has been readily available to Garneau as well as to Connelly and Torkelson;  
16 if she was unaware of this information, it was only by intentionally avoiding the  
17 truth.

#### 18 (b) Reliance

19 The Figgie standard for reliance is easily satisfied in this case. As discussed  
20 above, the representation that Defendants would negotiate substantial reductions in  
21 their clients' total amount of unsecured debt was express and was therefore material.  
22 The representation was also widespread, as evidenced by the fact that Defendants  
23 have been in business for over four years, have advertised on the World Wide Web,  
24 have had significant sales in over 40 states (Szkudlarek ¶ 49, Ex. 8), have accepted  
25 on average roughly 500 new clients each month (Id. at ¶ 137), and have generated  
26 \$1.5 to \$2.5. million in monthly revenues. Evidence of Defendants' revenues also  
27 shows that consumers have purchased Defendants' service.

1 e. Plaintiff is Likely to Succeed in Showing That Defendants  
2 Have Operated as a Common Enterprise

3 "Where one or more corporate entities operate in a common enterprise, each  
4 may be held liable for the deceptive acts and practices of the others." FTC v. Think  
5 Achievement Corp., 144 F. Supp. 2d 993, 1011 (N.D. Ind. 2000), rev'd in part on  
6 other grounds, 312 F.3d 259 (7th Cir. 2002). Courts look at a variety of factors in  
7 determining whether businesses are operating as a common enterprise, including,  
8 inter alia: common control, the sharing of office space and officers, whether  
9 business is transacted through a maze of interrelated companies, the commingling of  
10 corporate funds and failure to maintain separation of companies, unified advertising,  
11 and evidence which reveals that no real distinction existed between the Corporate  
12 Defendants. FTC v. Wolf, 1997-1 Trade Cases ¶ 71,713, 1996 U.S. Dist. LEXIS  
13 1760 at \*22-23 (S.D. Fla. 1996) (citing cases that discuss each of these factors).

14 Defendants in this case have operated as a common enterprise. Defendants  
15 Homeland, NSS and United are or were owned and operated by Defendants  
16 Connelly and Torkelson. Connelly also has owned Freedom First. Defendant USA  
17 Debt appears to be a successor to Freedom First, as it took over the office space  
18 previously occupied by Freedom First, and both companies are Wyoming LLCs with  
19 the same registered agent. Defendant Prosper is operated by Garneau, Torkelson's  
20 mother, who regularly visited NSS's business premises. Prosper tells consumers that  
21 "Support Services is part of Prosper" and "it's all the same company" (Gosha pgs.  
22 134:26, 162:14-15). Garneau is also listed as the President of Nationwide Support  
23 Services (which may later be added as a defendant), which appears to be the  
24 successor to National Support Services, and which now occupies United's former  
25 office space. Moreover, these entities use the same advertising, in the form of  
26 websites created by Connelly and Torkelson, and use the same sales pitches, scripted  
27 by NSS. All of the Defendants are part of common enterprise to sell a single debt-  
28 negotiation program using a unified sales approach.

1 As a common enterprise, "these defendants are jointly and severally liable for  
2 the injury caused by their violations of the FTC Act." FTC v. Wolf, 1996 U.S. Dist.  
3 LEXIS 1760 at \*23.

4 3. The Equities Balance in the Commission's Favor

5 The public equities in this case overwhelmingly warrant preliminary and  
6 ancillary injunctive relief. The proposed TRO and preliminary injunction would  
7 prohibit Defendants from engaging in deceptive conduct in operating their  
8 businesses, and from providing others with the means or instrumentalities to engage  
9 in deceptive conduct. Defendants' past conduct demonstrates that they will not stop  
10 their deceptive practices absent a definitive order to do so. Moreover, the conduct  
11 prohibitions contained in the proposed TRO would work no hardship on Defendants,  
12 as they have no right to engage in practices that violate the law. See World Wide  
13 Factors, 882 F.2d at 347; United States v. Diapulse Corp. of America, 457 F.2d 25,  
14 29 (2d Cir. 1972).

15 **C. An Asset Freeze, Temporary Receiver, and Immediate Access to the**  
16 **Corporate Business Premises Are Necessary to Prevent Dissipation**  
17 **of Assets and to Preserve the Possibility of Effective Final Relief for**  
18 **Consumers**

19 Defendants' assets should be frozen. In the Ninth Circuit, an asset freeze may  
20 be imposed when the *possibility* of dissipation of assets exists. FSLIC v. Sahni, 868  
21 F.2d 1096, 1097 (9th Cir. 1989).<sup>166</sup> Where the defendants have committed fraud, a  
22 court may conclude there is a likelihood that assets will be dissipated. See, e.g.,  
23

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24 <sup>166</sup> In Sahni, the Ninth Circuit reversed a district court's denial of an asset  
25 freeze where the district court had required a showing that asset dissipation was  
26 not only possible but likely. 868 F.2d at 1097. The court held that "[s]o long as  
27 the district court continued to believe that FSLIC was likely to succeed on the  
28 merits, the court should only have required FSLIC to show a possibility of  
dissipation of assets." Id. Requiring a showing of a "likelihood" of dissipation  
"placed an unnecessarily heavy burden on FSLIC." Id. at 1097.

1 SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1106 (2d Cir. 1972) (upholding  
2 freeze pending sale of property after entry of judgment, on the grounds that,  
3 "[b]ecause of the fraudulent nature of appellants' violations, the court could not be  
4 assured that appellants would not waste their assets prior to refunding public  
5 investors' money"). In addition to the nature of the defendant's past conduct, the  
6 magnitude of the defendant's ultimate liability also warrants the entry of an asset  
7 freeze. FTC v. USA Bevs., Inc., 2005 U.S. Dist. LEXIS 39075 at \*24-25 (S.D. Fla.  
8 2005) ("The scope of the monetary liability for Defendants' unlawful conduct is  
9 enormous and provides considerable motivation for defendants to place their assets  
10 beyond the Court's reach").

11 While a pattern of fraud implies a possibility of intentional concealment, the  
12 possibility of dissipation for any reason should suffice to warrant an asset freeze. If,  
13 for example, Defendants' potential liability exceeds the amount of assets in their  
14 possession, any expenditure by Defendants will dissipate assets and leave  
15 Defendants less able to redress the consumer injury they have caused.

16 In this case, an asset freeze is warranted for a number reasons. First,  
17 Defendants' business is permeated by fraud. Second, Connelly has been convicted  
18 of five counts of felony money laundering, and then violated the terms of his  
19 supervised release on more than one occasion. Third, Plaintiff's evidence shows that  
20 Connelly has violated this Court's previous order prohibiting him from making  
21 misrepresentations in the course of telemarketing. Fourth, Connelly and Torkelson  
22 have put their businesses in the names of third parties to hide their ownership. Fifth,  
23 Connelly and Torkelson have attempted to obscure the trail of money they have  
24 received from NSS by not using their own names to receive their salary and draw.  
25 And sixth, Defendants face a potential liability of over \$100 million, giving them  
26 ample motivation to hide their funds. There is simply no reason to believe that,  
27 absent an asset freeze, Defendants will not dissipate their assets pending the  
28 outcome of this case. A TRO that freezes Defendants' assets would preserve the



1 possibility of full and effective relief for defrauded consumers by preserving the  
2 status quo pending a hearing on the preliminary injunction. At a minimum a  
3 temporary asset freeze should be imposed until it can be determined whether  
4 Defendants have sufficient assets to cover their potential liability.

5 As another means to maintain the status quo, Plaintiff seeks the appointment  
6 of a temporary receiver, who will locate and preserve corporate assets and records to  
7 obviate the threat of destruction, dissipation, or concealment. In cases involving  
8 fraud, a temporary receiver is particularly appropriate to maintain the status quo.  
9 SEC v. First Financial Group, 645 F.2d 429, 438-39 (5th Cir. 1981); see also SEC v.  
10 Keller Corp., 323 F.2d 397, 403 (7th Cir. 1963) ("It is hardly conceivable that the  
11 trial court should have permitted those who were enjoined from fraudulent  
12 misconduct to continue in control of [the corporate defendant's] affairs for the  
13 benefit of those shown to have been defrauded. In such cases the appointment of a  
14 trustee-receiver becomes a necessary implementation of injunctive relief").

15 A receiver is necessary here because, as shown above, Defendants' business is  
16 permeated by fraud and Defendants' have attempted to hide their ownership interest  
17 in their companies, and have filtered payments to themselves through at least one or  
18 two layers of buffer companies. Furthermore, given current computer technology,  
19 records and assets can be destroyed or concealed at the touch of a button unless a  
20 third party takes immediate possession of the business.

21 The proposed TRO would impose a temporary receivership over the assets  
22 and businesses of Defendants Homeland, NSS, United, Prosper, Freedom First, and  
23 USA Debt, as well as Nationwide Support Services. A receivership over  
24 Nationwide is justified, since (a) it appears that the operation of NSS has been  
25 transferred to Nationwide; (b) in its corporate filings Nationwide has identified  
26 Defendant Joanne Garneau as its President and has given an address that is identical  
27 to Prosper's address; (c) Nationwide occupies office space that formerly belonged to  
28

1 Defendant United; and (d) NSS's Chief Operating Officer is the BBB's contact for  
2 Nationwide.


3 Finally, Defendants' dishonest conduct also justifies an order allowing  
4 Plaintiff immediate access to Defendants' business premises. Immediate access is  
5 necessary to allow Plaintiff to quickly identify the nature and location of  
6 Defendants' assets and documents to ensure that they remain secure during the  
7 pendency of the TRO. A quick determination of the amount and location of  
8 Defendants' assets will also help determine whether Defendants have sufficient  
9 assets to meet their potential liability, and thus whether and to what extent  
10 Defendants' assets need to remain frozen until the case is resolved.

11 **V. CONCLUSION**

12 For the foregoing reasons, the Court should enter the requested TRO and  
13 order Defendants to show cause why a preliminary injunction should not issue and a  
14 permanent receiver should not be appointed over Defendants' businesses.

15  
16 Dated: August 2, 2006

Federal Trade Commission

  
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