

1 LAURA SCHNEIDER
2 lschneider@ftc.gov, (202) 326-2604 (tel.)
3 KORIN K. EWING
4 kewing@ftc.gov, (202) 326-3556 (tel.)
5 Federal Trade Commission
6 601 New Jersey Avenue, NW, Rm. 2122
7 Washington, DC 20001
8 (202) 326-2558 (fax)

9 JOHN D. JACOBS
10 Cal. Bar No. 134154
11 Federal Trade Commission
12 10877 Wilshire Boulevard
13 Suite 700
14 Los Angeles, CA 90024
15 (310) 824-4360
16 (310) 824-4380 (fax)

17 ATTORNEYS FOR PLAINTIFF
18 FEDERAL TRADE COMMISSION

19 UNITED STATES DISTRICT COURT
20 SOUTHERN DISTRICT OF CALIFORNIA

21 FEDERAL TRADE COMMISSION,

22 Plaintiff,

23 v.

24 NEOVI, INC., d/b/a NEOVI DATA
25 CORPORATION and QCHEX.COM, et al.,

26 Defendants.

27 CASE NO. 06 CV 1952 JLS (JMA)

28 **FEDERAL TRADE COMMISSION'S
MEMORANDUM IN SUPPORT OF ITS
APPLICATION FOR AN ORDER TO
SHOW CAUSE WHY THOMAS
VILLWOCK, JAMES M. DANFORTH,
G7 PRODUCTIVITY SYSTEMS,
IPROLOG CORPORATION AND
FREEQUICK WIRE CORPORATION
SHOULD NOT BE HELD IN
CONTEMPT**

Hearing Date: January 21, 2010
Time: 1:30pm
Courtroom 6
Judge: Hon. Janis L. Sammartino

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MF *Plaintiff FTC's Motion for Summary Judgment Statement of Material Facts as to Which There Exists No Genuine Issue to Be Tried* (Docket # 89-3) ... 18, 23

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1/7/09 Order *Order: (1) Denying Defendants' Reconsideration Motion; (2) Denying Plaintiff's Motion to Strike; and (3) Granting Plaintiff's Proposed Injunctive Relief* (Docket #117) 2, 15, 23

1 **I. INTRODUCTION**

2 Contrary to this Court's clear prohibitions in the Final Order for Permanent Injunction
3 and Other Equitable Relief ("Final Order") entered on January 7, 2009¹ (PX 1), Thomas
4 Villwock, James M. Danforth, G7 Productivity Systems ("G7"), iProlog Corporation
5 ("iProlog") and FreeQuick Wire Corporation (collectively "Contempt Defendants"), fail to
6 perform any identity or account verification before creating and delivering checks for
7 customers, nor do they follow any of the Court's complaint investigation procedures. Indeed,
8 Contempt Defendants are engaged in business as usual, continuing, as this Court stated, to
9 "ring the dinner bell for fraudsters" who use their services to commit check fraud, without any
10 concern for the harm to innocent consumers.

11 Specifically, the Contempt Defendants have been violating the core provisions of the
12 Final Order since the date it was issued through their continuing operation of
13 FreeQuickWire.com ("FQW"), an electronic check creation and delivery service nearly
14 identical to the Qchex and GoChex services that the Court found violated Section 5 of the FTC
15 Act and significantly facilitated fraudulent activity. Completely disregarding the Court's
16 express instructions in the Final Order, Contempt Defendants create checks through FQW
17 without implementing any of the required account control and identity verification procedures
18

19 ¹ In addition to the Federal Trade Commission's Application For An Order to Show
20 Cause Why Thomas Villwock, James M. Danforth, G7 Productivity Systems, iProlog
21 Corporation and FreeQuick Wire Corporation Should Not Be Held in Contempt ("Contempt
22 Application"), the FTC is concurrently filing a Motion to Modify the Final Order with
23 accompanying memorandum.

23 In support of its Applications, the FTC is filing combined exhibits entitled Exhibits to
24 Memoranda in Support of Federal Trade Commission's Application For An Order to Show
25 Cause Why Thomas Villwock, James M. Danforth, G7 Productivity Systems, iProlog
26 Corporation and FreeQuick Wire Corporation Should Not Be Held in Contempt and Motion to
27 Modify the Final Order ("Exhibits to Memoranda"). Exhibits filed concurrently with these
28 applications are cited as "PX Number," and Declarations filed concurrently with these
applications are cited by PX Number and the declarant's last name, followed by the appropriate
declaration paragraph number(s), and/or attachment number(s), and/or attachment page numbers,
e.g., PX 4, Owens ¶4, Att. B at 4-5. Exhibits cited in the memoranda that were filed previously
in this case are cited by the short name of the document. See this memorandum's Table of
Exhibits for the full titles, docket numbers, and locations of each exhibit cited.

1 or the mandatory investigative regiment, thereby leaving unsuspecting consumers' financial
2 accounts vulnerable to fraud. Indeed, as discussed below, FTC investigators easily created
3 eleven "unauthorized" checks through FQW, using one undercover identity to "steal" money
4 from another identity's undercover financial account. In total, FTC investigators created and
5 delivered eighteen FQW checks, printing fifteen and depositing nine of those checks, all
6 without any attempts by FQW to verify any information whatsoever from the FQW user.

7 Accordingly, the Commission is seeking an order to show cause why Contempt
8 Defendants should not be held in civil contempt for violating the Final Order and the entry of
9 contempt sanctions. In addition, Contempt Defendants have not shown any inclination to
10 comply with the Final Order or that they can operate this type of business lawfully even under
11 a court order. Because of these changed circumstances, the Commission is concurrently filing
12 a separate motion against Defendants Villwock, Danforth, and G7, pursuant to Federal Rule of
13 Civil Procedure 60(b), seeking to modify the Final Order to ban them permanently from
14 participating in services that create or deliver checks to consumers.

15 **II. STATEMENT OF FACTS**

16 **A. The Underlying Action**

17 The underlying action against Neovi, Inc., d/b/a Qchex ("Neovi"), G7, and their
18 principals, Villwock and Danforth, concerned their check creation and delivery services
19 offered through the Qchex and GoChex websites. (SJ Order at 2, 16, 17). Specifically, the
20 defendants made no effort to verify the identities of the individuals creating checks using their
21 services, nor did they confirm that those individuals had authority to draw funds on the
22 financial accounts listed on the checks. (*Id.* at 13; 1/7/09 Order at 4-5). As a result, from 2000
23 to 2006, Qchex sent nearly 155,000 checks from 13,770 Qchex accounts that were later frozen
24 for fraud. (SJ Order at 8). The total face value of these checks was \$402,753,276 – more than
25 half of the entire face value of Qchex checks printed overall. (*Id.*).

26 On September 19, 2006, the Commission filed a complaint and Motion for a
27 Temporary Restraining Order against Neovi, G7, Danforth, and Villwock. (Complaint, TRO
28 Motion). The complaint alleged that the defendants engaged in unfair practices by creating

1 checks for individuals without first verifying that those individuals had the authority to draw
2 funds on the bank accounts named on the checks, resulting in unauthorized withdrawals.
3 (Complaint ¶¶ 11, 27, 28). Victimized consumers often were unable to locate a telephone
4 number or other means to contact the defendants to report the unauthorized withdrawals.
5 (Complaint ¶29). In addition, even when consumers were able to contact the defendants, the
6 defendants continued to create and deliver unauthorized checks drawn on those consumers'
7 accounts. (Complaint ¶30).

8 In October 2007, Neovi filed for bankruptcy, and the following day Defendants
9 Villwock, Danforth, and G7 created iProlog, which essentially took over Neovi's business
10 activities, using the same G7-owned assets and facilities that had been used by Neovi. (SJ
11 Order at 2-3; PX 3, R. Lewis, Att. I at 5, 12, 19-20). Undeterred by the ongoing proceedings
12 against them, Defendants Villwock and Danforth also formed FreeQuick Wire Corporation,
13 which, along with Defendant G7 and iProlog, launched the FQW website, offering check
14 creation and delivery services substantially identical to those offered by Qchex. (SJ Order at 3;
15 PX 3, R. Lewis, Att. A, Att. I at 25; *see also* PX 2, L. Lewis, Atts. A-B).

16 On September 16, 2008, the Court granted the FTC's motion for summary judgment,
17 finding that the defendants had engaged in unfair acts or practices that caused substantial harm
18 to consumers that they could not reasonably avoid. (SJ Order). On January 7, 2009, the Court
19 entered an Order barring the defendants from creating or delivering any check for a customer
20 unless they: (1) take specific steps to verify the authority of each prospective customer to draw
21 funds on a particular financial account; (2) take specific steps to verify the identity of each
22 prospective customer; (3) disclose specified contact information to allow victims easily to
23 report claims of unauthorized use of their financial accounts; and (4) take specific steps to
24 investigate and respond to any complaints of such unauthorized use. (PX 1). The defendants
25 have appealed the Order to the Ninth Circuit; however, they have not moved to stay its
26 injunctive provisions. (*See FTC v. Neovi, Inc. et al.*, Docket # 09-55093, 9th Cir.).

27

28

1 **B. Parties to Current Action: Contempt Defendants**

2 **1. Thomas Villwock** was the owner of Neovi and served as the company's
3 President and Chief Executive Officer ("CEO"). (SJ Order at 2). In his recent supplemental
4 compliance report, Villwock confirmed that he is now the CEO of iProlog (PX 3, R. Lewis,
5 Att. H at 2), which, as the Court found in the underlying litigation, continued many of Neovi's
6 business activities.² (SJ Order at 3).

7 Villwock describes his role for G7 as a "business consultant" (PX 3, R. Lewis, Att. E at
8 1, Att. H at 1), however, in the underlying litigation, the Court found him to be the *de facto*
9 President. (SJ Order at 2). Regardless of his title, in his recent supplemental compliance
10 report, Villwock confirmed that his role at G7 has not changed since the Court's ruling. (PX 3,
11 R. Lewis, Att. H at 1).

12 The 2008 corporate annual report filed with the Delaware Secretary of State for
13 FreeQuick Wire Corporation identifies Villwock as President (PX 3, R. Lewis, Att. A at 4),
14 and the Court found him to be President of the company in the underlying litigation.³ (SJ
15 Order at 3). Moreover, in a February 2008 deposition in the underlying case, Danforth
16 testified that Villwock was the President of FreeQuick Wire Corporation. (PX 3, R. Lewis,
17 Att. BB at 60-61; 63-64). However, in his recent compliance report, Villwock denies that he
18 has ever had any role with that company. (PX 3, R. Lewis, Att. H at 2).

19 **2. James Danforth** was Neovi's Vice President, Chief Operating Officer
20 ("COO"), Treasurer, Secretary, and registered service agent. (SJ Order at 2). In his
21 supplemental compliance report, Danforth confirmed that he recently became the President of
22

23
24 ² During the Neovi bankruptcy proceedings, it became clear that Neovi, Inc. held few
25 assets independently and that equipment, payroll, operations, and assets had been funded by G7.
26 (See PX 3, R. Lewis, Att. I at 5-28). Those G7-funded assets were assumed by iProlog, which
27 began operations the day after Neovi, Inc. ceased operations, using the same equipment, office
28 location, and employees. (*Id.*).

³ FreeQuick Wire Corporation has not filed a 2009 corporate annual report with the
Delaware Secretary of State, nor has it filed any amendments to change its list of identified
officers. (PX 3, R. Lewis, ¶3a).

1 iProlog, having previously served as the COO. (PX 3, R. Lewis, Att. H at 2; *see also* PX 3, R.
2 Lewis, Att. F at 1; SJ Order at 3).

3 Danforth serves as G7's Executive Vice President ("EVP"), Chief Financial Officer
4 ("CFO"), Secretary, and registered service agent. (SJ Order at 2). He submitted G7's recent
5 compliance report, confirming that he continues to hold these positions. (PX 3, R. Lewis, Att.
6 G at 1).

7 FreeQuick Wire Corporation's 2008 Delaware corporate annual report identifies
8 Danforth as its COO (PX 3, R. Lewis, Att. A at 4), and the Court found him to be the COO in
9 the underlying litigation. (SJ Order at 3). Moreover, Danforth testified at his February 2008
10 deposition that he was the COO of FreeQuick Wire Corporation. (PX 3, R. Lewis, Att. BB at
11 60-61). However, in his recent compliance report, Danforth claims that he never served as
12 COO of the company and claims that this was "an erroneous conclusion reached by the court."
13 (PX 3, R. Lewis, Att. H at 2-3). Instead, he claims that he served only as acting CFO until
14 September 2008 and has held no position with FreeQuick Wire Corporation since that time.
15 (*Id.*).

16 **3. G7 Productivity Systems** is a California corporation that produces
17 software, ink, and paper, including VersaCheck® paper and VersaInk™, for sale to U.S.
18 retailers and consumers. (SJ Order at 2; PX 3, R. Lewis, Att. B; *see also* PX 2, L. Lewis ¶ 10,
19 Att. F (www.g7ps.com website)). Recipients of FQW e-checks must purchase these G7
20 products in order to print their checks. (PX 2, L. Lewis ¶ 96, Att. A at 12, Att. B at 1, 17-21,
21 Att. S at 17-24; PX 3, R. Lewis, Att. BB at 62-64). G7, along with Villwock, Danforth, and
22 iProlog, created and launched the FQW website. (SJ Order at 3; PX 3, R. Lewis, Att. I at 25-
23 26, Att. BB at 60). G7 stores and transmits the information FQW consumers enter to create a
24 check on FQW on G7's servers. (PX 3, R. Lewis, Att. BB at 81-83).

25 **4. iProlog Corporation** is a Delaware corporation with its principal place
26 of business in San Diego, California. (PX 3, R. Lewis, Att. C). As the Court found in the
27 underlying litigation, Danforth and Villwock established iProlog in the wake of Neovi's
28 bankruptcy (the day after Neovi went out of business). (SJ Order at 3; PX 3, R. Lewis, Att. I at

1 5). The Court further found that iProlog hired all of Neovi's employees and conducts many of
 2 Neovi's former business activities, which include providing marketing, engineering, and
 3 administrative support to G7. (SJ Order at 3; PX 3, R. Lewis, Att. H at 2, Att. I at 5, Att. CC at
 4 5-8; *see also* PX 2, L. Lewis ¶ 9, Att. E (www.iprolog.com website)). In addition to working
 5 with G7 to launch the FQW website, iProlog created and sells the TrueSign™ digital signing
 6 technology that FQW customers must use to electronically sign check images. (PX 2, L.
 7 Lewis ¶ 71, Att. B at 10, Att. E at 3-4; PX 3, R. Lewis, Att. BB at 69, 71).

8 **5. FreeQuick Wire Corporation** is a Delaware corporation with its
 9 principal place of business at Villwock's residential address in San Diego, California. (PX 3,
 10 R. Lewis, Att. A, Att. E). The corporation was formed on November 8, 2007, with Diana
 11 Villwock, Villwock's daughter, as the director of the corporation in order to hold the FQW
 12 website, which offers a check creation and delivery service over the Internet. (SJ Order at 3;
 13 PX 3, R. Lewis, Att. A, Att. BB at 60-64).

14 **C. FreeQuick Wire: Contempt Defendants' New Business Practices**

15 **1. FreeQuickWire.com: How it Works**

16 In October 2007, during the pendency of the underlying case, Villwock, Danforth, and
 17 their corporations, G7 and iProlog, launched the FQW website, where customers can create
 18 and send e-checks to third parties via email. (SJ Order at 3). As the Court found in granting
 19 Plaintiff's Motion for Summary Judgment, "FQW is a check delivery service that is similar to
 20 Qchex and GoChex." (*Id.*).

21 As with Qchex, to create and send an e-check on FQW, a customer must register with
 22 FQW by submitting a valid email address and then confirming that address by clicking on a
 23 button in an email sent from FQW.⁴ (PX 4, Owens ¶¶ 5-8, 12-13; PX 5, Burton ¶¶ 10-13; *See*
 24 SJ Order at 3; *see also* PX 2, L. Lewis, Att. B at 26). The customer may then go onto the FQW
 25 website and create a check by entering data, including the customer's and payee's email

26
 27 ⁴ Although an individual may open FQW and create a check without registering an email
 28 address, FQW will not send, or "deliver," the e-check to the recipient until after the FQW user
 has registered his or her email account. (PX 2, L. Lewis ¶¶ 21-24, Att. B at 11; PX 5, Burton ¶
 11).

1 addresses, as well as the name and address of the payor, the financial account and bank routing
 2 number from which to draw the funds for the check,⁵ the name and address of that bank, the
 3 amount of the check, and the name of the check recipient.⁶ (PX 2, L. Lewis ¶ 12, Att. G at 3-
 4 4). Notably, a person can obtain an individual's bank account number and bank routing
 5 number simply by looking at the face of any pre-printed check. (PX 2, L. Lewis, Att. B at 27,
 6 33). FQW directs the customer to "sign" the check using iProlog's TrueSign™ digital signing
 7 technology or upload a signature previously created using iProlog's TrueSign™ digital signing
 8 technology. (*Id.*, Att. B at 10; PX 4, Owens ¶¶10; PX 5, Burton ¶¶ 6-7). Within seconds of
 9 signing, FQW sends an email to the check recipient with a link to the e-check image and an
 10 email to the FQW customer confirming that the e-check has been sent. (PX 2, L. Lewis ¶ 79,
 11 Att. R; PX 4, Owens ¶¶ 10-11).⁷

12 Although FQW does not charge the customer to create and send an e-check (PX 2, L.
 13 Lewis, Att. A at 1, 5, 7, 9-10), in order to print a paper copy of an e-check for deposit into a
 14 bank account, check recipients must download software from FQW and purchase
 15 VersaCheck® paper and VersaInk™, G7's products that are available online or at retailers
 16 such as Staples. (PX 2, L. Lewis ¶¶ 82-83, 96, Att. A at 1, 12, Att. B at 1, 17-21, Att. F at 2,
 17 Att. S at 2-11, 17-24). Both the ink and paper packages contain a code that check recipients
 18

19
 20 ⁵ While the Qchex system allowed users to visit a "Bank Account Setup Wizard" to
 21 provide information on the bank accounts from which they wished to draw checks and stored
 22 that information for future check creation, FQW does not ask its users to register such
 23 information. Instead, the user inputs the financial account information for each check created; as
 24 a result, a single user can create checks using an unlimited number of financial accounts and
 routing numbers. (PX 2, L. Lewis ¶¶ 73-74). But FQW does offer an "upgraded" software
 system that purports to allow users to save bank information to the users' computers for use in
 creating future checks. (PX 2, L. Lewis, Att. A at 15-17).

25 ⁶ A check recipient can be the customer or a third party.

26 ⁷ Contempt Defendants promote their e-checks as being negotiable instruments and
 27 convert customers' raw data into a negotiable instrument by composing a check document that
 28 matches U.S. banking regulations when printed. (PX 2, L. Lewis, Att. A at 5, 14, 20, Att. S at 3,
 17, 28-29). The format of the check is determined by FQW, and FQW determines the placement
 of information on the checks. (PX 2, L. Lewis ¶¶ 12-14, 72, Att. G at 2-8).

1 must enter before the FQW software will allow a check image to be printed.⁸ (PX 2, L. Lewis
2 ¶ 96, Att. S at 17-24; PX 3, R. Lewis, Atts. L-M; PX 4, Owens ¶¶ 22-23; PX 5, Burton ¶ 17).
3 Thus, while using the FQW website is free, check recipients cannot print the checks without
4 purchasing G7's related products. (PX 2, L. Lewis ¶¶ 92-96, Att. S at 17-24; PX 4, Owens ¶¶
5 22-23).

6 Throughout its website, FQW also includes links to two webpages that provide
7 information on its policies and practices, or lack thereof, regarding validation of FQW checks
8 and unauthorized withdrawals: one titled "Need Validation?" and the other titled "Identity
9 Theft?"⁹ (PX 2, L. Lewis, Att. A at 2-3). On the "Need Validation?" webpage, FQW explains,
10 "Free QuickWire does NOT offer validation of the identity of internet users, financial
11 information, bank accounts or available funds on accounts." (*Id.* at 2). Rather, FQW offers a
12 list of "suggestions" for how a recipient of a FQW e-check can attempt to confirm the validity
13 of a check, either directly or through a bank, prior to depositing or cashing the check. (*Id.*).
14 For example, FQW recommends that an e-check recipient "[c]ontact the financial institution
15 by telephone as displayed by search engines or yellow pages, confirm whether the payor is
16 known to the institution and authorized to draw funds from the account number printed on the
17 bottom of the check." (*Id.*). Alternately, FQW suggests the recipient "Request your bank to
18 verify authenticity and available funds on the payor's account prior to crediting the check
19 amount to your account." (*Id.*). Notably, FQW does not offer any suggestions for steps an e-
20

21
22 ⁸ After the initial printing of a check image, if the check recipient attempts to reprint that
23 check using the FQW software without first requesting reprint ability from FQW, the check
24 image will print with the word "VOID" across its face, making it unusable. (PX 2, L. Lewis,
25 Att. B at 22, 28, 31). However, upon downloading the check image, a computer savvy recipient
may save it as a pdf file, resulting in an unlimited ability to reprint that check. (PX 2, L. Lewis,
¶¶ 111-112, Att. S at 47-55).

26 ⁹ These webpages were not part of the FQW website when it was examined as part of the
27 underlying litigation. Moreover, the Contempt Defendants have added substantially similar
28 webpages to the Qchex website, although that website does not currently offer check creation
and delivery services but describes its previous services and provides updates on the defendants'
ongoing appeal of the underlying litigation. (PX 2, L. Lewis ¶ 7, Att. C at 2-4).

1 check recipient should take if they determine that, in fact, the FQW check they received is
2 invalid.

3 The “Identity Theft?” page is equally illuminating regarding FQW’s policy, or lack
4 thereof, with regard to complaints of unauthorized transactions:

5 **Do not waste precious time by contacting FreeQuickWire.com**

6 This service cannot reverse the fact that your identity was previously stolen;
7 FreeQuickWire does not possess any information regarding the identity of its
8 users and cannot stop anonymous illegitimate users from using stolen data.
9 Contacting FreeQuickWire.com will only help the ID thief by allowing
10 fraudulent checks and/or card payments more time to clear your bank account.

11 (emphasis in original). (*Id.* at 3). Instead of contacting FQW, the Contempt Defendants
12 recommend that a victim of unauthorized transfers contact his or her financial institution, file
13 an affidavit of fraud with the institution, and file a police report regarding the incident. (*Id.*)

14 **2. FTC Investigation**

15 The FQW check creation process has none of the account verification and control,
16 identity verification, or complaint investigation and response measures required by the Final
17 Order. To confirm that Contempt Defendants are essentially ignoring the Court’s Order, FTC
18 investigators created FQW accounts for four separate undercover identities and sent a series of
19 e-checks between and among them on FQW. (PX 2, L. Lewis ¶¶ 72-73; PX 4, Owens ¶¶ 4-11;
20 PX 5, Burton ¶¶ 4-9). Contempt Defendants allowed all of the undercover identities to write
21 and send checks almost instantaneously after validating their email address registrations. (; PX
22 2, L. Lewis ¶ 79, Att. R; PX 4, Owens ¶¶ 12-14; PX 5, Burton ¶¶ 11-12, 23; *see also* PX 2, L.
23 Lewis, Att. B at 26). No one contacted any of the four identities to verify their authority to
24 draw funds from the financial accounts they used. (PX 2, L. Lewis ¶¶ 75, 77-78; PX 4, Owens
25 ¶¶ 17, 19-20; PX 5, Burton ¶¶ 19, 21-22). Nor did anyone contact any of the four identities to
26 confirm that they were who they claimed to be. (PX 2, L. Lewis ¶¶ 75-76; PX 4, Owens ¶ 18;
27 PX 5, Burton ¶ 20).

28 Specifically, in the course of the investigation, FTC investigators created 18 separate e-
checks. Seven of these checks were “authorized,” drawn on the undercover identity’s own
financial account. (PX 2, L. Lewis ¶¶ 12-17, 34, 44-45, 74; PX 4, Owens ¶¶ 9-11; PX 5,

1 Burton ¶¶ 4-9). Eleven were “unauthorized,” where essentially one identity stole money from
2 another identity’s undercover account.¹⁰ (PX 2, L. Lewis ¶ 74). The FTC investigators created
3 and delivered the checks using FQW without any delays or any attempts by FQW to seek
4 additional information, aside from asking for confirmation of email addresses.

5 The only hurdle the FTC investigators faced was in attempting to print the checks sent
6 to the undercover identities. Before allowing any negotiable checks to be printed,¹¹ FQW
7 required that the investigators provide “validation codes” to prove that they had purchased
8 both VersaCheck® blank check paper and VersaInk™ printer ink cartridges. (PX 2, L. Lewis
9 ¶¶ 94-96, Att. S at 17-24; PX 4, Owens ¶¶ 22-23; PX 5, Burton ¶ 17). G7 is the maker of both
10 products, which can be purchased directly from the G7 website or from authorized retailers.
11 (PX 2, L. Lewis, Att. F at 2-6; PX 3, R. Lewis ¶ 6; PX 4, Owens ¶ 23). FQW provides links to
12 the G7 website to allow users to purchase the products. (PX 2, L. Lewis Att. B at 1-6).
13 Despite various attempts to bypass FQW’s validation code requirements (PX 2, L. Lewis
14 ¶¶ 95-96; PX 4, Owens ¶ 22), the FTC investigators could not print any negotiable FQW
15 checks until after they had entered two separate validation codes. (PX 2, L. Lewis ¶¶ 96, 98-
16 109). After successfully printing the FQW checks, FTC investigators deposited a number of
17 these checks into bank accounts, and the banks cleared these checks as negotiable instruments.
18 (PX 3, R. Lewis ¶¶ 11-18; PX 7, Harding ¶¶ 3-6).

19 After completing several unauthorized check deposits, an FTC investigator filed a
20 complaint with FQW in the name of one of the undercover identities. (PX 4, Owens ¶¶ 28-30).
21 In order to make the complaint, the investigator first had to locate contact information for
22 FQW. (PX 4, Owens ¶ 29). No information on the check itself indicates that FQW created it
23

24 ¹⁰ For nine of the unauthorized checks, the undercover identity drafted the FQW check
25 drawing funds on a second identity’s bank account and made payable to a third identity. (PX 2,
26 L. Lewis ¶¶ 20, 25, 27-28, 37, 43, 48, 52-53, 57, 63-64, 68). For the remaining two
27 unauthorized checks, the undercover identities created checks payable to themselves but drawing
28 funds from a separate identity’s bank account. (*Id.*, ¶¶ 38-40, 51).

¹¹ FQW did allow the FTC investigators to print “test checks” without inputting the
VersaCheck® and VersaInk™ validation codes, but those checks printed with the word “VOID”
superimposed across their faces. (PX 4, Owens ¶ 22; PX 5, Burton ¶ 17).

1 or provides contact information for FQW. (PX 4, Owens ¶ 19; *see also* PX 2, L. Lewis ¶¶ 112-
2 113, 132-143, Att. S at 53-55, Att. W at 5). As a result, a defrauded consumer who learns that
3 an unauthorized check using their financial information has been cleared by their bank would
4 have no way of determining who issued the check. The FTC investigator, therefore, went to
5 the FQW website to find a means to contact FQW. (PX 4, Owens ¶ 29). On the website, the
6 only contact information FQW offers is an email interface on the “Contact Us” webpage. (PX
7 4, Owens ¶29; *see also* PX 2, L. Lewis, Att. A at 18). There is no postal address or telephone
8 number for FQW anywhere on the FQW website. (PX 4, Owens ¶ 29; *see also* PX 2, L. Lewis,
9 Atts. A-B).

10 Because the only way to contact FQW is through the email address provided on its
11 website, the FTC investigator sent an email complaining that someone had written a check
12 using her financial account information without authorization. (PX 4, Owens ¶ 30). Despite
13 expressly asking that someone from FQW contact her by telephone, the almost-immediate
14 response from FQW was what appears to be an auto-reply email containing a list of hyperlinks
15 to a “Frequently Asked Questions” webpage. (PX 4, Owens ¶ 31, Att. G; *see also* PX 2, L.
16 Lewis Att. B at 26-34 (showing FQW’s “Frequently Asked Questions” webpage and FQW’s
17 responses to certain questions)). The email states that if none of those FAQs answer the
18 customer’s question – which they did not – then the customer should resend the email. (PX 4,
19 Owens ¶ 31, Att. G). The FTC investigator then sent a second email, restating the complaint
20 and again requesting that someone from FQW contact her by telephone. (PX 4, Owens ¶ 32,
21 Att. H).

22 In response to this second email, the FTC investigator received a second, almost-
23 instantaneous response email from FQW, this time with a hyperlink to the “Identity Theft?”
24 webpage, discussed above. (PX 4, Owens ¶ 33, Att. I). This page suggests contacting your
25 financial institution as the “only” way to “reliably stop unauthorized activity on your bank or
26 other financial accounts” and warns customers not to “waste precious time by contacting
27 FreeQuickWire.com,” because FQW will not stop illegitimate users from making the
28 unauthorized transactions. (PX 4, Owens, Att. J). At the bottom of the webpage, FQW states:

1 “For more information regarding consumer protection please visit:
2 <http://www.ftc.gov/bcp/index.shtml>,” the link to the FTC Bureau of Consumer Protection
3 homepage. (PX 4, Owens, Att. J).

4 Finally, the FTC investigator sent a third email identifying the undercover identity who
5 sent the unauthorized check, *i.e.*, the person who had stolen the complainant’s money. (PX 4,
6 Owens ¶ 34). However, the Contempt Defendants did not send any further communications to
7 either undercover identity – the complaining victim or the FQW customer/thief. (PX 4, Owens
8 ¶¶ 35-36; PX 2, L. Lewis ¶ 80). Instead, Contempt Defendants continued to allow the alleged
9 thief to create and send more unauthorized e-checks, which were then deposited, withdrawing
10 funds from the complaining victim’s bank account both four and seven days after the initial
11 complaint. (PX 2, L. Lewis ¶¶ 57-64, 129-130; PX 3, R. Lewis ¶¶ 13-18). Indeed, even
12 almost four months later, Contempt Defendants continued to allow the same alleged thief to
13 create and send another check via FQW using the same complaining victim’s bank account
14 information. (PX 2, L. Lewis ¶ 68). Once again, FTC investigators had no difficulty creating
15 or sending any of these unauthorized checks. (PX 2, L. Lewis ¶¶ 57-70). At no point did the
16 Contempt Defendants contact the alleged unauthorized user. (*Id.*). Moreover, Contempt
17 Defendants never sent the complaining victim a report about any investigation, nor did they
18 confirm that any unauthorized transfers had occurred. (PX 4, Owens ¶ 36).

19 **III. LEGAL DISCUSSION**

20 **A. This Court Has the Authority to Grant the Requested Relief.**

21 The Court has the inherent power to enforce its orders through civil contempt.
22 *Shillitani v. United States*, 384 U.S. 364, 370, 86 S. Ct. 1531, 1535, 16 L. Ed. 2d 622, 627
23 (1966). The FTC, as a party to the original action, may invoke the court’s powers by initiating
24 a civil contempt proceeding as part of that action. *Gompers v. Bucks Stove & Range Co.*, 221
25 U.S. 418, 444-45, 31 S. Ct. 492, 499, 55 L. Ed. 797, 807 (1911).

26 Civil contempt is warranted where there is clear and convincing evidence that parties
27 knew of and violated a specific and definite order of the court. *See FTC v. Affordable Media,*
28 *LLC*, 179 F.3d 1228, 1239 (9th Cir. 1999). Here, there is overwhelming evidence that

1 Contempt Defendants are bound by and violated unambiguous provisions of the Final Order
2 and should, therefore, be held in contempt.

3 **1. Named Defendants Villwock, Danforth, and G7 Are Bound by the**
4 **Final Order.**

5 Under Federal Rule of Civil Procedure 65(d), a permanent injunction is binding on a
6 party with actual notice. Fed. R. Civ. P. 65(d). Villwock, Danforth, and G7 are named
7 defendants and signed and returned an affidavit acknowledging receipt of the Final Order in
8 January 2009. (PX 3, R. Lewis, Att. D, Att. E at 2, Att. F at 2, Att. G at 2). Thus, Villwock,
9 Danforth, and G7 had actual notice of and are bound by the Final Order.

10 **2. iProlog and FreeQuick Wire Corporation Are Bound by the Final**
11 **Order as Rule 65(d) Defendants.**

12 A permanent injunction also is binding on any person or entity who has actual notice
13 and is in “active concert” with a party. Fed. R. Civ. P. 65(d). Here, the Final Order is binding
14 upon iProlog¹² and FreeQuick Wire Corporation as Rule 65(d) defendants because they had
15 notice of the Final Order and are acting in concert with the named defendants. First, both
16 iProlog and FreeQuick Wire Corporation had notice of the Final Order through their principals
17 Villwock and Danforth. *See Funk v. Tiffit*, 515 F.2d 23, 26 n.4 (9th Cir. 1975) (recognizing that
18 the knowledge of an agent is attributable to the principal); *see also* Cal. Civ. Code § 2332;
19 *People v. Forest E. Olson, Inc.*, 137 Cal. App. 3d 137, 140, 186 Cal. Rptr. 804, 806-07 (Cal.

20 ¹² iProlog also is bound by the Final Order as the successor company of Neovi, a named
21 defendant. In the bankruptcy proceedings, Danforth testified that upon Neovi’s closing, iProlog
22 and G7 continued to use its office space and equipment, including desks, computers, and copiers.
23 (PX 3, R. Lewis, Att. I at 5-28). iProlog has the same officers and directors (Villwock and
24 Danforth) and employees, continued Neovi’s business activities by providing marketing,
25 engineering, and administrative support to G7, and took over use of Neovi’s office and its
26 equipment (Neovi had few assets). (SJ Order at 3; PX 3, R. Lewis, Att. H at 2; Att. I at 5; Att.
27 CC at 5-8; PX 2, L. Lewis ¶ 9, Att. E (www.iprolog.com website)). Further, there is no evidence
28 that iProlog paid any consideration to Neovi. Accordingly, iProlog is the successor company of
Neovi. *See Katzir’s Floor and Home Design, Inc. v. M-MLS.com*, 394 F.3d 1143, 1150 (9th Cir.
2004) (A successor corporation is a mere continuation when one or both of the following
elements is present: (1) a lack of adequate consideration for acquisition of the former
corporation’s assets to be made available to creditors, or (2) one or more persons were officers,
directors, or shareholders of both corporations. Inadequate consideration is an essential
ingredient to a finding that one entity is a mere continuation of another.).

1 Ct. App. 1982). Second, both iProlog and FreeQuick Wire Corporation are in active concert
 2 and participation with the named defendants in the operation of FQW. Specifically, as
 3 discussed above, in conjunction with G7, iProlog created and launched FQW. (SJ Order at 3;
 4 PX 3, R. Lewis, Att. I at 25). FQW also uses iProlog's TrueSign™ technology to allow
 5 customers to electronically sign FQW checks. (PX 3, R. Lewis, Att. BB at 69, 71). FreeQuick
 6 Wire Corporation operates in conjunction with G7, requiring FQW check recipients to
 7 purchase and use G7's VersaCheck® and VersaInk™ products in order to print their checks.¹³
 8 (PX 2, L. Lewis ¶ 96, Att. A at 12, Att. B at 1, 17-21, Att. S at 17-24; PX 3, R. Lewis, Att. BB
 9 at 62-64). On its website, FQW also advertises G7 products and includes numerous hyperlinks
 10 that, when clicked, redirect the computer to G7's website.¹⁴ (PX 2, L. Lewis, Att. B at 1-6).
 11 Similarly, G7's website displays the FQW logo on many of its webpages, each of which is a
 12 hyperlink to the FQW website. (PX 2, L. Lewis, Att. F at 3-8). G7 also expressly advertises
 13 on its website and in its product ad inserts that its products are for use on FQW. (PX 2, L.
 14 Lewis, Att. F at 4; PX 3, R. Lewis ¶ 7, Att. K). Thus, iProlog and FreeQuick Wire Corporation
 15 are in active concert with Villwock, Danforth, and G7 and are bound by the Final Order.

16 3. The Provisions of the Final Order are Clear and Unambiguous.

17 The Final Order sets out detailed steps that the defendants and those in active concert
 18 or participation with them must take before creating or delivering a check for any customer to
 19 verify both the prospective customer's authority to draw funds on a financial account and the
 20 customer's identity. (PX 1 at 4-6). Further, the Final Order specifies the contact information
 21 that the defendants must disclose in marketing materials, on their website, and on any check
 22 that they create or deliver, including a U.S. postal address, telephone number, and either a
 23 website or e-mail address. (*Id.* at 7). The Final Order also clearly enumerates the actions the
 24 defendants must take to "conduct a thorough investigation" and to respond to complaints of
 25 unauthorized access. (*Id.* at 9). Indeed, the Court took great pains to make certain that the

26
 27 ¹³ Also, according to Contempt Defendant Danforth, the information entered to create a
 28 check on FQW is stored and transmitted on G7's servers. (PX 3, R. Lewis, Att. BB at 81-83).

¹⁴ These same hyperlinks are included in the Qchex website. (PX 2, L. Lewis, Att. D).

1 injunctive relief in the Final Order provided clear and detailed steps for the defendants to take
 2 in order to comply, expressly finding that the injunctive provisions at issue here “provide[]
 3 definite standards on which to evaluate whether Defendants have violated the injunction’s
 4 terms.” (1/7/09 Order at 13).

5 **4. Clear and Convincing Evidence Establishes that Contempt**
 6 **Defendants Violated the Final Order.**

7 Contempt Defendants have violated the Final Order’s core conduct prohibitions in
 8 offering a service to “create” checks for customers. Contempt Defendants have utterly failed
 9 to: (1) implement either of the account verification procedures required by Part I of the Final
 10 Order; (2) implement the identity verification procedures required by Part I of the Final
 11 Order;¹⁵ (3) disclose adequate contact information as required by Part III of the Final Order;
 12 and (4) implement any of the required steps for investigating and responding to complaints of
 13 unauthorized access of an individual’s financial account as required by Part III of the Final
 14 Order.

15 As an initial matter, the conduct provisions of the Final Order apply to those who create
 16 checks. The Final Order defines “creating a check” as “*any involvement* in the creating,
 17 designing, composing, drawing, or writing on paper or electronic media a check drawn on a
 18 specific financial institution.” (PX 1 at 3) (emphasis added). Each Contempt Defendant is
 19 involved in creating the FQW checks. FreeQuick Wire Corporation offers a check creation
 20 and delivery service via the FQW website, creating, designing, composing, emailing, and
 21 ultimately, through its software, allowing the FQW customer to compose the check in
 22 electronic media and the recipient to print a written version of the check. (SJ Order at 3; PX 2,
 23 L. Lewis, Att. A at 4-7). G7 also “creates” checks because it launched FQW, along with

24 ¹⁵ As an alternative to these account verification procedures and the identity verification
 25 procedures, discussed *infra*, the Final Order allows the defendants to “engage a monitor that has
 26 been agreed to by both Defendants and Plaintiff, and establish and utilize procedures that the
 27 monitor has approved as effective to verify: (a) the identity of each prospective customer and
 28 (b) the authority of each such customer to draw funds on a financial account before creating an
 account for that customer with any of the Defendants.” (PX 1 at 6). However, Contempt
 Defendants have not sought the FTC’s agreement to engage a third-party monitor to perform
 these services. (PX 3, R. Lewis ¶ 5).

1 iProlog. (SJ Order at 3; PX 3, R. Lewis, Att. I at 25-26; Att. BB at 60). G7 also is involved in
 2 creating, drawing, and writing the FQW checks because FQW e-check recipients *must* use G7
 3 check paper and magnetic ink to print their checks before they can deposit or otherwise use
 4 them as legal tender. (PX 2, L. Lewis ¶¶ 94-96, Att. A at 12, Att. B at 17-21, 24, 29, Att. S at
 5 17-24; PX 3, R. Lewis, Att. B at 62-64). In addition to launching FQW, iProlog “creates”
 6 checks because FQW customers cannot compose their checks without using iProlog’s
 7 TrueSign™ technology to draw their electronic signatures on the checks.¹⁶ (PX 2, L. Lewis ¶
 8 71, Att. B at 10, Att. E at 3-4; PX 3, R. Lewis, Att. BB at 69, 71). Villwock and Danforth are
 9 involved in all aspects of the FQW check creation process because they are the principals of all
 10 three corporations – FreeQuick Wire Corporation, G7, and iProlog – and direct the
 11 operations.¹⁷ (SJ Order at 3; PX 3, R. Lewis, Atts. A-C, E-H, Att. BB at 60-61).

12 Moreover, Contempt Defendants are aiding and abetting each other in the
 13 contumacious conduct. *See TD Ameritrade, Inc. v. The Nevada Agency and Trust Co.*, 2008
 14 U.S. Dist. LEXIS 105677 (D. Nev. 2008) (injunctions are binding on nonparties who aid and
 15 abet named parties when the nonparty shares common interests with the party, is in privity
 16 with the party, is represented by the party, or is subject to a party’s control); *see also Goya*
 17 *Foods, Inc. v. Wallach Mgmt. Co.*, 290 F.3d 63, 75 (1st Cir. 2002) (finding that “it has long
 18 been recognized that a nonparty may be held in civil contempt if, and to the extent that, he
 19 knowingly aids or abets an enjoined party in transgressing a court order”); *FTC v. Productive*
 20 *Mktg, Inc.*, 136 F. Supp. 22 1096, 1104 (C.D. Cal. 2001) (citing *Gemco Latino Am., Inc. v.*
 21 *Seiko Time Corp.*, 61 F.3d 94, 98 (1st Cir. 1995) (knowingly aiding and abetting party in
 22

23 ¹⁶ On the previous Qchex system, customers could opt to create checks without an actual
 24 signature, and the defendants would substitute a legally accepted statement authorizing the
 25 check. (SJ Order at 4). That option is not available on FQW; customers cannot complete the
 26 creation of a FQW check until they draw a signature for the check using iProlog’s TrueSign™
 technology or upload a signature. (PX 2, L. Lewis ¶ 71, Att. B at 10; PX 5, Burton ¶¶ 6-7).

27 ¹⁷ Even if Villwock and Danforth’s self-serving denials of a present connection to
 28 FreeQuick Wire Corporation in their compliance reports were true, they both admitted their
 control over G7 and iProlog and are, thus, violating the Order through G7’s and iProlog’s
 conduct.

1 violating court order subjects nonparty to that order)). As a result, each Contempt Defendant
2 is involved in creating the FQW checks, and thus, each is required to ensure that the Court's
3 verification and complaint response procedures are implemented.

4 **a. Failure to Implement Financial Account Verification**
5 **Procedures**

6 Contempt Defendants are violating Part I of the Final Order by failing to implement
7 "account control verification" procedures to verify that each prospective FQW customer has
8 authority to draw on each financial account the customer intends to use. Specifically, the Final
9 Order provides two ways to verify a prospective customer's authority to draw funds on a
10 financial account, one of which must be employed prior to allowing the customer to open an
11 account and to create or deliver any check: (1) hiring a third party to obtain from the customer
12 his "online banking user name and password information" and confirming that information
13 with the bank; or (2) placing "random deposits between \$.01 and \$.99" into the prospective
14 customer's financial account and requiring the customer to confirm the amount of each
15 deposit. (PX 1 at 4-5).

16 Contempt Defendants are doing neither. First, FTC Investigators were able to open
17 FQW accounts in four different names and create and send 18 separate e-checks without ever
18 being asked by anyone for online banking user names or passwords. (PX 2, L. Lewis ¶ 77; PX
19 4, Owens ¶¶ 4-11, 17-20; PX 5, Burton ¶¶ 4-12, 19-22). Second, Contempt Defendants did not
20 make any random deposits into any of the FTC undercover financial accounts prior to allowing
21 the FTC investigators to open FQW accounts and create and send the e-checks. (PX 2, L.
22 Lewis ¶ 78; PX 3, R. Lewis ¶¶ 14-19; PX 4, Owens ¶ 20; PX 5, Burton ¶ 22). Indeed,
23 Contempt Defendants specifically state – quite accurately – on the FQW website, "Free
24 QuickWire does NOT offer validation of the identity of internet users, financial information,
25 bank accounts or available funds on accounts." (PX 2, L. Lewis, Att. A at 2).

26 **b. Failure to Verify Customer's Identity**

27 Contempt Defendants also are violating Part I of the Final Order by failing to perform
28 the required "identity verification" procedures to confirm that a prospective customer is

1 actually who he or she claims to be. Prior to allowing a customer to open a FQW account and
2 before creating or delivering any check, the Final Order expressly requires the defendants and
3 those in active concert or participation with them to “engag[e] a person not related to,
4 controlled by, or owned by any of the Defendants . . . to obtain information *from* and about
5 each prospective customer and . . . use the information to verify the prospective customer’s
6 identity.” (PX 1 at 4-5) (emphasis added).

7 FTC Investigators were able to register each of the four FQW accounts simply by
8 inputting a valid email address. (PX 2, L. Lewis ¶¶ 21-23; PX 4, Owens ¶¶ 4-8, 12-14, 21-22;
9 PX 5, Burton ¶¶ 10-15). Within moments, FQW sent an email to that address with a message
10 containing a “validate” button that FTC Investigators then clicked to confirm the registration.
11 (PX 2, L. Lewis ¶¶ 21-23, Att. B at 11-12; PX 4, Owens ¶¶ 4-8, 12-14, 21-22; PX 5, Burton ¶¶
12 10-15). This same confirmatory email process was used in Qchex, and the rampant fraud on
13 that system demonstrated its inadequacy. As George Tsantes, the FTC’s expert on customer
14 authentication in the underlying litigation, explained, using such confirmatory emails “is not
15 sufficient to authenticate a customer or determine if they are the rightful user of [financial
16 account] information, as it merely demonstrates they are the owner of an email account and
17 many email accounts do not require user authentication to set up, particularly free email
18 accounts like Yahoo mail or Gmail.” (MF, Ex. 518, Tsantes Dec., Ex. 1 at 14). Here, FTC
19 investigators used assumed names and free yahoo email accounts. (PX 6, Wright ¶¶ 3-7).
20 Contempt Defendants sent the checks created by FTC investigators within seconds of their
21 completing the check creation process. (PX 2, L. Lewis ¶ 79, Att. R). At no time did any of
22 the Contempt Defendants, or a third party acting on their behalf, seek information from our
23 undercover identities regarding either their identity or their authority to use the specified
24 financial account information. (PX 2, L. Lewis ¶¶ 74-78; PX 4, Owens ¶¶ 17-20; PX 5, Burton
25 ¶¶ 19-22).

26 **c. Failure to Provide Contact Information**

27 Contempt Defendants also plainly violate Part III of the Final Order by failing to
28 provide adequate and accessible contact information. Section III.A of the Final Order requires

1 that, in connection with the marketing or sale of any service to create or deliver checks, the
2 defendants and those in active concert or participation with them must clearly and
3 conspicuously disclose contact information, including “a U.S. postal address, telephone
4 number, and website or e-mail address” in their “advertising or marketing materials, on their
5 Internet website(s), and on any check that they, directly or indirectly, create or deliver.” (PX 1
6 at 7).

7 Contrary to these requirements, Contempt Defendants do not include the FQW name,
8 address, telephone number, and website or email address on any of the checks they create and
9 deliver. (PX 2, L. Lewis ¶¶ 132-134, Att. S at 53-55, Att. T, Att. U at 7, Atts. V-X; PX 3, R.
10 Lewis Atts. R, T, U, W, X; PX 7, Harding Atts. A, C-E). Nor do Contempt Defendants include
11 any postal address or telephone number anywhere on the FQW website, on FQW
12 advertisements, or in FQW email communications with users and e-check recipients.¹⁸ (PX 2,
13 L. Lewis ¶¶ 132-134, Atts. A-B, Att. Q, Att. S at 53-55, Att. T, Att. U at 7, Atts. V-X; PX 3, R.
14 Lewis, Att. K; PX 4, Owens Atts. E, G, I, J). The only contact a user can make with FQW is
15 through an email interface on the “Contact Us” button.¹⁹ (PX 4, Owens ¶¶ 29-30). However,
16 even when an FTC Investigator, acting as an assumed identity, complained of unauthorized
17 transfers and expressly requested to be contacted by telephone, Contempt
18 Defendants did not call and refused to provide any other means by which to contact them.
19 (PX 4, Owens ¶¶ 31-35).

24 ¹⁸ The G7 website, www.g7ps.com, and the iProlog website, www.iprolog.com, both
25 contain contact information for the corporations, including U.S. postal addresses, telephone
26 numbers, and email addresses. (PX 2, L. Lewis, Att. E at 8, Att. F at 2).

27 ¹⁹ When e-check recipients print the FQW checks, they receive printed advertisements for
28 G7 products, but the only contact information included on those marketing materials is a website
for ordering products, versajette.com, which automatically redirects to the G7 website,
g7ps.com. (PX 2, L. Lewis ¶¶ 112-114, 116, 123, 126, 128, 130, Att. S at 53-55, Att. T, Att. U
at 7, Atts. V-X).

1 **d. Failure to Investigate and Respond to Complaints of**
2 **Unauthorized Use of Financial Account Information**

3 Contempt Defendants also violate Part III of the Final Order by failing to investigate
4 and respond to complaints of unauthorized use of an individual's financial information. Part
5 III.C of the Final Order requires the defendants and those in active concert or participation
6 with them to take specific steps in response to such a complaint, including suspending a
7 customer's use of any of the defendants' products or services upon notice of unauthorized use;
8 conducting a "thorough investigation;" "permanently terminat[ing] access" by that customer if
9 the customer was involved in such unauthorized use; and, within five business days,
10 completing the investigation and responding to the complainant. (PX 1 at 8). The Final Order
11 further specifies the information that, at a minimum, the defendants and those in active concert
12 or participation with them must report to the complainant, including the specific details of any
13 unauthorized access of the complainant's financial information; the date that the defendants
14 suspended or terminated the unauthorized user's access to the defendants' products or services,
15 or an explanation if the defendants did not suspend or terminate the user's access; and "a toll-
16 free telephone number and contact person that the complainant may call and reach during
17 normal business hours to discuss the matter." (*Id.*).

18 Contempt Defendants failed to follow any of the Final Order's investigative or
19 complaint response requirements in response to complaints by an FTC Investigator acting
20 under an assumed identity regarding unauthorized checks drawn on her bank account. First,
21 Contempt Defendants did not suspend the unauthorized user's access to FQW. (PX 2, L.
22 Lewis ¶¶ 57-68). Indeed, the assumed identity identified as the unauthorized user in the emails
23 continued to use FQW to create and deliver e-checks on the complainant's account. (*Id.*)
24 Second, Contempt Defendants' response to the unauthorized use complaint – an auto-reply
25 email followed by an email directing the complainant to the Identity Theft webpage (PX 4,
26 Owens ¶¶ 31-33) – hardly constitutes a "thorough investigation." Third, Contempt Defendants
27 did not permanently terminate the unauthorized user's access to FQW, again evidenced by the
28 unauthorized user's continued creation and delivery of unauthorized checks drawn on the

1 complainant's bank account during the five-day investigation period and after that period had
2 ended. (PX 2, L. Lewis ¶¶ 57-68). Finally, Contempt Defendants did not respond at all to the
3 complaining victim, much less within five days, to report any findings made during any
4 investigation. (PX 4, Owens ¶¶ 35-36). Contempt Defendants never informed the
5 complaining victim of any investigation details, failed to explain why the unauthorized user's
6 access to FQW had not been suspended or terminated, and certainly never provided a
7 telephone number or contact person with whom the complaining victim could discuss the
8 matter. (PX 4, Owens ¶ 36). Thus, Contempt Defendants appear to have taken no steps
9 whatsoever to comply with Part III of the Final Order.

10 **B. Contempt Defendants Should Pay Sanctions.**

11 Once a party is found in contempt, the Court has wide discretion in determining the
12 appropriate sanctions. *United States v. United Mine Workers of Am.*, 330 U.S. 258, 303-04
13 (1947). Sanctions for civil contempt can serve two purposes: to coerce the defendant into
14 compliance or to compensate victims for losses sustained by the contempt. *Id.* Here, in light
15 of Contempt Defendants' utter disregard for the Court's specific and detailed requirements in
16 the operation of their check creation and delivery service, as well as the harm to which they
17 subject consumers by offering their service without implementing these procedures, both
18 coercive and compensatory sanctions are warranted.

19 **1. Coercive Sanctions**

20 To the extent that a contempt sanction is coercive, the court has broad discretion to
21 design a remedy that will bring about compliance. *Falstaff Brewing Corp v. Miller Brewing*
22 *Co.*, 702 F.2d 770, 779-80 (9th Cir. 1983). The two paradigmatic civil contempt sanctions are
23 imprisonment and a per diem fine imposed for each day a contemnor fails to comply with an
24 affirmative court order. *United Mine Workers of Am. v. Bagwell*, 512 U.S. 821, 829 (1994).
25 Civil contempt sanctions, however, are only appropriate where the contemnor is able to purge
26 the contempt by his own affirmative act and "carries the keys of his prison in his own pocket."
27 *Id.* Per diem fines exert a constant coercive pressure, and once the commands of the injunction
28 are obeyed, daily fines may be purged. *See also FTC v. Productive Mktg. Inc.*, 136 F. Supp. 2d

1 1096, 1112-13 (C.D. Cal. 2001) (finding nonparty in civil contempt for failing to turn over
2 assets to a court-ordered receivership and issuing a per diem fine that doubled each day the
3 nonparty failed to comply). Here, in light of Contempt Defendants utter disregard of the
4 Order, it is appropriate to impose, at a minimum, a daily coercive sanction – either a per diem
5 fine of \$10,000 or imprisonment – until Contempt Defendants come into full compliance with
6 the Final Order.

7 2. Compensatory Sanctions

8 Ordinarily, the amount of a compensatory sanction is the actual damage caused to the
9 petitioner by the respondent's contumacious act. *United States v. Asay*, 614 F.2d 655, 660 (9th
10 Cir. 1980). However, "a civil compensatory sanction need not always be dependent upon
11 proof of actual loss." *In re: General Motors Corp.*, 110 F.3d 1003, 1018-19 fn. 16 (4th Cir.
12 1997). "Where a 'harm' amount is difficult to calculate, a court is wholly justified in requiring
13 the party in contempt to disgorge any profits it may have received that resulted in whole or in
14 part from the contemptuous conduct." *Id.* The district court has the equitable authority to
15 order such disgorgement. *See also FTC v. Kuykendall*, 371 F.3d 745, 764 (10th Cir. 2004)
16 (FTC may seek contempt sanctions in an amount reflecting the defendants' gross receipts);
17 *Asay*, 614 F.2d at 660 (finding no abuse of discretion in the imposition of a fine for recovery of
18 all expenses incurred where it was impossible to determine how much money the government
19 'lost'); *Rebis v. Universal Cad Consultants, Inc.*, No. C-96-4201 SC, 1998 U.S. Dist. LEXIS
20 12366, at *11 (N.D. Cal. Aug. 11, 1998) (contempt sanction based on gross revenue generated
21 from the illicit product is warranted in order to deter future violations) (citing *Colonial*
22 *Williamsburg Found. v. Kittinger Co.*, 792 F. Supp. 1397, 1407 (E.D. Va. 1992)); *see also*
23 *Leman v. Krentler-Arnold Hinge Last Co.*, 284 U.S. 448, 455-57 (1932) (in a proceeding for
24 civil contempt for violation of an injunction against infringement of a patent, profits may be
25 included in the concept of compensatory relief); *Tom James Co. v. Morgan*, 141 Fed. App'x
26 894, 899 (11th Cir. 2005).

27 By eliminating any reference to FQW on the resulting check itself, Contempt
28 Defendants have ensured that calculating actual damages in this case will be extremely

1 difficult. In operating FQW, Contempt Defendants implemented lessons learned from the
2 underlying litigation, namely, they learned to better conceal their connection to any fraudulent
3 transfers.²⁰ For example, a portion of the Qchex checks included the “Qchex” name on the
4 check and a tracking code. (MF ¶¶ 97, 106, 108, 111, 115-117). As a result, unsuspecting
5 consumers whose financial information was used in unauthorized transfers, as well as banks
6 who were presented with unauthorized checks, at least had the Qchex name and a tracking
7 number to try to contact Qchex and report the fraudulent activity. On the contrary, in
8 operating FQW, Contempt Defendants have seen to it that there is no reference to FQW on the
9 checks. Thus, neither an unsuspecting bank account holder whose information was used by a
10 FQW customer without authorization nor the bank processing the fraudulent check would be
11 aware of the role of FQW or of Contempt Defendants in the unauthorized withdrawal, thereby
12 preventing complaints from being made and records from being generated that reveal the
13 extent of harm caused by Contempt Defendants’ creation of fraudulent checks.

14 Contempt Defendants also learned to better conceal the profits they made from their
15 contumacious conduct. In operating Qchex, the defendants charged customers for printing and
16 mailing checks to recipients. (SJ Order at 2, 4, 6, 13). In operating FQW, Contempt
17 Defendants have discontinued that practice and require FQW to create and send all checks
18 electronically. As a result, FQW customers do not pay any money directly to FQW in order to
19 create and send checks. Contempt Defendants’ profit from operating FQW derives mostly
20 from requiring FQW check recipients to purchase and use G7’s VersaCheck® paper and
21

22 ²⁰ In the underlying litigation, the Court awarded damages in the amount of \$535,358.00,
23 equaling the disgorgement of all revenues received by Neovi, Inc. (1/7/09 Order at 13-15). In
24 awarding those damages, the Court found that the defendants’ practice of creating and delivering
25 unverified checks was an unfair business practice under the FTC Act (*Id.* at 14) and that the
26 “defendants’ own records showed that their failure to employ and maintain adequate verification
27 procedures, over approximately six years, led to substantial losses for consumers that had
28 unauthorized checks drawn on their bank accounts.” (SJ Order at 13-14). While this portion of
the harm to consumers potentially could be calculated from the defendants’ records, the Court
found additional harm that could not be determined from the evidence: “consumers not only lost
the use of funds withdrawn from their accounts, but they often spent a considerable amount of
time and resources contesting the checks at their banks, protecting their accounts, and attempting
to get their money back.” (*Id.* at 14).

1 VersaInk™ in order to print the e-checks they receive, but that money is paid to G7 and not
2 directly to FQW.

3 Because Contempt Defendants have taken these steps, it will be very difficult to
4 determine either how many fraudulent checks have been created using FQW or the extent of
5 consumer harm resulting from these fraudulent checks. Moreover, as in the underlying
6 litigation, the harm to consumers is broader than the face amounts of the fraudulent checks, as
7 consumers would again need to spend “a considerable amount of time and resources contesting
8 the checks at their banks, protecting their accounts, and attempting to get their money back.”
9 (SJ Order at 14). Therefore, disgorgement may be a more appropriate remedy for the
10 Contempt Defendants’ violative conduct. Because Contempt Defendants allowed FQW
11 customers to create all checks, both fraudulent and legitimate, without the required
12 verification, the appropriate disgorgement would include, at a minimum, Contempt
13 Defendants’ total revenue from operating FQW, including, but not limited to, revenues
14 generated from the sale of G7’s VersaCheck® and VersaInk™ products purchased by FQW e-
15 check recipients and revenues generated by iProlog in the use of its TrueSign™ technology on
16 FQW.²¹

17 Furthermore, any award of monetary relief should be entered jointly and severally since
18 each Contempt Defendant is responsible for the repeated order violations. *NLRB v. AFL-CIO*,
19 882 F.2d 949, 955 (5th Cir. 1989) (“Where ... parties join together to evade a judgment, they
20 become jointly and severally liable for the amount of damages resulting from the
21 contumacious conduct.”); *Colonial Williamsburg Found.*, 792 F. Supp. at 1406 (holding
22 contempt defendants jointly and severally liable because all defendants had actively violated
23 consent judgment). Villwock and Danforth are the principals of FreeQuick Wire Corp., G7,
24 and iProlog. As described above, each party had notice of the Final Order and violated, or
25 aided and abetted in violating, the Final Order by creating checks through FQW. *See, e.g.*,

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27
28 ²¹ Because FQW requires e-check recipients to enter both paper and ink validation codes
from G7 products before they can print their e-checks, FQW should have records reflecting the
type and quantity of G7 products actually purchased by FQW e-check recipients.

1 *McGraw-Edison Co. v. Preformed Line Prods. Co.*, 362 F.2d 339, 344 (9th Cir. 1966) (finding
2 that even “[n]onparties may be found in contempt of an injunction provided they have actual
3 notice of the injunction and aid or abet in its violations”); *see also Red I Investments, Inc. v.*
4 *Amphion Int’l Ltd., et al.*, 2007 U.S. Dist. LEXIS 85675, at *6 (E.D. Wash. Nov. 9, 2007)
5 (same).

6 **IV. CONCLUSION**

7 For the foregoing reasons, the FTC requests that the Court enter the proposed Order to
8 Show Cause.

9
10
11 Date Submitted: October 15, 2009

Respectfully submitted,

12
13 /s/ Laura Schneider

14 Laura Schneider
15 Korin K. Ewing
16 Attorneys for Plaintiff
17 FEDERAL TRADE COMMISSION
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