UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION
OFFICE OF ADMINISTRATIVE LAW JUDGES

In the Matter of	)	**PUBLIC**
LabMD, Inc., a corporation, Respondent.	)	Docket No. 9357

REPLY IN SUPPORT OF RESPONDENT'S MOTION FOR SANCTIONS

The pending motion concerns the consequences of FTC's undisclosed relationship with Tiversa, Inc., its role in the creation and abuse of the "Privacy Institute" front group, and its failure to confirm the origin of or to have a chain of custody for the 1718 File.[1] Complaint Counsel's opposition ignores FTC's relationship with Tiversa and the "Privacy Institute." Admitting that FTC never questioned or confirmed how Tiversa obtained the 1718 File and that the only document "proving" that the 1718 File was found and not stolen is CX-19, Complaint Counsel spends much of its opposition arguing the merits using "evidence" obtained after the complaint was filed to justify its conduct. *See generally* Compl. Counsel's Opp'n to Resp't's Mot. for Sanctions (Aug. 25, 2014) ("Opp'n Br.").

[1] As previously discussed, government attorneys have a heightened duty to act fairly and ethically. Resp't's Mot. for Sanctions, at 9 & n.9 (Aug. 14, 2014) ("Resp't's Mot."). Without the 1718 File, FTC never would have investigated LabMD. Therefore, FTC and Complaint Counsel were required to conduct a detailed and diligent investigation of Tiversa and the 1718 File before proceeding against LabMD, particularly given that Complaint Counsel was well aware of LabMD's concerns that Tiversa had stolen the 1718 File from LabMD's workstation in violation of Georgia law. *See Williams v. Sullivan*, 779 F. Supp. 471, 472 (W.D. Mo. 1991) (finding that "a special duty [is] imposed on government lawyer[]s to 'seek justice and develop a full and fair record'"); *Jones v. Heckler*, 583 F. Supp. 1250, 1256 n.7 (N.D. Ill. 1984); Model Code of Professional Responsibility EC 7-14 (1980). Yet, at best, FTC and Complaint Counsel ignored their obligations.

The parties will have adequate opportunity to address the merits during post-trial briefing, and LabMD is confident that FTC cannot meet its burden. But ***this is not a post-trial brief***. The pending motion turns on whether FTC's relationship with Tiversa and the Privacy Institute was properly transparent in all respects and whether it verified the reliability and truth of the evidence upon which the Commission relied to initiate its investigation and ultimately file its complaint against LabMD.[2] On this issue, it is clear that FTC and Complaint Counsel, with the 1718 File as the seminal basis of their investigation, shirked their obligations and knowingly proceeded against LabMD without regard to the quality of the evidence upon which they have so heavily relied. In either instance, whether by act or omission, these circumstances warrant dismissal.

Complaint Counsel relies on *In re Exxon Corp.*, No. 8934, 1974 FTC LEXIS 226, at *2-3 (F.T.C. June 4, 1974), to cloak its conduct from review. Opp'n Br., at 2 n.1. *Exxon,* however, is no cloak. In *Exxon,* the respondent charged that Commission action was the result of undue Congressional influence and not concern for the public interest – in other words, it challenged the Commissioners' subjective motivations. But, none of the challenged communications were "even remotely of the character deemed improper by the courts" and thus the issue to be litigated was "not the adequacy of the Commission's pre-complaint information or the diligence of its

[2] Complaint Counsel improperly raises procedural issues as a smokescreen. *See, e.g., Colida v. Nokia Inc.*, No. 07 Civ. 8056, 2008 U.S. Dist. LEXIS 75450, at *5-6 (S.D.N.Y. Sept. 26, 2008) ("[W]hether any particular motion for sanctions is dispositive or non-dispositive depends on whether the sanctions imposed actually dispose of a claim."); 14 James Wm. Moore, *et al.*, Moore's Federal Practice § 72.02[7][b] (3d ed. 2004) ("If imposition of a sanction would terminate the litigation, the sanction is considered dispositive[.]"); Rule 3.22(c) & Add'l Provisions, Sched. Order ¶ 5 (Sept. 25, 2013) (10,000 word limit for dispositive motions); Add'l Provisions, Sched. Order ¶ 4 (no meet and confer requirement for dispositive motions like motions to dismiss or motions for summary decision); *Veleron v. Bnp*, No. 12-CV-5966, 2014 U.S. Dist. LEXIS 117509, at *7 (S.D.N.Y. Aug. 22, 2014) (no meet and confer requirement, particularly "where efforts at informal compromise would have been clearly futile").

study of the material in question but whether the alleged violation has in fact occurred." *In re Exxon*, 1974 FTC LEXIS 226, at *2-3.

Here, however, the challenged conduct *has* been deemed improper by the courts and thus *Exxon*, by its own terms, does not foreclose review. At issue are the integrity of pre-complaint information and investigation, not their "adequacy," and the government's fundamental duty of fairness and its obligation to develop a full and fair record, not the Commissioners' subjective motivations. *Exxon* does not purport to change the rule prohibiting FTC from commencing an investigation or bringing a case based on tainted evidence. *Atlantic Richfield Co. v. FTC*, 546 F.2d 646, 651 (5th Cir. 1977) ("[I]f the FTC act[ed] improperly or illegally in obtaining evidence for the adjudicative proceeding . . . [Respondent] should be entitled to have any evidence so obtained – as well as its 'fruits' – excluded from the proceeding[.]"); *Knoll Associates v. FTC*, 397 F.2d 530 (7th Cir. 1968) (remanding case to FTC with instruction to reconsider evidence without documents and testimony given or produced by or through witness who stole materials from respondent). Nor does it purport to relieve Complaint Counsel from its duty to develop a full and fair record before bringing a complaint. *See* 16 C.F.R. § 2.4 (requiring the "just . . . resolution of investigations"). Therefore, given that the 1718 File was almost certainly stolen from LabMD in violation of Georgia law, given that Complaint Counsel admittedly has no 1718 File chain of custody, given that Complaint Counsel admittedly did nothing to check how Tiversa obtained the 1718 File despite LabMD's concerns, and given that there is no evidence FTC has ever fully and seasonably disclosed to the Commission, LabMD, or this Court the true

nature and extent of its relationship with Tiversa and the "Privacy Institute," *Exxon* does not apply and sanctions are proper.[3]

It is clear now, beyond any question, that FTC never questioned or confirmed how Tiversa obtained the 1718 File (neither the origin of nor chain of custody for the 1718 File). Moreover, the authenticity of the only document "demonstrating" that the 1718 File could be found somewhere other than a LabMD workstation (CX-19) has been impeached by Tiversa itself. Trial Tr. at 1228-30 (May 30, 2014); RX-542 (proposed exhibit) (Letter from Rep. Darrell Issa, Chairman, U.S. House of Representatives, Comm. on Oversight & Gov't Reform, to FTC (June 11, 2014) (stating that Boback relied on incomplete information regarding the origin of the 1718 File)); RX-541, at 33:10-15 (June 7, 2014) (stating that Wallace could have fabricated the spread analysis for the 1718 File).

On these issues, Complaint Counsel offers nothing, thereby confirming what LabMD has said for years. Without describing *how* Tiversa "discovered" the 1718 File, Complaint Counsel simply restates its claim that "Tiversa[] found the 1718 File at multiple [IP] addresses." Opp'n Br., at 3. And while Complaint Counsel talks about its reviewing "thousands of pages" of LabMD documents, cites its "Investigational Hearings," and the input of third parties, it never

[3] This Court cited *Exxon* in its January 30, 2014, Order on Complaint Counsel's Motion to Quash Subpoena Served on Complaint Counsel. *See* Order on Compl. Counsel's Mot. to Quash Subpoena Served on Compl. Counsel and for Protective Order, at 6 (Jan. 30, 2014). It should be noted that Complaint Counsel, from the moment it began its investigation in 2010, was well aware that the Commission has consistently ruled that pre-complaint attorney communications with those persons or entities that provide it with the evidence upon which its decisions are based are generally not discoverable. In fact, Complaint Counsel apparently considers itself entirely free to gather, rely upon, and manipulate the evidence in any manner suitable to its purposes, assuming that its decisions in this regard cannot be challenged or even questioned. This, however, is not the law. *See, e.g., Chaplaincy of Full Gospel Churches v. Johnson*, 217 F.R.D. 250, 257-58 (D.D.C. 2003). FTC wishes this Court to ignore the circumstances of this case and continue to afford it unfettered discretion. This wish should be denied.

once references *any* efforts to validate or verify Tiversa's conduct or claims with respect to the 1718 File. *Id.* at 2.

Nor has Complaint Counsel offered any evidence to refute LabMD's long-standing claim that the 1718 File was illegally obtained in contravention of Georgia statutory law. *See id.* at 7. Instead, it argues that Respondent has offered "*no* admissible evidence" to support its assertion that Tiversa stole the 1718 File. To the contrary, Respondent cited numerous problems with Tiversa's "evidence," including Robert Boback's contradictory testimony, Tiversa's perverse financial incentives, an ongoing congressional investigation of Tiversa's possible manipulation of FTC, and the suspicious circumstances surrounding the transfer of the 1718 File from Tiversa to the Privacy Institute and finally to FTC. Resp't's Mot., at 1, 4-5, 7-8, 10. Similarly, FTC's assertion that it disclosed its relationship with the Privacy Institute in its initial disclosure (*see* Opp'n Br., at 2) misses the point; the initial disclosures provided nothing about its collusion with Tiversa to create the Privacy Institute as a conduit for the transfer of stolen files or about whether FTC was appropriately transparent with the Commissioners, LabMD, and this Court about all aspects of its Tiversa/Privacy Institute relationship. In truth, FTC has repeatedly stonewalled LabMD's repeated requests for full disclosure regarding FTC/Complaint Counsel's current and past contacts with Tiversa and/or the Privacy Institute, and regarding the measures taken by FTC to determine whether the 1718 File had been stolen. *See* Resp't's Mot., at 7.

Continuing its pattern of impropriety, Complaint Counsel disguises its circumvention of this Court's July 23, 2014 Order by claiming that its recent supplemental disclosures were intended to "[d]ischarg[e] any possible obligation . . . under Rule 3.31(e)." *Compare* Opp'n Br., at 4, *with* Order Den. Compl. Counsel's Mot. for Leave, at 2 (July 23, 2014) ("Order"). Yet, these "supplemental disclosures" were made only five days after this Court rejected Complaint

Counsel's attempt to impeach Richard Wallace.[4] Complaint Counsel at *every* opportunity (including in its opposition) raises issues relating to Mr. Wallace's personal, medical, and employment information. Thus, it appears that Complaint Counsel's true motivation in filing its supplemental disclosures was to impeach the credibility of a witness who has yet to testify – in direct contravention of the Court's Order – on the very topic (*i.e.*, the 1718 File) that is at the heart of its case and the pending motion for sanctions.

Moreover, Complaint Counsel does not deny the financial and otherwise improper relationship between FTC, Tiversa, and the Privacy Institute. Former Commissioner Rosch made clear his concerns about the "evidence" from Tiversa, due to Tiversa's financial incentives in exposing and capturing sensitive files. *See* Resp't's Mot., at 8. In fact, Commissioner Rosch recommended that the Commission not rely on evidence obtained from Tiversa, including the 1718 File, to "avoid even the appearance of bias or impropriety."[5] *Id.* Thus, Complaint Counsel breached its ethical obligations by blindly relying upon a third party with questionable financial incentives as the source of its most critical piece of evidence against Respondent.[6]

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[4] Complaint Counsel's attempt to characterize the Court's recent Order is to no avail. *See* Opp'n Br., at 3 n.2. It is beyond debate that this Court rejected Complaint Counsel's request to issue subpoenas for rebuttal evidence. *See generally* Order.

[5] Complaint Counsel admits that it inaccurately stated that Tiversa had received no federal funding in response to an "unanticipated question" during Complaint Counsel's opening statement. Opp'n Br., at 6 n.6. Given Commissioner's Rosch's concerns about the appearance of bias and impropriety created by relying on Tiversa as a witness, at the least, Complaint Counsel should have anticipated the relevance of Tiversa's affiliation with government entities. In light of Commissioner Rosch's warning, FTC also should have conducted the minimal investigation which would have revealed Tiversa's financial arrangements with government agencies.

[6] Commissioner Rosch's dissent suggests that the Commission was not informed about the FTC/Tiversa/Privacy Institute nexus. Given Tiversa's financial interest in this case, the government lawyers working on the matter should have checked to see if the 1718 File had been stolen and also made full disclosure about FTC's relationship to the Commission and to LabMD. *See* 5 C.F.R. § 2635.101(b)(5), (8), (14); 16 C.F.R. § 5.1.

To prevent these types of abusive tactics, Commission rules clearly grant the ALJ broad discretion in imposing sanctions. *See* 16 C.F.R. § 3.38(b) (stating that the ALJ may enter any sanction order that is "just"); *In re USLife Credit Corp.*, No. 9057, 91 F.T.C. 984 (May 23, 1978) ("In our view, the administrative law judges may properly exercise discretion in deciding what kind of sanction, if any, is warranted."). Rule 3.42 specifically states that ALJs "shall have the duty to conduct fair and impartial hearings, to take *all necessary action* to avoid delay in the disposition of proceedings, and to maintain order. They shall have *all powers necessary to that end*." 16 C.F.R. § 3.42(c) (emphasis added). If an ALJ has the power to enter an adverse determination against a party for violation of a discovery order, then this Court must have discretion to order dismissal as a sanction when the government's conduct threatens the integrity of Commission proceedings. *See* 16 C.F.R. § 3.38(b)(6) (allowing an ALJ to rule "that a decision of the proceeding be rendered against the party" based on the party's violation of a discovery obligation). *Cf. In re Gemtronics, Inc.*, No. 9330, 2010 FTC LEXIS 40, at *8 (F.T.C. Apr. 27, 2010) (cited by Complaint Counsel, but irrelevant because that case concerned the ALJ's authority to assess $50,000 in monetary sanctions against complaint counsel and, here, LabMD does not seek monetary sanctions).

As explained above, FTC's conduct here warrants the severest of sanctions. FTC should not be permitted to shield this misconduct simply by disclaiming the relevance of its pre-complaint investigation. Indeed, if Rule 3.42(c) is to have any meaning, then this Court must be authorized to sanction government misconduct of the degree present in this case to ensure the integrity of its proceedings. Accordingly, Respondent respectfully requests that the Court sanction FTC by dismissing this case with prejudice and awarding Respondent reasonable attorneys' fees and costs.

Dated: September 2, 2014

Respectfully submitted,

Prashant K. Khetan
Robyn N. Burrows
Cause of Action
1919 Pennsylvania Ave., NW, Suite 650
Washington, D.C. 20006
Phone: 202.499.4232
Fax: 202.330.5842
Email: prashant.khetan@causeofaction.org

/s/ Reed D. Rubinstein
Reed D. Rubinstein
William A. Sherman, II
Dinsmore & Shohl, L.L.P.
801 Pennsylvania Ave., NW, Suite 610
Washington, D.C. 20006
Telephone: 202.372.9120
Fax: 202.372.9141
Email: reed.rubinstein@dinsmore.com

Counsel for Respondent, LabMD

CERTIFICATE OF SERVICE

I hereby certify that on September 2, 2014, I filed the foregoing document electronically using the FTC's E-Filing System, which will send notification of such filing to:

Donald S. Clark, Esq.
Secretary
Federal Trade Commission
600 Pennsylvania Ave., NW, Rm. H-113
Washington, DC 20580

I also certify that I delivered via electronic mail and priority mail a copy of the foregoing document to:

The Honorable D. Michael Chappell
Chief Administrative Law Judge
Federal Trade Commission
600 Pennsylvania Ave., NW, Rm. H-110
Washington, DC 20580

I further certify that I delivered via electronic mail a copy of the foregoing document to:

Alain Sheer, Esq.
Laura Riposo VanDruff
Megan Cox
Margaret Lassack
Ryan Mehm
Division of Privacy and Identity Protection
Federal Trade Commission
600 Pennsylvania Ave., N.W.
Mail Stop NJ-8122
Washington, D.C. 20580

CERTIFICATE OF ELECTRONIC FILING

I certify that the electronic copy sent to the Secretary of the Commission is a true and correct copy of the paper original and that I possess a paper original of the signed document that is available for review by the parties and the adjudicator.

Dated: September 2, 2014 By: /s/ Robyn N. Burrows