

FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FEDERAL TRADE COMMISSION,
Plaintiff-Appellee,

v.

NEOVI, INC., DBA Neovi Data
Corporation, DBA Qchex.com; G7
PRODUCTIVITY SYSTEMS, INC., DBA
Qchex.com; JAMES M. DANFORTH,
individually, and as an officer of
Neovi, Inc. and G7 Productivity
Systems, Inc.; THOMAS VILLWOCK
individually, and as an officer of
Neovi, Inc.,

Defendants-Appellants

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No. 09-55093

D.C. No.
3:06-cv-01952-JLS-
JMA

ORDER
AMENDING
OPINION AND
AMENDED
OPINION

Appeal from the United States District Court
for the Southern District of California
Janis L. Sammartino, District Judge, Presiding

Argued and Submitted
March 4, 2010 San Diego, California

Filed May 14, 2010
Amended June 15, 2010

Before: Michael Daly Hawkins, Sidney R. Thomas, and
M. Margaret McKeown, Circuit Judges.

Opinion by Judge McKeown

8740

FTC v. NEOVI, INC.

COUNSEL

Michael L. Mallow (argued), Los Angeles, California, for the appellants.

Lawrence DeMille-Wagman (argued), Washington, DC, for the appellee.

ORDER

The court's opinion, filed May 14, 2010, is amended as follows:

At page 6989 of the slip opinion, replace <We examine here the reach of § 5 of the Act, which empowers the FTC to pre-

vent the use of ^aunfair methods of competition in or affecting commerce^o 15 U.S.C. § 45(a)(1).> with <We examine here the reach of § 5 of the Act, which empowers the FTC to prevent the use of ^aunfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce^o 15 U.S.C. § 45(a)(1).>.

OPINION

McKEOWN, Circuit Judge:

The Federal Trade Commission (^aFTC^o) has broad powers under the FTC Act to prevent businesses from engaging in unfair or deceptive practices. 15 U.S.C. §§ 41-58. This case arises from a website managed by Neovi Data Corporation (DBA Qchex.com), G7 Productivity Systems (DBA Qchex.com), James Danforth, and Thomas Villwock (together ^aQchex^o) that created and delivered unverified checks at the direction of registered users. During its six-year run, fraudsters and con artists extensively abused the website.

We examine here the reach of § 5 of the Act, which empowers the FTC to prevent the use of ^aunfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce^o 15 U.S.C. § 45(a)(1). The key issue on appeal is whether Qchex is liable for causing substantial injury to consumers that is not reasonably avoidable or outweighed by countervailing benefits. 15 U.S.C. § 45(n). The district court granted summary judgment in favor of the FTC, finding that Qchex's profound lack of diligence, coupled with the affirmative acts of creating and delivering hundreds of thousands of unverified checks over 150,000 of which were from accounts later frozen for fraud warranted liability under the Act. Qchex was ordered to disgorge \$535,358 in revenue and permanently enjoined from operating any similar business without taking appropriate, specified measures to protect consumers. We affirm.

8744

FTC v. NEOVI, INC.

Federal Communications Commission, and, ironically, the FTC itself.

Qchex contends that it was attuned to the risk of fraud from the outset and acted responsibly to curtail it. Before 2005, Qchex argues that it took multiple fraud reduction measures, pointing specifically to the "Qchex Monitor" system that enabled employees to spot irregular activity like the presence of large volumes of high-denomination checks. Internet Protocol addresses associated with fraudulent transactions were blacklisted and Qchex placed warnings on the checks alerting the payees that it could not verify whether the check was duly authorized by the payors. On a case-by-case basis, Qchex froze suspicious accounts. Finally, Qchex encrypted the check data it transmitted over the Internet and used barcoding to obscure account data on the face of the checks it issued.

None of these measures proved successful. The Qchex Monitor was underutilized and does not appear to have been employed in any focused way to target or unearth fraud. The rest of the measures were either reactive—taking place after fraud had already occurred—or unresponsive to the chief concern that checks were being drawn against unauthorized accounts.

In 2005, after meeting with the American Banking Association and the Federal Deposit Insurance Corporation, Qchex implemented a "micro-deposit" program called the "Qchex Validation System" ("QVS"). To verify that a user's account was legitimate, Qchex made a single, nominal deposit of somewhere between three and twenty cents in the account the user provided. The user was required to check the account to determine the deposit's value. Qchex declined to deliver checks from a provided account unless the user was first able to accurately report the value of the micro-deposit. After three failed attempts, the Qchex account would be frozen.

Although it was a step in the right direction, QVS had a number of loopholes that rendered it ineffective. For example,

it only applied to accounts that were newly activated. Users who had balances established before the new security system was adopted were still able to send checks by mail. Even for new users the system was easy to game. Because QVS validated just one bank account per registered user, as long as a user had legitimate access to one bank account, other accounts—possibly unauthorized—could be used without verification through QVS. Significantly, the new system did not apply to emailed checks at all. Whatever its failings, the QVS system was short lived. For reasons that are unclear, the payment processor that enabled Qchex to run the system terminated its contract in April 2006.

ANALYSIS

I. UNFAIR PRACTICES UNDER § 5 OF THE FTC ACT

[1] Under § 5 of the FTC Act, an unfair practice or act is one that ^acauses or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.^o 15 U.S.C. § 45(n).

A. Causation

The district court found that Qchex is liable for the ^a[u]nfair creation and delivery of unverified checks.^o Qchex urges that this charge is both ^alegally^o and ^aliterally^o impossible. It claims that only users can create checks because ^awithout user input nothing, and certainly not a check, . . . could be created or delivered.^o This semantic argument is meant to encompass not only the causation requirement, but also Qchex's claim that it was not given adequate notice of the charges.

[2] Qchex's challenge to causation is best captured in its statement that it did not ^aobtain, input or direct^o the delivery of consumer information nor facilitate the theft. This spin

ignores the fact that Qchex created and controlled a system that facilitated fraud and that the company was on notice as to the high fraud rate. Qchex's approach would immunize a website operator that turned a blind eye to fraudulent business made possible only through the operator's software. Even if the creation of the checks was impossible without user input,

it is common practice for states with consumer protection statutes modeled on the FTC Act to rely on federal authority when interpreting those statutes, the reverse is not the case. As the FTC points out, given the abundance of state laws on which such interpretations could be based, this practice would likely result in a sea of inconsistent rulings. See *Orkin Exterminating Co., Inc. v. FTC*, 849 F.2d 1354, 1363 (11th Cir. 1988) (noting that there is nothing constraining the FTC ^ato follow judicial interpretations of state statutes in construing the agency's section 5 authority^o).

Qchex also criticizes the district court's reliance on two unpublished district court cases. Although not precedential, these cases are instructive insofar as they illustrate the role of a facilitator under the FTC Act.

In *FTC v. Windward Marketing, Ltd.*, the court found multiple defendants liable for a magazine telemarketing scheme in which defendants obtained victims' banking information over the phone and illegitimately debited their accounts for magazine subscriptions they did not realize they were purchasing. Defendant Wholesale Capital Corporation (^aWholesale^o) maintained several bank accounts used to collect on victims' invoices. See No. Civ.A. 1:96-CV-615F, 1997 WL 33642380, at *11-*12 (N.D. Ga. Sept. 30, 1997). The court noted that 40% of the drafts were returned unauthorized and that, at the very least, Wholesale was ^aon notice of a high probability of fraud and/or unfairness^o Id. at *13.

Although Wholesale did not itself make any misrepresentations or initiate the fraudulent scheme, the court found Wholesale liable under the FTC Act because it ^afacilitated and provided substantial assistance to [a] . . . deceptive scheme,^o resulting in substantial injury to consumers. Id. at *12-*13. This conduct was enough to find Wholesale primarily liable^o as opposed to liable as an accomplice^o under the Act. Id.

Similarly, in *FTC v. Accusearch, Inc.*, Accusearch was held liable for maintaining a website that sold the GPS locations of

gious number of complaints Qchex received, its president testified that Qchex expected the site would be used for fraudulent purposes from the beginning. Qchex nonetheless continued to create and deliver checks without proper verification. By doing so it engaged in a practice that facilitated and provided substantial assistance to a multitude of deceptive schemes.

[6] To be clear, none of this is to say that Qchex is liable under a theory of aiding and abetting. Qchex engaged in behavior that was, itself, injurious to consumers. Qchex's

B. Substantial Injury

[8] The FTC met its burden of establishing substantial injury; there is no triable issue of fact with respect to this issue. The district court based its findings on record facts that it pulled from various sources, including Qchex's database, Qchex's declarations, and consumer complaints. Qchex's claim that the district court based its findings on ^aspeculation, not evidence,^o is without support.

The district court acknowledged that the number of fraudulent items created could not be definitively quantified, but it also said that more than half the total value of all the checks drawn with the help of Qchex came from accounts later frozen for fraud. That concrete and quantifiable finding is sufficient to show substantial harm because it establishes that consumers ^awere injured by a practice for which they did not bargain.^o See *Windward Marketing*, 1997 WL at *11 (citing *Orkin Exterminating Co.*, 849 F.2d at 1364-65). An act or practice can cause ^asubstantial injury^o by doing a ^asmall harm to a large number of people, or if it raises a significant risk of concrete harm.^o *Am. Fin. Servs. Ass'n v. FTC*, 767 F.2d 957, 972 (D.C. Cir. 1985) (quotation marks and citations omitted) cert. denied, 475 U.S. 1011 (1986).

Finally, in an effort to skirt liability, Qchex observes that because the victims of fraud already had their banking information compromised, they would have had to spend time protecting their accounts whether or not the Qchex system was instrumental in their loss. *Iwming Chnbaser oe heehad tChnbask* ^asubstantial injuad tC(consume,if ie is ne denauselso yes that) Tj 0 -14.2 Td 81.6 Tw matisk

frauds stemming from the Qchex system involved victims whose account information was not compromised.⁶

C. Reasonable Avoidability

[9] In determining whether consumers' injuries were reasonably avoidable, courts look to whether the consumers had a free and informed choice. See *Am. Fin. Servs. Ass'n*, 767 F.2d at 976. Qchex argues that there are triable issues of fact

put forth admissible evidence demonstrating that Neovi realized \$535,358 in 'ill gotten gains.'⁹ The district court derived this specific figure from the gross receipts on Neovi's tax return, the details of which were not disputed.⁹ Qchex argues that the figure is invalid because Qchex's revenues were exceeded by developing, maintenance, and operating costs for the software and website.

Qchex's argument is puzzling. The court explicitly declined to reduce the disgorgement by the cost of developing and maintaining the Qchex system because those activities^a facilitated and contributed to the check fraud,^o and because Qchex did^a not offer evidence showing exact costs or expenses which the Court could reasonably use in its calculations.^o It is unclear what facts could be uncovered at an evidentiary hearing that Qchex did not have the opportunity to present to the district court. In any case, as the FTC points out, the disputed points appear to be questions of law, not of fact.

III. THE INJUNCTION

[13] Under the injunction order, Qchex is prohibited from

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[14] According to the most general understanding of the distinction between mandatory and prohibitive injunctions, the district court's order is prohibitive, not mandatory. See Black's Law Dictionary 855 (9th ed. 2009) (defining "prohibitive injunction" as an injunction that "forbids or restrains an act," and "mandatory injunction" as an injunction that "orders an affirmative act or mandates a specified course of conduct"). The prohibition contains an exception, but this language does not convert it from a prohibitive to a mandatory injunction; Qchex is not ordered to undertake any affirmative action.

AFFIRMED.