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UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA, PHOENIX DIVISION

Federal Trade Commission, Plaintiff, v. RJB Telcom, Inc., a corporation; Robert J. Botto, Jr., individually, and as an officer of RJB Telcom, Inc., and Robert J. Botto, Jr. and Suzette Botto, as Husband and Wife; Richard D. Botto, individually, and as an officer of RJB Telcom, Inc., and Richard D. Botto and Anne Botto, as Husband and Wife, Defendants.	CV- No. **MEMORANDUM IN SUPPORT OF MOTION FOR <u>EX</u> <u>PARTE</u> TEMPORARY RESTRAINING ORDER AND ORDER TO SHOW CAUSE FOR A PRELIMINARY INJUNCTION**

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I. SUMMARY

Plaintiff Federal Trade Commission ("FTC" or "Commission") brings this action to halt a multi-million dollar scam involving unauthorized credit and debit card billings, as well as telephone billings. The FTC seeks a temporary restraining order ("TRO") with an asset freeze, and appointment of a Receiver in order to halt unfair and deceptive acts and practices which violate Section 5(a) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45(a).

Defendants – RJB Telcom, Inc., Robert J. Botto, Jr., and Richard D. Botto – operate a company in Scottsdale which offers adult entertainment on the Internet through a series of web sites. Acting without consumers' authorization or knowledge, defendants post charges for their services to credit and debit cards and phone bills. During the current year alone, as indicated in the attached declarations from financial institutions, credit card networks, and from information supplied to the FTC by AT&T, there have been more than 200,000 charge-backs, credits and telephone bill refunds involving defendants' business practices. Moreover, as this complaint is filed, defendants' fraudulent practices continue unabated.

Defendants' revenues from their business are huge: between June 1999 and May 2000, two merchant accounts utilized by defendants received a total of at least **$48 million** in deposits.[1] By May 2000, plaintiff's monthly revenues exceeded $6 million.

[1] As noted in Section II.C, infra, these numbers are based on information supplied to Visa and MasterCard by Benchmark Bank, which maintained an account on behalf of defendants from May - August 1999 and by AmTrade International Bank, which has maintained an account for defendants from August 1999 through the present (AmTrade figures from June 2000 to the present are not available). In fact, defendants have at least two other operative merchant

Although a portion of defendants' business may be legitimate, it is abundantly clear from the exhibits submitted in support of this motion that the overall business of defendants is permeated by fraud and that the fraudulent and legitimate portions of the business cannot be meaningfully distinguished. It is also clear that defendants have earned and continue to earn millions of dollars from their illicit activities, and that these activities are increasing. Finally, defendants' recent establishment of merchant accounts at two overseas banks underscore the danger of asset dissipation through extraterritorial transfers of funds.[2]

Given the defendants' egregious conduct, the broad relief sought in the FTC's proposed TRO is clearly warranted. Without it, defendants will continue to defraud numerous consumers on a daily basis, and dissipate assets which could be used as redress for the countless consumers they have already defrauded. In addition, plaintiff's motion for a preliminary injunction, including appointment of a permanent receiver, should in all respects be granted.

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accounts -- both in overseas banks and both established in recent months. Thus, the $48 million figure clearly **understates** defendants' gross revenues.

[2] As will be noted infra, p.27, the present defendants' fraudulent scheme has a number of striking similarities to the illicit acts of defendants in a recently decided case in this Circuit -- *FTC v. J.K. Publications, Inc., et al.*, Civ. No. CV 99-0044 (C.D. Cal.). The partial summary judgment decision in *J.K. Publications* is found at 99 F. Supp.2d 1176 (C.D. Cal. 2000); other relevant decisions in *J.K. Publications*, including the Court's findings of fact and conclusions of law after trial, are found in the Exhibits In Support Of Ex Parte Motion For Temporary Restraining Order And Other Equitable Relief, Exh. 37, (hereafter, cited as TRO Exh., followed by the appropriate exhibit number and internal exhibit reference).

II. STATEMENT OF THE CASE

A. The Parties

1. Plaintiff

Plaintiff FTC, is an independent agency of the United States government created by the FTC Act, 15 U.S.C. § 41, et seq. The FTC is charged, among other things, with enforcement of Section 5 of the FTC Act, 15 U.S.C. § 45(a), which prohibits unfair or deceptive acts or practices in or affecting commerce.

2. Defendants

Corporate defendant, **RJB Telcom, Inc. ("RJB")**, is an Arizona corporation that was incorporated on May 11, 1999. The company has been doing business under the RJB name since at least 1997.[3] RJB owns or operates a group of Internet web sites which supply adult entertainment.[4]

According to RJB's incorporation documents, it has two principals: **Robert J. Botto, Jr.** and **Richard D. Botto**. Robert Botto is listed on RJB's incorporation documents as the company's president and secretary; Richard Botto, as its Vice President and Treasurer.[5] In addition to appearing on RJB's incorporation papers, the Bottos have also signed as the company's principals on merchant account application forms utilized

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[3] TRO Exh. 35 (Vera), para. 4. RJB's pre-incorporation d/b/a status in Arizona is confirmed by Federal Express records indicating that its principals were mailing and receiving correspondence using the RJB name as early as 1997. In addition, RJB was incorporated in New York on October 17, 1999, and dissolved in New York on March 29, 2000. Id, Att. E.

[4] TRO Exh. 35 (Vera), paras. 8-11.

[5] TRO Exh. 35 (Vera), Att. A.

by Benchmark Bank ("Benchmark") and AmTrade International Bank ("AmTrade").[6] One of these applications is as recent as September 20 of this year.[7] On it, each of the Bottos describes himself as a "CEO"; further, each Botto indicates that he owns 50% of RJB. As noted supra, Benchmark and AmTrade processed $48 million worth of business for RJB between June 1, 1999 and May 31, 2000. Finally, RJB's Federal Express billing records list the two Bottos as the company's principal recipients and senders of mail.[8]

Since starting their Arizona business, defendants have operated from both residential and office sites.[9] At present, they are operating in an office building located at 8601 N. Scottsdale Rd., Ste. 330, Scottsdale 85253.[10] This is apparent from its annual report and certificate of disclosure filed with the Arizona Corporation Commission in July, 2000;[11] from the account statement filed by RJB with AmTrade on September 20,

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[6] TRO Exh. 34 (MasterCard/Brady), Atts. 2-3.

[7] TRO Exh. 34 (MasterCard/Brady), Att. 3.

[8] TRO Exh. 35 (Vera), Atts. B-C.

[9] Defendants' Federal Express account records indicates they have used at least three residential sites for billings -- 10785 E. Salt Brush Drive in Scottsdale; 16320 Crystal Ridge Drive in Fountain Hills; and 440 Durant Ave. in Staten Island, NY – as well as one office site – 7702 E. Doubletree Ranch Rd. in Scottsdale. TRO Exh.35 (Vera), paras. 4 and 5 and Atts. B, C, and D. The business site (7702 E. Doubletree Ranch Rd.) was used until June of this year. TRO Exh. 36 (Tendick), para. 3 and TRO Exh. 35 (Vera), para. 4(a). As for the residential sites, Federal Express indicates that RJB Telcom continues to have an account open for 10785 E. Salt Brush Drive. TRO Exh. 35 (Vera), para. 4(b).

[10] From August 1999 to at least June of this year, defendants operated from 7702 E. Doubletree Ranch Rd., #305, Scottsdale 85258. TRO Exh. 35 (Vera), para.4 (a). Based on the investigation by Postal Inspector Tendick, plaintiff believes defendant is no longer doing business from this site.

[11] TRO Exh. 35 (Vera), Att. A.

2000;[12] and from the October 17, 2000 investigation of United States Postal Inspector, James Tendick.[13] In addition, registration statements filed by RJB with Network Solutions, a company which registers Internet domain names, list RJB's business address as 13771 Fountain Hills Blvd. #247, Fountain Hills, AZ 85268.[14] The recent investigation by Postal Inspector Tendick indicates that 13771 Fountain Hills Blvd. is a mail drop.[15]

3. Relief Defendants

Under community property laws of Arizona, a party seeking to proceed against the assets of a marital community must sue both spouses jointly in order to afford due process. *Arizona Revised Statutes § 25-215(D). See also, Spudnuts, Inc. v. Lane*, 139 Ariz. 35, 676 P.2d 669 (Ariz. Ct. App. 1984). Therefore, Suzette Botto and Anne Botto, spouses of the individual defendants, are being named as relief defendants.

Suzette Botto is named as a relief defendant because she is the wife of defendant Robert Botto. Since at all times Robert Botto has acted on behalf of the marital community, Suzette Botto is being named for community liability purposes at this point

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[12] TRO Exh.34 (MasterCard/Brady), Att.3.

[13] TRO Exh. 36 (Tendick), para. 2.

[14] TRO Exh. 35 (Vera), para. 9, indicating the registrations are as recent as September 6 of this year. The 13771 Fountain Hills Blvd address is also listed on RJB's annual report to the Arizona Corporation Commission. TRO. Exh. 35 (Vera), Att. A.

[15] TRO Exh. 36 (Tendick), para. 5.

in time. There is additional evidence that Suzette Botto jointly owns property with her husband, and controls a trust for their benefit.[16]

Anne Botto is named as a relief defendant because she is the wife of Richard Botto. Since at all times Richard Botto has acted on behalf of the marital community, Anne Botto is being named for community liability purposes at this point in time.

B. Defendants' Business Operation

1. Operation of Defendants' Internet Web Sites

Beginning on December 19, 1997, and continuing as recently as September 6 of this year, RJB has registered 82 different Internet web sites with Network solutions -- each with a separate, sexually explicit descriptor advertising the type of adult entertainment it offers (e.g., "ASIANPLEASURES.COM." "CLUBCOCK.COM," "ABSOLUTELYMALE.COM," "WETLESBIANS.COM," "MAJORMELONS.COM").[17] Defendant's proprietary interest in the web sites is explicitly set forth on the initial web page, as well as on subsequent pages, through a copyright notice and inclusion of an email address with the RJB name.[18]

The web sites all have a common modus operandi: through a series of sexually explicit pictures and statements, they attempt to persuade viewers to purchase a trial membership (typically $2.95) using either their credit card or a check, or, if that fails, by

[16] TRO Exh. 35 (Vera), para. 5.

[17] TRO Exh. 35 (Vera), para.8, Att. F.

[18] TRO Exh. 35(Vera), Att. I.

accepting a telephone billing option which provides for a significantly more costly connection to defendants' web sites.[19]

On the majority of defendants' web sites, the credit or debit card/check payment option is offered first.[20] In their "Terms and Conditions," defendants state that their memberships are automatically renewed at "the standard one month rate" unless canceled "within 1 day prior to expiration."[21] Unless viewers separately click on the "terms and conditions" option at the time they sign up, they will be unaware of this.[22] Moreover, as indicated in the materials from defendants' "Major Melons" web site, defendants do not indicate the amount of their "standard one month rate."[23]

Viewers who decline the credit or debit card/check payment option and elect to close the web site are unable to do so; they are instead "mouse trapped" within defendants web site and hyperlinked to a new web page which promotes a phone payment option with the inducement: "NO CREDIT CARD NEEDED!...PAY BY PHONE!" The web page indicates that "PAYING BY PHONE is as easy as 1,2,3!" This payment option

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[19] Id.

[20] TRO Exh. 35 (Vera), paras. 13-14.

[21] TRO Exh. 35 (vera), Att. I.

[22] Id.

[23] Id.

is far more costly than the credit/debit option and is billed at a rate up to $7.34 per minute.[24] Consumers who were billed, accumulated charges as high as $1938.[25]

The "pay by phone" billing option installs a dialer on the viewer's computer which disconnects his modem from his usual Internet service provider and reconnects the computer's modem to the Internet, via an international call, opening to the advertised pornographic site. Prior to choosing the "pay by phone" option, viewers must indicate that they have read a disclaimer which, among other things, states that the viewer must be eighteen years of age or older, and indicates that billing for RJB's services will be in the form of an international call billed to the line subscriber. If the viewer chooses the "pay by phone" option, an icon appears on his computer's desktop screen to simplify future use of the web site through telephonic billing. Viewers refusing the "pay by phone" are nonetheless hyperlinked to several more pages containing explicit sexual imagery and more invitations to join before they are able to close down the web site.[26]

Defendants' "pay by phone" option provides no mechanism or process to assure that the person making the purchase is the line subscriber. As a result, line subscribers get billed for charges made from their telephone line even if they did not make or authorize the calls. Advertising materials from defendants' billing company, Global Internet Billing, indicates that the "pay by phone" billing option is targeted at teenagers and other unauthorized minors who do not have credit cards. On its web site, Global

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[24] Id.

[25] TRO Exh. 35 (Vera), para. 21, Att. L.

[26] TRO Exh. 35 (Vera), paras. 14-15.

Internet Billing describes the phone option as a way to solicit "kids and freespending teenagers" since they do not have credit cards.[27]

Defendants' web sites purportedly offer a cancellation option for previous viewers who are seeking to terminate their memberships. In fact, however, as indicated in the Vera declaration, exercise of this option is difficult and time consuming.[28] Moreover, there is evidence that the cancellation option is ineffective, because defendants billed viewers who canceled their memberships immediately.[29]

2. Defendants' Billing Practices and Revenues

As indicated in the accompanying exhibits from financial institutions, Visa, MasterCard, and complaining consumers, defendants have been billing consumers' charge and debit cards using two descriptors -- "DBL*RJBTE" and "RJBTELCOM WWW.FSX2.COM." The former descriptor was associated with a merchant account at Benchmark Bank ("Benchmark"), through which defendants' business was processed from May 1999 - August 1999; the latter was (and still is) associated with defendants' merchant account at AmTrade International Bank ("AmTrade"), which has been receiving deposits from defendants' business since August 1999.[30]

With respect to telephone-based billing, records from AT&T indicate that defendants have been using this method since at least March of this year. Although

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[27] TRO Exh. 35 (Vera), Att. J.

[28] TRO Exh. 35 (Vera), para. 23.

[29] TRO Exh. 12, para. 6 (Keswani); 8, para. 4 (Higgins).

[30] TRO Exh. 34 (MasterCard/Brady), Att. 5.

AT&T ceased handling calls to defendants' Madagascar number on July 23[31] of this year, defendants have continued to use the number, apparently by substituting other carriers and intermediaries for AT&T.[32] In fact, one such intermediary, Verity International, Ltd., is now the subject of an ex parte TRO, as a result of deceptive billing practices which caused more than 540 consumer complaints to the FTC in a five day period. *FTC v. Verity Int'l Ltd., et al.*, Civ. No. 00 CIV. 7422 (S.D.N.Y., Oct. 2, 2000).[33]

C. Defendants' Billing Scam

1. Complaints About Defendants' Credit and Debit Card Billings

From at least June 1999 (the month after defendants Benchmark Bank account was established) to the present, there has been an outpouring of consumer complaints regarding RJB's credit and debit card billings. As indicated in the declarations supporting plaintiff's present motions, virtually all of the complaints involve a common theme – that defendants are engaging in unauthorized billing.[34] In fact, the vast majority of the declarations indicate that consumers did not know who defendants were or what services they were offering until they inquired about the charges on their credit and debit card statements.[35] The declarations also make it clear that there is no conceivable way the

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[31] TRO Exh. 35 (Vera), para. 20.

[32] TRO Exh.14 (Sarah Mangan)

[33] TRO Exh. 38.

[34] See, TRO Exhs. 1-28 (Declarations of injured consumers).

[35] See, e.g., TRO Exhs. 2 (Andreasen), 3 (Beard), 4 (Brendel), 5 (Bulas), 7 (Euttsler), 9 (Horowtiz), 11 (Jarrett), 13 (Lamb), 15 (Radbill), 16 (Sayarath), 17 (Scalio), 18 (Sexton), 20 (Starkel), 21 (Strickler), 23 (Wallenstein), 24 (Zeitler), 25 (Commodore), 26 (Winkler), and 28 (Johnson).

consumers could have authorized defendants' charges. For instance, one consumer –a mother of four girls eleven years and younger – had no computer in her house when the charges were purportedly authorized.[36] Another consumer was overseas on vacation when the charges were placed. The credit card on which the charges appeared arrived during this time and had not been activated.[37] Another consumer had cut up the credit card on which the charges were placed several months before the charges were purportedly authorized.[38] Yet another consumer had not used the credit card with the charges in two years and kept it locked in her home.[39] Still another consumer was an 88 year old woman with vision impairment.[40] Another consumer who had no knowledge of what RJB was until she received her credit card statement, testified about subsequently seeing more than 100 complaint messages regarding RJB's unauthorized billings from consumers at a shopping coupon web site which she used.[41]

The credit and debit card statement containing defendants' charges set forth a phone number for customer complaints. However, as indicated in the declaration of FTC investigator, Martha Vera, this connects consumers to a separate entity, incorporated in

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[36] TRO Exh. 9 (Wendie Horowitz).

[37] TRO Exh. 15 (Ruth Radbill).

[38] TRO Exh. 4 (Eric Brendel).

[39] TRO Exh. 3 (Peggy Beard).

[40] TRO Exh. 25 (Linda Commodore).

[41] TRO Exh. 28 (Johnson).

California, which identifies itself as "Jettis.com."[42] Thus, consumers are not able to identify the merchant who actually placed the charges. Moreover, even after complaining to RJB's customer service number and receiving assurances that the charges would stop, some customers continued to be charged in subsequent months.[43]

The consumer declarations just described are not isolated occurrences; rather, they are evidence of a broader pattern – one that indicates a business permeated by fraud. This is apparent from the declarations of Visa, MasterCard, and American Express ("AMEX") representatives, all of which describe disciplinary actions taken against RJB as a result of excessive chargeback patterns involving credit and debit cards.[44] It is also apparent from the declarations of representatives of two banks – Chase Credit Card Services ("Chase") and Capital One – each of which describes their institution's extensive, recent complaint activity involving RJB charges.[45]

The Visa declaration indicates that, as a result of RJB's excessive chargebacks, it has taken the extraordinary step of notifying AmTrade -- the United States bank at which RJB currently maintains a merchant account – that it intends to disqualify RJB from the U.S. Region.[46] This step -- decided at a July 26 Visa meeting and announced in a letter to

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[42] TRO Exh. 35 (Vera), para. 23.

[43] TRO Exhs. 2, 8, and 12 (Higgins, Andreasen, and Keswani).

[44] TRO Exhs. 30, 33, 34 (AMEX/Marshall; Visa/Elliott; MasterCard/Brady).

[45] TRO Exhs. 31,32 (Capital One/Barksdale; Chase/Locke).

[46] TRO Exh. 33 (Visa/Elliott), para. 28. The disqualification notice was sent to AmTrade on August 9, 2000. Because AmTrade is appealing the decision, the account had not been terminated at the time the declaration was signed. Id. However, complaint counsel was advised by Visa on October 19, that the AmTrade appeal was denied.

AmTrade dated August 9, 2000 -- followed a six month period during which RJB's average monthly chargeback rate exceeded Visa's chargeback monitoring guidelines.[47] Because of its chargeback problems, RJB had been monitored in Visa programs for high risk merchants -- first, in Visa's Merchant Chargeback Monitoring Program ("MCMP") and subsequently, from April 2000 on, in Visa High Risk Merchant Monitoring Program.[48]

As indicated in the Visa declaration, the MCMP applies to only a statistically infinitesimal number of Visa merchants. In a typical month only 70-80 merchants out of the 3-4 million in the Visa system, are placed in MCMP; of this group an even smaller number – a mere 4 to 8 per month -- enter "active monitoring."[49] Defendants' horrendous chargeback numbers placed them in this latter group. Even more tellingly, from a global perspective, in four of the first eight months of this year (March, April, May, and August), RJB generated more chargebacks and penalties for their merchant bank than any

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[47] TRO Exh.33 (Visa/Elliott), para. 25, Att. B. Visa's guidelines provide for monitoring of merchants whose monthly chargeback rates -- measured by number of chargebacks divided by number of sales - exceed 2.5%. As noted infra, only an infinitesimal portion of Visa merchants violate this norm. Id., paras. 7-10. In contrast, the average Visa merchant has a chargeback rate of .067%. Id., para. 17. RJB's average monthly chargeback rate for January - May was 2.8%. Its average rate for January-September was 3.05%. Id., Att. B. (In June, RJB processed all of its sales through off shore merchant accounts.)

As indicated in the Visa declaration, refunds to complaining consumers are reflected in credits from the consumers' banks, as well as by chargebacks. TRO Exh.33 (Visa/Elliott), paras. 4-5. If both credits and chargebacks are taken into account, RJB's January - May 2000 refund rate more than triples.

[48] TRO Exh.33 (Visa/Elliott), paras. 6-9,11-12, 25, 28.

[49] TRO Exh.33 (Visa/Elliott), para. 8.

other merchant in Visa's global risk management program.[50] Incredibly, even **after** AmTrade was notified of the impending Visa disqualification, RJB continued to violate Visa's chargeback guidelines. Indeed, its August chargeback and chargeback/credit rates -- 4.4% and 14.76% respectively -- were its highest this year.[51] Put another way, in terms of individual sales, there were a total of **181,218** Visa - related chargebacks and credits involving RJB for the first nine months of this year.[52] Of this total, 44,491, or 24.6% of the nine-month total, were in the months of August and September.[53]

The Visa declaration also underscores the difficulty of curing RJB's fraud without judicial intervention. During June 2000, RJB established a merchant relationship with Aval Card, an offshore bank located in Costa Rica; in August, RJB established a second merchant account with Banco Uno, a Panamanian bank. These actions placed RJB beyond the jurisdiction of Visa USA.[54]

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[50] TRO Exh.33 (Visa/Elliott), para. 27.

[51] TRO Exh.33 (Visa/Elliott), Att. B. Although defendants chargeback rate "declined" in September to 2.7%, its overall chargeback and chargeback/credit rates – 10.99% – was still its second worst of the year. Id.

[52] TRO Exh.33 (Visa/Elliott), Att. B. Of this total, **51,524** were chargebacks and the remainder (**129,694)** were credits. Id.

[53] Id.

[54] TRO Exh.33 (Visa/Elliott), para. 27. In addition to changing banks, the Visa declaration also describes a second method by which high risk merchants can "game" the Visa system – by changing descriptors and thereby starting afresh in terms of Visa chargeback monitoring guidelines. Id., para. 15. In view of the fact that many of the FTC's consumer declarants have testified that, in addition to unauthorized RJB charges, they had unauthorized charges for other descriptors, there is a possibility that RJB is using this method as well. See, e.g., TRO Exhs. 13 (Lamb), 16 (Sayarath), 17 (Scalio), 18 (Sexton), 20 (Starkel) and 25 (Commodore).

With respect to MasterCard, it has recently completed an audit of RJB's AmTrade merchant account.[55] Like the Visa investigation, it showed a pattern of excessive chargebacks and credits. For the first six months of this year, RJB's total chargebacks and credits involving the Mastercard network, averaged 14.4%, reaching a high of 16.8% in June – the last month for which Mastercard obtained data.[56] In terms of individual accounts, this amounted to a total of **55,287** chargebacks and credits.[57] As in the case of Visa, RJB's chargeback/credit problems place it in a highly unique category of problem merchants.[58]

The Visa and MasterCard declarations also indicate that they encountered excessive chargeback problems during the period in 1999 when RJB business was being processed through a merchant account at Benchmark. As indicated in the exhibits appended to the MasterCard declaration, total chargebacks and credits during the four month period this account was operated amounted to 11.3%, when measured as a percentage in dollars of total deposits.[59]

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[55] TRO Exh. 34 (MasterCard/Brady), paras. 8-9.

[56] TRO Exh. 34 (MasterCard/Brady), para. 13, Att. 6. A description of MasterCard's triggering mechanisms for high risk merchant audits is found at Id., paras. 6-9

[57] TRO Exh. 34 (MasterCard/Brady), para. 13, Att.6.

[58] TRO Exh. 34 (MasterCard/Brady), para. 6 (b). As in the case of Visa, MasterCard audits involve an infinitesimal percentage of overall MasterCard merchants – in a typical month, approximately 10 merchants out of MasterCard's 14 million worldwide merchant base are audited. Id.

[59] TRO Exh. 34 (MasterCard/Brady), paras. 8, 10, Att. 4. Chargebacks accounted for 4.7% of gross deposits. RJB's Benchmark Account was closed by Benchmark before reaching Visa's MCMP disqualification trigger. TRO Exh.33 (Visa/Elliott), paras. 23-24. MasterCard subsequently fined Benchmark in connection with the RJB chargebacks. TRO Exh. 34

Finally, the American Express declaration indicates that it had an RJB merchant account which was opened on July 29, 1999, and canceled a mere nine months later – on April 28 of this year.[60] As in the case of Visa and MasterCard, the cancellation was due to a pattern of excessive chargebacks -- a pattern which first appeared in 1999 and escalated in the first four months of 2000.[61] Six weeks after cancellation of the RJB account, individual defendant Richard Botto opened up a new American Express account with a new descriptor, "RJBT."[62] Although the account was operative for less than two months -- from June 8 to August 4 -- it was flooded with even more chargebacks than its predecessor (20.5%). On the latter date, it too was canceled.[63]

The declarations from Chase and Capital One banks show the recent impact of defendants' fraud. According to the Capital One declaration, between January 1, 2000 and July 30, 2000, **40%** of attempted charges by RJB were rejected. Of the remaining charges, 7% were the subject of fraud complaints.[64] As for Chase, between February 1 and August 15, 13% of RJB's billings were the subject of consumer complaints.[65]

2. Complaints About Defendants' Telephone Billing

(MaterCard/Brady), para. 11.

[60] TRO Exh. 30 (AmEx/Marshall).

[61] Id., para. 4. In 1999, RJB's total chargeback rate was 6.2%. During the first four months of this year, the rate rose to 13.75%. Id.

[62] Id., para. 4(d).

[63] Id., para. 4(f).

[64] TRO Exh. 31 (Capital One/Barksdale), para.14.

[65] TRO Exh. 32 (Chase/Locke), para. 3.

Defendants' telephone billings, like those involving credit and debit cards, have also generated massive consumer complaints. As indicated in the appended consumer declarations, these customers, like those complaining about defendants' credit and debit card billings, assert that the charges were unauthorized and that they were unaware of them until receiving their phone bills.[66] Some declarants were charged without authorization for multiple calls on the same day. For instance, one consumer was charged seven times in one day for calls she never made, nor authorized anyone else to make.[67] In some instances, consumers have minors or other unauthorized individuals in their home that may have made the call.[68] In addition, some consumers suffered a loss of telephone service when their phone company disconnected service as a result of the astronomical charges.[69]

The declarations from consumers who were charged on their phone bills are further evidence of a business permeated by fraud. This is apparent from a chart furnished to the FTC by AT&T, which lists total charges and adjustments due to consumer complaints for a Madagascar-based phone number which was utilized by RJB between March and July of this year.[70] The Madagascar phone number generated

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[66] See e.g. TRO Exhs. 10, 14, 22, 29 (Paul Huntman, Sarah Mangan, Hue Tran, Robert Lowery).

[67] TRO Exh. 22 (Hue Tran).

[68] TRO Exh. 29 (Robert Lowery).

[69] TRO Exh. 27 (Ella Goddard).

[70] TRO Exh. 35 (Vera), Att. M. Ms. Vera's declaration indicates that her examination of RJB Internet web sites revealed that it is using other overseas billing numbers as well. Id., para. 22. At the present time, the FTC does not have revenue or refund information regarding these

$1,119,744 in charges before being cut off by AT&T on July 23 of this year. However, as of August 31, AT&T reported making $320,654, or 28.6%, in refunds to complaining customers.[71]

D. Scope of Defendants' Fraud

Defendants' revenues from their business are substantial. A spreadsheet prepared by MasterCard concerning the merchant account at Benchmark which handled defendants' claims indicates that at total of $10.0 million in Visa and MasterCard business for RJB was processed between May and August 1999.[72] With respect to AmTrade, $39 million was deposited to defendants' merchant accounts between September 1999 and May 2000.[73] Records of Visa/MasterCard deposits to RJB's AmTrade account show a steady increase in defendants' revenue flow: from a net revenue of $1.06 million in September 1999 to nets of $6.2 million and $6.05 million in April and May of this year.[74] Finally, defendants processed $ 2.7 million in sales through American

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numbers.

[71] TRO Exh. 35 (Vera), Att. K

[72] TRO Exh. 34 (MasterCard/Brady), Att. 4. The spreadsheet indicates that there were a total of $335,493 in chargebacks and returns on the MasterCard sales and an additional $285,905 in Chargebacks on the Visa sales. (Visa returns are not included on the spread sheet.) Thus, it can be presumed – allowing an additional amount for Visa returns based on MasterCard returns – that net deposits to this account were approximately $8.8 - $9.0 million.

[73] TRO Exh. 34 (MasterCard/Brady), Att. 5.

[74] TRO Exh.34 (MasterCard/Brady), Att.5. "Net Revenue" refers to RJB's total sales for Visa/MasterCard less returns, as set forth on account statements provided by AmTrade to MasterCard. Id. RJB's net for September - December 1999 averaged $2.95 million per month. In contrast, the net for the first five months of this year averaged $5.44 million. Id.

Express, virtually all of which is not reflected in the combined Benchmark and AmTrade figures.[75]

Although a reasoned inference can be made that some portion of defendants' business is legitimate – that is, results from charges for actual use of their web sites – it is also clear, as indicated in Section II.C, supra, that a substantial portion is the result of blatant fraud. This fraud began as early as May 1999, and has continued unabated through the present time. As indicated in this year's chargeback and credit figures for Visa and MasterCard alone, (through September for Visa and June for Mastercard), there were a total of **236,505** chargebacks and credits involving defendants' sales.[76] As the attached consumer declarations suggest, the vast majority of these probably encompassed multiple charges (e.g., $2.95 for a trial membership and $29.95 for a monthly membership) and, in many instances, probably also encompassed charges which had accumulated over two or more months. In addition, because of the comparatively small size of the charges, it can be presumed that there are a huge number of consumers who have been defrauded, but are not yet aware of this.[77] Finally, the Visa, MasterCard, and

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[75] TRO Exh.30 (AmEx/Marshall), and TRO Exh. 34 (MasterCard/Brady), Atts. 4,5. It is unclear whether the deposits alluded to above also include defendants' revenues from their telephone billings. As indicated in Section II.C, supra, these are substantial and growing. AT&T records indicate that for just one Madagascar number alone, total charges during June and July were $927,298.

[76] See, e.g., TRO Exh. 1 (Adams), 7 (Eutsler), and 21 (Strickler).The calculations above **exclude** a total of **$314,282** ins chargebacks to American Express customers and an additional **$320,654** in refunds to AT&T customers

[77] As the declarations indicate, some consumers did not become aware of defendants' charges until they have appeared on several months of credit card statements. See, e.g., TRO Exhs. 21 (Strickler) and 25 (Commodore). A similar problem was encountered in the *J.K. Publications* case. *See* 99 F. Supp.2d at 1186-1189 and 1193-1195, citing report of the FTC

American Express declarations indicate that the volume of defendants' fraud is increasing.[78] Given defendants huge revenues, as described in the preceding paragraph, it is clear that their profits from illicit activities are in the multi-millions.

III. LEGAL ARGUMENT

A. Section 13(b) Authorizes This Court to Grant the Requested Relief

1. Authority to Grant Permanent Relief

The FTC seeks a permanent injunction and equitable relief to redress the injury caused by defendants' deceptive practices. To prevent the defendants from committing further law violations pending resolution of this action and to preserve the possibility of effective final relief, the FTC also seeks an ex parte TRO, asset freeze, appointment of a receiver over defendants' businesses, immediate access to defendants' premises, expedited discovery, and an order to show cause why a preliminary injunction should not issue.

Section 13(b) of the FTC Act[79] specifically authorizes a district court to grant permanent injunctions to enjoin violations of the Act in "proper cases." A "proper case" includes any matter involving a violation of a law enforced by the FTC. *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1113 (9th Cir. 1982). In actions brought under Section

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expert, Card Alert Services.

[78] TRO Exhs. 30. (AMEX), 33 (Visa), and 34 (MC).

[79] The Commission proceeds under the second proviso of Section 13(b). As the Ninth Circuit has held, it is the second proviso that gives the Commission the authority to bring a permanent injunction action in district court, even where no administrative proceedings are pursued. *See Pantron I*, 33 F.3d at 1102; *Singer*, 668 F.2d at 1110-13.

13(b), the district court may exercise the full breadth of its equitable authority, including the imposition of any additional relief necessary to accomplish complete justice. *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1102 (9th Cir.), *cert. denied*, 115 S.Ct. 1794 (1995); *Singer*, 668 F.2d at 1113.

2. Authority to Grant Temporary and Preliminary Relief

Incident to its authority to issue permanent injunctive relief, this Court has the inherent equitable power to grant all temporary and preliminary relief necessary to effectuate ultimate relief. The Ninth Circuit has held that because Section 13(b) gives a court the authority to grant a permanent injunction, the statute by implication gives authority "to grant any ancillary relief necessary to accomplish complete justice because [Congress] did not limit that traditional equitable power explicitly or by necessary and inescapable inference." *Singer*, 668 F. 2d at 1113. Thus, in the context of an action for a permanent injunction under Section 13(b), the court may employ its inherent equitable authority to grant preliminary ancillary relief, including a preliminary injunction, an ex parte temporary restraining order, and whatever additional relief is necessary to preserve the possibility of effective ultimate relief. *Singer*, 668 F.2d at 1111.[80] Such preliminary ancillary relief may include asset freezes, restitution and/or disgorgement, and the appointment of receivers. *FTC v. World Wide Factors, Ltd.*, 882 F.2d 344, 346-47 (9th Cir. 1989) (affirming order freezing assets); *Singer*, 668 F.2d at 1111-13 (affirming order

[80] For a discussion of the legal authority for the provisions in plaintiff's ex parte TRO, see Section III.C, infra.

appointing a receiver, freezing corporate and personal assets and enjoining violations of the Act).

B. This Case Meets the Standard for a TRO and Preliminary Injunction

Section 13(b) of the FTC Act allows a district court to grant the FTC a TRO and a preliminary injunction "[u]pon a proper showing that, weighing the equities and considering the [FTC's] likelihood of ultimate success, such action would be in the public interest." 15 U.S.C. § 53(b). Section 13(b), therefore, "places a lighter burden on the [FTC] than that imposed on private litigants by the traditional equity standard; the [FTC] need not show irreparable harm to obtain a preliminary injunction." *FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1233 (9th Cir. 1999). *See also FTC v. University Health, Inc.*, 938 F.2d 1206, 1218-19 (11th Cir. 1991). This Court, therefore, need only consider: (1) the FTC's likelihood of success on the merits; and (2) the balance of hardships.[81]

In considering the likelihood of ultimate success, "the district court need only to find some chance of probable success on the merits," because irreparable injury is presumed in a federal statutory enforcement action. *World Wide Factors*, 882 F.2d at 346-47 (citing *United States v. Odessa Union Warehouse Co-op*, 833 F.2d 172, 175 (9th

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[81] Congress understood Section 13(b) to codify the preexisting standard applicable to all injunctive actions by the government to enforce remedial statutes. *See* H.R. Rep. No. 624, 93d Cong., 1st Sess. 18 (1973), *reprinted in* 1973 U.S. Code Cong. & Admin. News 2533 ("The intent is to maintain the statutory or 'public interest' standard which is now applicable, and not to impose the traditional 'equity' standard of irreparable damage, probability of success on the merits, and that the balance of equities favors the petitioner."). *See also Prayze FM v. Federal Communications Comm'n*, 214 F.3d 245, 250 (2d Cir. 2000) (proof of irreparable harm not required for preliminary injunction in FCC statutory enforcement action); *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 808 (2d Cir. 1975) (same in the context of SEC statutory enforcement action); *United States v. Diapulse Corp. of Am.*, 457 F.2d 25, 28 (2d Cir. 1972) (same in the context of government's enforcement of Federal Food, Drug and Cosmetic Act).

Cir. 1987). Moreover, since "[h]arm to the public interest is presumed . . . when a district court balances the hardships of the public interest against a private interest, the public interest should receive greater weight." *World Wide Factors,* 882 F.2d 346- 47 (citing *Odessa*, at 175).

1. The Evidence Shows the FTC Is Likely to Succeed on the Merits.

As indicated in Section II.C, supra, there is ample evidence that defendants continue to engage in repeated deceptive and/or unfair acts in violation of Section 5 of the FTC Act. Thus, the FTC has demonstrated not only a probable chance of success on the merits, but a clear and substantial showing of a likelihood of success in demonstrating that defendants have violated Section 5.

a. Defendants' Billing is Deceptive

The complaint alleges that defendants deceptively represent that: (1) consumers purchased or agreed to purchase adult entertainment services, and therefore owe money to defendants; and (2) the line subscriber of a telephone is liable for charges for adult entertainment services accessed through that telephone by another person. Under Section 5 of the FTC Act, 15 U.S.C. § 45(a), a practice is deceptive if it contains a material representation or omission that is likely to mislead consumers acting reasonably under the circumstances. *Pantron I Corp.*, 33 F.3d 1088, 1095 (9th Cir. 1994); *FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1029 (7th Cir. 1988); *FTC v. Five-Star Auto Club, Inc.*, 97 F. Supp.2d 502, 526 (S.D.N.Y. 2000).[82] Generally,

[82] The FTC need not prove that defendants' misrepresentations were made with an intent to defraud or deceive, or were made in bad faith. *See, e.g., World Travel Vacation Brokers*, 861 F.2d at 1029; *Removatron Int'l Corp. v. FTC*, 884 F.2d 1489, 1495 (1st Cir. 1989); *Five-Star*

misrepresentations are material if they involve facts that a reasonable person would consider important in choosing a course of action. *FTC v. Figgie Int'l, Inc.*, 994 F.2d 595, 603-04 (9th Cir. 1993), *cert. denied*, 510 U.S. 1110 (1994); *In re Thompson Medical Co.*, 104 F.T.C. 648, 816 (1984), *aff'd*, 791 F.2d 189 (D.C. Cir. 1986); *Kraft, Inc. v. FTC*, 970 F.2d 311, 322 (7th Cir. 1992); *Five-Star Auto Club*, 97 F. Supp.2d at 529.

As set forth in Section II., supra, defendants misrepresent material facts in order to induce consumers to pay for services that they neither purchased nor authorized. By billing consumers credit and debit cards, and by placing charges on consumers' telephone bills, -- in both instances without any prior authorization or awareness by consumers -- defendants misrepresent that consumers are legally obligated to pay charges for defendants' sexually-explicit Internet services. Consumers receive the bills and believe that they are obligated to pay them even though they never authorized defendants' services or the charges.

b. Defendants Engage In The Unfair Practice of Billing Consumers Without Authorization

In addition to deception, the complaint also alleges that defendants unfairly: (1) charge and debit consumers' credit or debit card accounts without authorization; and (2) attempt to bill and collect from line subscribers who did not access defendants' web sites. An act or practice is unfair under the FTC Act if it causes injury to consumers that: (1) is substantial; (2) is not outweighed by countervailing benefits to consumers or competition;

Auto Club, 97 F. Supp.2d at 526. Nor does the Commission need to show actual reliance by consumers. *Figgie*, 994 F.2d at 605-06; *FTC v. Security Rare Coin & Bullion Corp.*, 931 F.2d 1312, 1316 (8th Cir. 1991); *Five-Star Auto Club*, 97 F. Supp.2d at 530.

and (3) consumers themselves could not reasonably have avoided. *See* 15 U.S.C. § 45(n). *See also Orkin Exterminating Co., Inc. v. FTC*, 849 F.2d 1354, 1363-66 (11th Cir. 1988); *FTC v. J.K. Publications, Inc.*, 99 F. Supp.2d 1176, 1201 (C.D. Cal. 2000); *FTC v. Windward Marketing, Ltd.*, 1997 U.S. Dist. LEXIS 17114, at *29-31 (N.D. Ga. Sept. 30, 1997). Here, defendants' acts clearly satisfy the elements of unfairness.

First, consumer injury here is substantial. An overwhelming number of consumers who were charged by defendants never ordered anything from defendants; instead, the charge just showed up on their credit card statement or telephone bill. Indeed, many of these consumers were billed even though they neither accessed one of defendants' web sites, used defendants' dialer program, nor authorized anyone else to do so. Defendants have charged or debited these consumers from $2 to $1938.[83] These charges have no basis in any bargain or contract entered into by the line subscriber. Substantial injury has occurred in this case in that a large number of consumers have lost money due to a practice for which they did not bargain. *See Windward Marketing*, 1997 U.S. Dist. LEXIS 17114, at *31 (a finding of substantial injury may be established by showing that consumers "were injured by a practice for which they did not bargain"); *J.K. Publications*, 99 F. Supp.2d at 1201 (injury may be substantial if it causes small harm to a large class of people).

The injury to consumers here is not outweighed by benefits to consumers or competition. Defendants' acts of charging consumers' for services they never purchased

[83] TRO Exh. 35 (Vera), Att. L.

serves no countervailing benefit. A billing mechanism that lacks adequate safeguards to ensure that the proper person is billed and results in erroneous billing in a substantial number of cases cannot provide benefits to consumers or competition as a whole. *See Windward Marketing*, 1997 U.S. Dist. LEXIS 17114, at *32 (the second prong of the test is easily satisfied "when a practice produces clear adverse consequences for consumers that are not accompanied by an increase in services or benefits to consumers or by benefits to competition"); *J.K. Publications*, 99 F. Supp.2d at 1201 (same).

Moreover, consumers could not have reasonably avoided their injury in this case. With regard to that element, the focus is on "whether consumers had a free and informed choice that would have enabled them to avoid the unfair practice." *Windward Marketing*, 1997 U.S. Dist. LEXIS 17114, at *32. *See also J.K. Publications*, 99 F. Supp.2d at 1201. Here, the evidence demonstrates that consumers could not have avoided their injury. In the case of consumers whose credit and debit cards were charged, defendants placed these charges on consumers' accounts without their knowledge and authorization. Clearly, consumers cannot reasonably avoid unfair practices that they don't know about. In the case of consumers who were charged on their telephone bills, the consumer declarants were uniformly unaware that anyone was purchasing sexually explicit information services through international calls on their phone line. It is unreasonable to require consumers to block all calls to international numbers in order to avoid defendants' charges. In addition, many consumers cannot avoid multiple charges because defendants place recurring charges on the accounts during the same billing cycle.

Courts have found that charging and debiting consumers without their authorization constitutes unfair practices under Section 5 of the FTC Act.[84] In fact, defendants' credit and debit card billing scam here closely resembles the illicit activities of defendants in another recent Ninth Circuit case – *J.K. Publications*, 99 F. Supp.2d 1176. *J.K. Publications* also involved unauthorized charges for Internet adult entertainment. Based on consumer declarations asserting complaints similar to those made here, the Court issued an ex parte TRO virtually identical to that which plaintiff seeks in this case, which included an asset freeze, and appointment of a Receiver to run the defendants' business and marshal its assets.[85] Subsequently, summary judgment on the liability of the principal defendants was entered in favor of the FTC, and in August 2000, following a trial, the Court entered a $37.6 million judgment against defendants.[86] Defendants here likewise are engaged in the unfair practice of charging and debiting consumers' accounts and telephone bills without their authorization.[87]

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[84] *See, e.g.*, *Windward Marketing*, 1997 U.S. Dist. LEXIS 17114, at *3-5, 17, 32 (company which deposited numerous unauthorized bank drafts engaged in "unfair" practices pursuant to Section 5).

[85] TRO Exh. 37, (Ex parte TRO).

[86] Evidence of defendants' chargeback and credit rates in the J.K. Publications case was substantially similar to the evidence regarding the present defendants. 99 F. Supp 2d at 1188-1190. Ultimately, the Court found that only 9% of defendants' business was legitimate. TRO Exh. 37 (Findings of Fact and Conclusions of Law), at p. 39.

[87] The Commission has brought several actions alleging unfairness in cases where information or entertainment providers were engaged in the practice of billing line subscribers for services that the line subscriber neither authorized nor received. Defendants have agreed to Stipulated Preliminary Injunctions in: *FTC v. Hold Billing Services, Ltd.*, Civ. No. SA-98-CA-0629 FB (W.D. Texas, *filed* July 19, 1998) (unfair practice to bill line subscribers for membership based on phone numbers in sweepstakes entry forms filled out by someone other than line subscriber where line subscriber did not consent to the charges); *FTC v. Interactive Audiotext*

c. Defendants Robert and Richard Botto Are Individually Liable Under the FTC Act

Robert Botto and Richard Botto share responsibility for defendants' deceptive and unfair practices and should be subject to the preliminary and permanent injunctive relief. Individual defendants are liable for injunctive relief under the FTC Act if the individual defendants participated directly in the wrongful acts or practices or had authority to control the corporations. *See FTC v. Publishing Clearing House, Inc.*, 104 F.3d 1168, 1170 (9th Cir. 1997); *FTC v. Amy Travel Serv., Inc.*, 875 F.2d 564, 573 (7th Cir. 1989). "Authority to control the company can be evidenced by active involvement in business affairs and the making of corporate policy, including assuming the duties of a corporate officer." *Amy Travel*, 875 F.2d at 573. *See also J.K. Publications*, 99 F. Supp.2d 1176; *Publishing Clearing House*, 104 F.3d at 1170; *Five-Star Auto Club*, 97 F. Supp.2d at 535. "Intent to deceive is not a necessary element of an FTC violation, nor is it necessary to [show it to] obtain injunctive relief against an individual." *Five-Star Auto Club*, 97 F. Supp.2d at 535. *See also Amy Travel*, 875 F.2d at 574; *Publishing Clearing House*, 104 F.3d at 1171.

To be held liable for restitution, in addition to injunctive relief, the FTC must show that the individual defendants had some knowledge of the wrongful acts or practices, was recklessly indifferent to the truth, or had an awareness of a high probability

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Services, Inc., Civ. No. 98-3049 CBM (C.D. Cal., *filed* Apr. 22, 1998) (unfair practice to bill consumers whose telephones were used by someone else to access and purchase defendants' entertainment services by dialing non-blockable toll-free numbers); *In re Phone Programs, Inc.*, 115 F.T.C. 977 (Dec. 10, 1992) (unfair practice to induce children to dial 900 number without providing any reasonable means for persons responsible for payment to exercise control over the transaction).

of fraud coupled with an intentional avoidance of the truth. *Publishing Clearing House*, 104 F.3d at 1171; *J.K. Publications*, 99F. Supp.2d at 1204.

Here, it is clear that both Robert Botto and Richard Botto have control over, directly participate in, and have knowledge of the unlawful acts and practices of the corporate defendants. As indicated in Section II.C, supra, the Bottos have held themselves out as the principals of RJB in corporate filings with the Arizona Corporation Commission and in dealings with their merchant banks and Federal Express. In addition, based on the merchant account application forms filed by the Bottos with Benchmark and just five weeks ago with AmTrade, and based on the Bottos' dealings with Federal Express, it clear that both are actively involved in the business affairs of RJB.

The FTC has provided ample evidence that the Botto's knew, or at the least should have known about, the deceptive and unfair practices. *Windward Marketing*, 1997 U.S. LEXIS 17114, at *38-39 ("A heavy burden of exculpation rests on the chief executive and primary shareholder of a closely held corporation whose stock-in-trade is overreaching and deception."). Accordingly, the evidence establishes that both of these individuals are liable for violating Section 5 of the FTC Act, and therefore subject to injunctive relief.

2. The Equities Tip Decidedly in the Commission's Favor

The public's interest in preventing consumers from being victimized by defendants' scheme far outweighs any limited interest defendants may have in continuing to operate their business fraudulently. When a court balances the hardships of the public interest against a private interest, "the public interest should receive greater weight."

FTC v. World Wide Factors, 882 F.2d at 347. Those public equities include, but are not limited to, economic effects and pro-competitive advantages for consumers, and effective relief for the Commission. Moreover, defendants' past conduct is "highly suggestive" of a likelihood of future violations. *Five-Star Auto Club*, 97 F. Supp.2d at 536. *See also SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 807 (2d Cir. 1975).

The public equities here overwhelm any private interests. Defendants have engaged in the deceptive and unfair practices discussed above since at least 1999. The defendants should not have undertaken to bill consumers without clear evidence that they were billing the proper person. There is no private interest in erroneous billing that outweighs the public interest in billing only the right persons for amounts actually owed.

Without the entry of the proposed temporary injunctive relief, defendants will undoubtedly continue to harm the public. As indicated in Section II.C, supra, defendants' deceptive and unfair practices have resulted in more than 200,000 separate instances of chargebacks and credits to RJB consumers in just this year alone.. Moreover, defendants' practices continue unabated as of the date of this complaint. Although Visa and MasterCard are taking steps to terminate defendants' on-shore accounts, defendants have recently moved their credit card processing to Costa Rica and Panama. Additionally, defendants' actions continue to undermine consumer confidence in the Internet as a growing and important realm for commerce. The fraud should be halted immediately to prevent further substantial injury to the public.

C. AN EX PARTE TRO WITH AN ASSET FREEZE, APPOINTMENT OF A RECEIVER, AND EXPEDITED DISCOVERY ARE NECESSARY TO PRESERVE RECORDS AND ASSETS FOR EFFECTIVE FINAL RELIEF

The profuse evidence of defendants' deceptive and unfair business practices, and the substantial evidence that consumers are currently being charged without authorization, justifies the burden that a TRO would impose on defendants. As part of the permanent relief in this case, the FTC seeks restitution for consumers harmed by defendants' practices. To preserve the possibility of such relief, the FTC seeks a TRO with an immediate freeze of defendants' assets; a repatriation order; appointment of a receiver over the corporate defendant; immediate access to defendants' premises and business documents; and an accounting to prevent any concealment or dissipation of assets pending final resolution of this litigation.[88] Absent a TRO, there is a substantial

[88] A sampling of recent FTC actions in the Ninth Circuit in which temporary restraining orders and asset freezes were entered ex parte follows: *FTC v. YP.Net, Inc.*, Civ. No. 1210 PHX-SMM (D. Ariz. June 26, 2000); FTC *v. J. K. Publications, Inc.*, Civ. No. *** (C.D. Cal. Jan. 9, 1999); *FTC v. Walton*, Civ. No. CIV 98-0018 PCT FMN (D. Ariz. Jan. 8, 1998); *FTC v. Jewelway Int'l, Inc.*, Civ. No. CV97-383 TUC JMR (D. Ariz. June 24, 1997); *FTC v. Woofter Inv. Corp.*, Civ. No. CV-S-97-00515-LDG (RLH) (D. Nev. Apr. 29, 1997); *FTC v. Dayton Family Prod's, Inc.*, et al., Civ. No. CV-S-07- 00750-PMP (LRL) (D. Nev. June 20, 1997); *FTC v. Intellicom Serv's, Inc.*, Civ. No. 97-4572 TJH (Mcx) (C.D. Cal. June 23, 1997); *FTC v. Mentor Network, Inc.*, Civ. No. SACV96-1104 LHM (EEX) (C.D. Cal. Nov. 6, 1996); *FTC v. Global Assistance Network for Charities*, Civ. No. 96-2494 PHX RCB (D. Ariz. Nov. 5, 1996); *FTC v. American Exch. Group, Inc.*, Civ. No. CV-S-96-669-PMP (D. Nev. July 22, 1996); *FTC v. Oasis Southwest, Inc.*, Civ. No. CV-S-96-654-PMP (D. Nev. July 15, 1996); *FTC v. Ideal Credit Referral Serv's, Ltd.*, Civ. No. C96-0874R (W.D. Wash. June 6, 1996); *FTC v. Fortuna Alliance LLC*, Civ. No. C96-799M (W.D. Wash. May 24, 1996); *FTC v. Silver State W. Publ'g, Inc.*, Civ. No. CV-S-95-417-LDG (D. Nev. May 15, 1996); *FTC v. FANS, Inc.*, Civ. No. CV-S-96-191-LDG (D. Nev. Mar. 7, 1996); *FTC v. Ellis*, Civ. No. SA CV 96-114 LHM (Eex) (C.D. Cal. 1996); *FTC v. Showcase Dist'g, Inc.*, Civ. No. CV-95-1368- PHX-SMM (D. Ariz. July 10, 1995).

risk that defendants will hide or dissipate their assets and destroy documents to preclude satisfaction of any final order granting monetary relief to defrauded consumers. Moreover, the TRO is subject to prompt reconsideration and modification if circumstances warrant, thereby minimizing any potential harm to defendants.

1. An Asset Freeze and Repatriation Order Are Necessary to Preserve the Possibility of Effective Final Relief

A freeze of defendants' assets and a repatriation order are appropriate here to preserve the status quo and ensure that funds do not disappear during the course of this litigation. A district court's authority to enter orders preserving defendants' assets is ancillary to its equitable authority to order consumer redress. *FTC v. Gem Merchandising Corp.*, 87 F.3d 466, 469 (11th Cir. 1996); *World Wide Factor*s, 882 F.2d at 347; *Singer*, 668 F.2d at 1113. Moreover, a court may impose an asset freeze based on the mere possibility of dissipation of assets. *FSLIC v. Sahni*, 868 F.2d 1096, 1097 (9th Cir. 1989). That possibility certainly is present where, as here, defendants' are engaging in pervasive multi-million dollar fraudulent activity. *J.K. Publications*, 99 F. Supp 2d 1176; *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1106 (2d Cir. 1972); *Publishing Clearing House*, 104 F.3d at 1171; *Singer*, 668 F.2d at 1113; *FTC v. U.S. Oil & Gas Corp.*, 748 F.2d 1431 (11th Cir. 1984).

In addition to freezing company assets, courts have frozen individual defendants' assets where the individual defendants controlled the deceptive activity and had actual or constructive knowledge of the deceptive nature of the practices in which they were

engaged. *Amy Travel*, 875 F.2d at 574; *World Travel Vacation Brokers*, 861 F.2d at 1031.

Furthermore, repatriation of assets held abroad is necessary where, as here, defendants have set up overseas accounts to process their fraudulent activity, thereby indicating that their ill-gotten gains may be off-shore as well. *J.K. Publications*, 99 F. Supp 2d 1176 (upholding order to repatriate overseas assets)[89]; *FTC v. Affordable Media, LLC*, 179 F.3d 1228 (9th Cir. 1999) (upholding order to repatriate assets held in offshore trust); *FTC v. Slimamerica, Inc.*, 77 F. Supp.2d 1263, 1277 (S.D. Fla. 1999) (ordering repatriation of assets held abroad). A freeze of corporate and individual assets and an order repatriating assets will reduce the risk of dissipation, and preserve assets for possible redress to victimized consumers.

2. A Receiver Is Necessary to Preserve and Marshall Assets for Consumer Redress

Appointing a receiver is appropriate to preserve the potential for a complete remedy in this case. *FTC v. American Nat'l Cellular*, 810 F.2d 1511, 1512-14 (9th Cir. 1987); *Five-Star Auto*, 97 F. Supp.2d at 534. Appointment of a receiver will serve to maintain the *status quo*, thereby preventing the destruction of documents and the secretion of assets while the case is pending. *In re National Credit Management Group.*, 21 F. Supp.2d 424, 463 (D. N.J. 1998). Such an appointment is particularly appropriate

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[89] In *J.K. Publications*, defendants transferred a total of $25.3 million to offshore accounts prior to the start of the case. 99 F. Supp.2d at 1195-1196. Notwithstanding the Court's ex parte TRO and preliminary injunctions, both of which contained asset freezes, defendants transferred and utilized substantial portions of these assets during the first three months of the case. 99 F. Supp.2d at 1179-1180.

where defendants' pervasive fraud presents the likelihood of continued misconduct and the public faces a risk that the business may continue to operate in an illegal manner without a receiver's oversight. *SEC v. Bowler*, 427 F.2d 190, 197-98 (4th Cir. 1970) (finding *prima facie* showing of fraud and mismanagement, absent insolvency, is sufficient basis for appointment of receiver); *SEC v. Keller Corp.*, 323 F.2d 397, 403 (7th Cir. 1963) ("[I]t is hardly conceivable that the trial court should have permitted those who were enjoined from fraudulent misconduct to continue in control of [the corporate defendant's] affairs for the benefit of those shown to have been defrauded.").

Here, it is clear that defendants cannot be relied upon to operate their Internet operation legitimately. For at least sixteen months, defendants have been operating a business permeated by fraud. They have continued their fraudulent practices in spite of repeated warnings from all of the major credit and debit card networks. Indeed, despite being notified by Visa in July 2000 that it intended to close their account, defendants' chargeback and credit record for August and September continued to be one of the worst of any merchant in the Visa network.

Whatever proposals defendants make for continued operations should be directed through a receiver who can provide the Court with an independent assessment of those proposals. Moreover, if defendants are allowed to remain in control of their business, it is also likely that evidence of their fraud will be destroyed and that the fruits of their illegal activity will be misappropriated. The appointment of a receiver will eliminate those risks without disrupting any legitimate business activity. At the same time, a receiver will be helpful to the court in determining the extent of defendants' fraud, tracing

the proceeds of that fraud, preparing an accounting, and making an independent report of defendants' activities to the Court.[90]

3. Immediate Access and Expedited Discovery Is Essential

In addition, the Commission seeks to obtain immediate access to defendants' business premises at 8601 North Scottsdale Rd and their mail drop at 13771 Fountain Hills Blvd. in order to locate assets wrongfully obtained from defrauded consumers and to ensure that no tampering with or destruction of records or accounting books occurs.[91] Given the mobile nature of defendants' business and the egregious amount of fraud committed by it during the past sixteen months, there is a substantial danger of record destruction or asset movement. In fact, Defendants' can conduct business from virtually any location, including their residences. The immediate access provisions would forestall this and help preserve assets for the many consumers who have been defrauded by defendants' practices. This relief has been granted regularly in similar FTC actions, including in the District of Arizona.[92]

To prepare for the Show Cause hearing, the Commission also seeks leave of Court to expedite discovery. District courts are authorized to depart from normal discovery procedures and fashion discovery by order to meet discovery needs in particular cases.

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[90] In *J.K. Publications*, the Receiver, Robb Evans & Associates, located and helped preserve millions of dollars of defendants' off-shore assets. Defendants were held in contempt in connection with transfers of these assets. 99 F. Supp.2d at 1179-1180.

[91] In *J.K. Publications*, 99 F. Supp.2d at 1193, a CD-ROM purportedly containing defendants' customer service records "disappeared," and was never provided to the Receiver or the FTC.

[92] *See* citations, *supra*, at note 88.

Fed. R. Civ. P. 1, 26(b), 34(b). Specifically, the Commission seeks permission to subpoena certain critical records related to defendants' customer service operation, and sales, which appear to be held by third parties; to conduct depositions of custodians of these records; and to conduct depositions of defendants regarding their assets. For the limited purposes of locating and securing individual and community assets for final relief, the FTC also requests that the Court order the individual defendants to make a full financial accounting. The FTC has attached to the proposed Order copies of financial statements to be completed by the individual defendants. This type of discovery order reflects the Court's broad and flexible authority in equity to grant preliminary emergency relief in cases involving the public interest. *See Porter v. Warner Holding Co.*, 328 U.S. 395, 398 (1946); *FSLIC v. Dixon*, 835 F.2d 554, 562 (5th Cir. 1987).

4. An Ex Parte Temporary Restraining Order Should Be Issued

The defendants' widespread and persistent pattern of fraudulent conduct demonstrates the need for ex parte relief. Federal Rule of Civil Procedure 65(b), Fed. R. Civ. P. 65(b), permits this Court to enter ex parte orders upon a clear showing that "immediate and irreparable injury, loss, or damage will result" if notice is given. Proper circumstances for ex parte relief include situations where notice would "render fruitless further prosecution of the action." *In re Vuitton et Fils*, 606 F.2d 1, 5 (2d Cir. 1979); *Carroll v. Princess Anne*, 393 U.S. 175, 180 (1968). As is set forth in the Declaration of Counsel pursuant to Rule 65(b), notice to defendants would cause irreparable injury. Defendants are regularly billing consumers and receiving payments. It is very likely that payments would be transferred overseas, in the regular course of business, during any

time given before a noticed hearing. The ex parte relief that the Commission seeks is critical to preserve the status quo for the possibility of full and effective final relief. If providing notice of this action were to lead to destruction of documents or the secretion of assets, it would irreparably harm the Commission's ability to secure effective final relief for consumers. *See Cenergy Corp. v. Bryson Oil & Gas PLC,* 657 F. Supp. 867, 870 (D. Nev. 1987) ("[I]t appears proper to enter the TRO without notice, for giving notice itself may defeat the very purpose for the TRO.").

Consumer fraud cases, such as this one, fit squarely into the category of situations where ex parte relief is not only appropriate, but necessary to make possible full and effective final relief. As demonstrated, defendants RJB, Robert Botto, and Richard Botto are engaged in a deceptive and unfair scheme that exposes them to substantial potential monetary liability, and thus, they have every incentive to secrete recoverable assets if given notice of this action. As noted in the Declaration of Counsel pursuant to Rule 65(b), the FTC's past experiences have shown that, upon discovery of impending legal action, defendants engaged in similar schemes withdrew funds from bank accounts. Consequently, providing notice of this action would likely impair the FTC's ability to secure relief for consumers by prompting concealment of assets, a result that would cause immediate and irreparable harm.

IV. CONCLUSION

The defendants have caused and are likely to continue to cause great injury to consumers through their deceptive and unfair practices, in violation of Section 5(a) of the FTC Act. To halt those practices and to help ensure the possibility of effective final

relief in the form of monetary redress to consumers, the FTC respectfully urges that this Court issue the proposed ex parte Temporary Restraining Order appointing a receiver; freezing assets; providing immediate access to defendants' business premises; permitting expedited discovery; ordering a financial accounting; and ordering defendants to show cause why a permanent receiver should not be appointed and why a preliminary injunction should not issue.

Dated this __ day of October, 2000

Respectfully submitted,

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