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SOUTHERN DISTRICT OF CALIFORNIA

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UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA

ORIGINAL

FEDERAL TRADE COMMISSION,  
  
Plaintiff,  
  
v.  
  
NEOVI, INC., d/b/a NEOVI DATA  
CORPORATION and QCHEX.COM, et al.,  
  
Defendants.

CIVIL NO. ~~06CV 1952~~ R JMA

MEMORANDUM OF  
POINTS AND  
AUTHORITIES IN  
SUPPORT OF PLAINTIFF'S  
MOTION FOR  
TEMPORARY  
RESTRAINING ORDER  
WITH OTHER EQUITABLE  
RELIEF AND ORDER TO  
SHOW CAUSE

*RM*

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1 **I. INTRODUCTION**

2 Defendants offer online check printing services to the public via their website  
3 www.qchex.com. Defendants did not and still do not require a customer requesting those  
4 services to demonstrate that he or she has authority to write checks on an identified bank account.  
5 As a result of Defendants' failure to verify their customers' authority to write checks drawn on  
6 identified accounts, Defendants have created and delivered numerous bogus checks for fraud  
7 operators. As described in greater detail below, this pattern of conduct harms both the persons  
8 whose bank accounts have been used without their authorization, and those persons who have  
9 received the fraudulent checks as payment.

10 Prior to September 2005, Qchex offered their services without even the pretense of  
11 verifying their customers' authority to write checks on identified bank accounts before  
12 Defendants created and delivered checks for them. Anyone could open a Qchex account with  
13 any bank account number and Qchex would create and deliver checks for them. Indeed, the  
14 name and address the Qchex customer entered did not need to match the name and address on the  
15 bank account. Since approximately September 5, 2005, Defendants have implemented and  
16 subsequently abandoned a series of purported verification procedures, presumably to rectify the  
17 inadequacies in their business model. However, as discussed below, their efforts have been  
18 ineffective and poorly implemented, and individuals and businesses continue to be harmed by  
19 Defendants' business practices.

20 By creating and delivering checks without taking steps to verify that the customers have  
21 authority to write checks on the bank accounts provided to Qchex, Defendants have engaged and  
22 continue to engage in "unfair" acts or practices that violate Section 5 of the Federal Trade  
23 Commission Act ("FTC Act"), 15 U.S.C. § 45(a) and (n). As discussed below, these unfair  
24 practices cause or are likely to cause substantial consumer injury, that injury is not outweighed by  
25 countervailing benefits, and it is not reasonably avoidable by consumers. In order to halt  
26

1 immediately these unfair practices and to remedy effectively the substantial harm these unfair  
2 practices cause, the Federal Trade Commission (“Commission” or “FTC”) seeks temporary,  
3 preliminary, and permanent injunctive relief, as well as other equitable remedies, including  
4 restitution and disgorgement, pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b). In its  
5 proposed Temporary Restraining Order (“TRO”) filed herewith, the Commission asks this Court  
6 to order Defendants, among other things, to stop engaging in their unfair practices.

7 Defendants have received notice of the harm caused by the Qchex website from banks,  
8 individuals, businesses, the Federal Deposit Insurance Corporation (“FDIC”), and the FTC.  
9 Nevertheless, Defendants have persisted in their course of conduct, even after being notified  
10 repeatedly and from numerous quarters of the substantial injury it causes. Because Defendants  
11 have demonstrated that they are unwilling to modify their business practices to incorporate  
12 safeguards to stop the harm, Plaintiff respectfully requests that the Court issue a TRO that,  
13 among other things, would immediately halt Defendants’ unfair practices. In support of this  
14 motion, Plaintiff has filed nineteen exhibits demonstrating Defendants’ law violations and their  
15 failure to remedy them despite repeated notice.<sup>1</sup>

16 **II. PARTIES, JURISDICTION, AND VENUE**

17 **A. Parties**

18 **1. Plaintiff**

19 Plaintiff, the Federal Trade Commission, is an independent agency of the United States  
20 Government created by statute. 15 U.S.C. § 41 *et seq.* The Commission is charged, *inter alia*,

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21  
22 <sup>1</sup> The evidence cited in this memorandum references the nineteen exhibits filed herewith  
23 titled *Exhibits in Support of Plaintiff’s Motion for Temporary Restraining Order and Other*  
24 *Equitable Relief* (PX1-PX19). Cites to the information in these exhibits include, in the following  
25 order: (a) exhibit number; (b) paragraph number within the exhibit; (c) letter of relevant  
26 attachment, if any; and (d) page number. (For example: PX1 ¶5, Att. A, pp. 3-4). For privacy  
reasons, sensitive personal and financial information or other confidential information contained  
in the declarations (or attachments thereto) has been redacted. Some additional sensitive  
information was redacted after the declarants signed their declarations.

1 with enforcement of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), which prohibits unfair or  
2 deceptive acts or practices in or affecting commerce. The Commission is authorized to initiate  
3 federal district court proceedings, by its own attorneys, to enjoin violations of the FTC Act and to  
4 secure such other equitable relief as may be appropriate. 15 U.S.C. § 53(b); *FTC v. H.N. Singer,*  
5 *Inc.*, 668 F.2d 1107, 1111-13 (9th Cir. 1982).

## 6 2. Defendants

7 Defendants Neovi, Inc., d/b/a Neovi Data Corporation and Qchex.com, G7 Productivity  
8 Systems, Inc. d/b/a Qchex.com, James M. Danforth, and Thomas Villwock (also referred to  
9 collectively as “Qchex” or “Defendants”) operate their business through two corporate entities,  
10 Neovi, Inc. and G7 Productivity Systems. As discussed below, G7 and Neovi are very closely  
11 related and operate as a common enterprise.

12 Defendant **Neovi, Inc.** (“Neovi”) is a California corporation with its current principal  
13 place of business located at 10946 Willow Court, #100, San Diego, California 92127.<sup>2</sup> It has  
14 used and continues to use the address 10710 Thornmint Road, San Diego, California 92127.<sup>3</sup>  
15 Neovi does business under the name Neovi Data Corp. and Qchex.com.<sup>4</sup> Since 2000, Neovi has  
16 offered check writing services to the public on Qchex.com.<sup>5</sup>

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21 <sup>2</sup> PX15 ¶39, Att. R, pp.1995-96, 2003-04, Att. S, pp. 2008-11 (corp. filings); PX14 ¶23,  
Att. C, p. 863 (address on Qchex.com).

22 <sup>3</sup> PX15 ¶39, Att. R, pp. 2000, 2002, 2006 (corp. filings), ¶42 (domain name  
23 registrations); PX9 ¶9, Att. D, p. 331 (company business cards).

24 <sup>4</sup> PX15 ¶39, Att. S, pp. 2006-11 (fictitious business name filings).

25 <sup>5</sup> PX15 ¶39, Att. R pp. 1996 (art. of incorp.); PX9 ¶10, Att. E, pp. 336, 341 (FDIC  
26 presentation).



1 Defendant **G7 Productivity Systems** (“G7”), is a California corporation with its principal  
2 place of business located at 10946 Willow Court, #100, San Diego, California 92127.<sup>6</sup> It also  
3 uses and has used the address 10710 Thornmint Road, San Diego, California 92127.<sup>7</sup> Since  
4 2000, G7 has offered, in concert with Neovi, check writing services to the public on Qchex.com.<sup>8</sup>

5 Defendant **James M. Danforth** is an officer of Neovi and an officer and agent of G7.<sup>9</sup>  
6 Defendant **Thomas Villwock** is the Chief Executive Officer and a director of Neovi.<sup>10</sup>

7 **B. Jurisdiction and Venue**

8 The Court has subject matter jurisdiction over the allegations pursuant to 15 U.S.C.  
9 §§ 45(a), 53(b), and 28 U.S.C. §§ 1331, 1337(a), and 1345. Venue in the United States District  
10 Court for the Southern District of California is proper under 15 U.S.C. §§ 53(b), and 28 U.S.C.  
11 § 1391(b) and (c). Neovi and G7’s principal place of business is located in this district at 10946  
12 Willow Court, #100, San Diego, CA 92127.<sup>11</sup> They have used the address at 10710 Thornmint  
13 Road, San Diego, CA 92127,<sup>12</sup> but as of June of 2006 that property appears to be vacant.<sup>13</sup>

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14  
15  
16 <sup>6</sup> PX15 ¶39, Att. R, pp. 1993-94 (corp. filings); PX10 ¶5, Att. B, p. 344 (G7 products at Willow Street address).

17  
18 <sup>7</sup> PX15 ¶39, Att. R, pp. 1998, 2001, 2004 (corp. filings), ¶42 (domain name registrations).

19  
20 <sup>8</sup> PX15 ¶60, Att. KK, p. 2169 (Qchex advertised on G7ps.com as an “online service” of G7); ¶63, Att. MM, p. 2188 (same); ¶65, Att. OO, pp. 2199-2200; ¶66, Att. PP, pp. 2201-09; ¶67, Att. QQ, pp. 2210-12.

21  
22 <sup>9</sup> PX15 ¶39, Att. R, pp. 1998, 2001, 2004 (corp. filings).

23  
24 <sup>10</sup> PX15 ¶39, Att. R, pp. 2003, 2005 (corp. filings).

25  
26 <sup>11</sup> *See supra* notes 2 & 6.

<sup>12</sup> *See supra* notes 3 & 7.

<sup>13</sup> PX10 ¶4, Att. A, pp. 359-60.

1 Defendants Danforth and Villwock are principals of Neovi and G7 and they transact or have  
2 transacted business in this District.<sup>14</sup>

3 **III. STATEMENT OF FACTS**

4 Defendants offer an online check creation and delivery service to members of the public  
5 without verifying that the persons who request the creation and delivery of the checks have  
6 authority to draw checks on the specified bank accounts. Such conduct has caused harm and  
7 continues to harm individuals and businesses through the United States.<sup>15</sup>

8 **A. Defendants' Unfair Business Practices**

9 **1. How the Qchex Website Works**

10 Qchex creates checks for its customers through its website at *www.qchex.com* and sends  
11 the checks to third parties.<sup>16</sup> To use the Qchex website, a customer establishes a Qchex account  
12 by entering his or her purported name and email address, and creating a password for the Qchex  
13 account.<sup>17</sup> Initially, to identify a bank account to Qchex, a Qchex customer must enter: the  
14 purported name and address of the purported payer; the purported name, address, and telephone  
15 number of the bank purportedly holding the account; the bank routing number and bank account  
16 number from which checks will be written; and a starting check number.<sup>18</sup> To then create a  
17 check on the Qchex website, the customer provides the name and address of the payee and the  
18

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19 <sup>14</sup> See *supra* notes 9-10.

20 <sup>15</sup> See, e.g., PX1-PX8, PX16 (Declarations of individuals and businesses); PX13 ¶¶5-11  
21 (summary of FTC complaints).

22 <sup>16</sup> PX15 ¶45, Att. U, pp. 2021-22, 2030-31, 2035; PX14 ¶4, Att. A, pp. 499-509, 529.

23 <sup>17</sup> PX15 ¶¶5-6, Att. A, pp. 1866-68; PX14 ¶¶11-12, Att. B, pp. 730-33, ¶72, Att. P, pp.  
24 1264-65.

25 <sup>18</sup> PX15 ¶7, Att. A, pp. 1868-73; PX14 ¶17, Att. B, pp. 786-805, ¶77, Att. P, pp. 1299-  
26 1317.

1 payment amount.<sup>19</sup> Qchex will place either a digital signature<sup>20</sup> that the customer provides or the  
2 payer's typed name and the words "Signature Not Required" on the checks.<sup>21</sup> In the past, Qchex  
3 customers also had the option to send Qchex a bank logo to be printed on the checks.<sup>22</sup> At the  
4 customer's request, Qchex either will print and send the check directly to the payee via U.S. mail  
5 or will send a link to an electronic image of the check to the payee via email.<sup>23</sup> Consumers  
6 receiving links to the electronic images of the checks can print out the checks from their  
7 computers.<sup>24</sup> Consumers receiving checks from Qchex then take the checks to their banks to  
8 deposit the checks into their bank accounts.<sup>25</sup>

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11 <sup>19</sup> PX15 ¶15, Att. E, pp. 1909-25; PX14 ¶¶38-41, Att. F, pp. 1042-54, ¶¶60-61, Att. L,  
12 pp. 1199-1203, ¶¶78-79, Att. P, pp. 1321-31.

13 <sup>20</sup> See, e.g., PX14 ¶¶62-63, Att. L, p. 1220; PX2 ¶¶2, 6, Atts. A, B, pp. 67, 69.

14 <sup>21</sup> PX15 ¶45, Att. U, pp. 2030-31, 2043, 2061, 2083; PX14 ¶4, Att. A, pp. 508, 539, ¶22,  
15 Att. C, p. 859; see, e.g., PX15 ¶¶16-17, Att. F, p. 1926, ¶¶23-24, Att. K, p. 1971; PX14 ¶48, Att.  
G, p. 1129, ¶84, Att. P, p. 1371; PX1 ¶9, Att. A, pp. 12, 16, 20, 22-25.

16 <sup>22</sup> PX15 ¶15, Att. A, p. 1874 (page stating "please click on logo, or signature to add, edit  
17 or delete); see, e.g., PX1 ¶9, Att. A, p. 16.

18 <sup>23</sup> PX15 ¶45, Att. U, p. 2032; PX14 ¶126, Att. EE, p. 1750; see, e.g., PX15 ¶¶16-17, Att.  
19 F, pp. 1926-27 (check sent by U.S. Mail); PX14 ¶¶42-48, Att. G, p. 1129 (check printed from  
20 email link). Recently, Qchex has claimed that it will send the check directly to the bank of the  
payee for deposit to the payee's account. PX14 ¶126, Att. EE, p. 1750 ("Qchex can send checks .  
.. directly to your bank account).

21 <sup>24</sup> PX14 ¶¶42-48, Att. G, p. 1129 (check printed from email link), ¶¶62-63, Att. L, p.  
22 1220 (same), ¶¶80-84, Att. P, p. 1371 (same). A FTC investigator printed the checks on plain  
23 paper and the checks were accepted by the depositing banks. *Id.* The Qchex website makes  
inconsistent statements about the ink and paper required to print the checks, suggesting that  
24 recipients must or should purchase special ink and paper produced by G7 Productivity Systems.  
See PX15 ¶44, Att. T, p. 2019, ¶52, Att. BB, p. 2121, ¶53, Att. DD, p. 2130.

25 <sup>25</sup> See, e.g., PX6 ¶13; PX7 ¶5; PX8 ¶4; see also PX13 ¶¶9-10 (complaints by consumers  
26 receiving and depositing checks).

1                   **2. Defendants Create and Deliver Unauthorized Checks**

2           Defendants create and deliver checks for their customers without verifying the customers'  
3 authority to write checks drawn on accounts identified by those customers. As described below,  
4 Defendants have adopted – and subsequently abandoned – a series of purported verification  
5 procedures, but they have failed to implement any procedures that safeguard against the harm  
6 they cause.

7                                   **a. Defendants Initially Created and Delivered Checks Without Any**  
8                                   **Pretense of Verification**

9           Before September 2005, Qchex created checks using the information supplied by its  
10 customers without even a pretense of verifying that the customers possessed authority to write  
11 checks from the bank accounts on which the checks were to be drawn. Anyone with access to  
12 the Internet could request checks from any bank account on qchex.com, and Defendants would  
13 create and deliver the checks for them without any apparent oversight.<sup>26</sup> The evidence shows that  
14 Qchex created checks even when the customer's name and mailing address differed from the  
15 name and mailing address on the bank account listed on the check and the name and mailing  
16 address on the credit card account used to pay for Qchex's services.<sup>27</sup> Indeed, Qchex created and  
17 sent out a check for a customer using the sample account information listed on the sample check  
18 on the Qchex website "Quick Demo."<sup>28</sup>

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21                   <sup>26</sup> See PX5 ¶13 (statement of Qchex employee to a consumer); see, e.g., PX15 ¶¶5-7, 15-  
22 17. Att. F, p. 1926.

23                   <sup>27</sup> PX15 ¶¶5-7, 13-17, Att. F, p. 1926.

24                   <sup>28</sup> See PX15 ¶45, Att. U, pp. 2032-33 and PX1 ¶12, Att. C, p. 42 (consumer who  
25 received a check drawn on an account purportedly held by "ABC Company" in Sun City, CA,  
26 which is the same name and account number as on the sample check that Qchex uses in its  
"Quick Demo" on Qchex.com).

1           FTC Investigator Linda Henry tested the Qchex system in July and August 2005.  
2 Investigator Henry created a Qchex account in the name of "Sydney Brazen" by supplying a  
3 Yahoo email address and creating a password.<sup>29</sup> Investigator Henry then identified an undercover  
4 bank account to Qchex by entering its number and a mailing address on Qchex.com.<sup>30</sup> The name  
5 "Sydney Brazen" was not an authorized signatory on the bank account and was not associated  
6 with the bank account in any way.<sup>31</sup> Investigator Henry pre-paid Qchex \$10 for its services with  
7 an undercover FTC credit card account held under yet another name.<sup>32</sup> Investigator Henry then  
8 requested that Qchex create a check for \$100 and send it to a fictitious undercover identity with  
9 the initials "M.S."<sup>33</sup> Qchex accepted Investigator Henry's payment from the credit card and  
10 generated and printed the check with "Sydney Brazen" as account holder despite the fact that  
11 "Sydney Brazen" was not an authorized signatory on the bank account.<sup>34</sup> Qchex sent this check  
12

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13           <sup>29</sup> PX15 ¶¶4-6, Att. A, pp. 1866-68.

14           <sup>30</sup> PX15 ¶7, Att. A, p. 1872.

15           <sup>31</sup> PX15 ¶7. Before September 2005, Qchex had two procedures on their website,  
16 apparently believed to be anti-fraud protections. First, a customer who established a Qchex  
17 account would receive an email message from Qchex with instructions to click on the link in the  
18 email messages to "activate" the Qchex account. *Id.* ¶12, Att. B, pp. 1896-97. Defendant  
19 Danforth has represented this verification of a customer's email address is a procedure  
20 "specifically designed to ensure authorized transactions are conducted on the Qchex system." *Id.*  
21 ¶33, Att. Q, p. 1985. Second, Defendants required their customers to agree to the Qchex Terms  
22 of Service, which, according to Danforth, "obligates all customers to act responsibly and legally."  
23 *Id.* Investigator Henry's test of the website demonstrates that neither of these requirements is an  
24 impediment to stop unauthorized check requests. Investigator Henry was able to set up a Qchex  
25 account with a Yahoo email account, and "agreeing to the Terms of Service" consisted of  
26 checking a box on the website. *Id.* ¶¶4-5, Att. A, p. 1867, ¶8, Att. A, p. 1875. These provisions  
do nothing to actually demonstrate whether the person has authority to request a check.

23           <sup>32</sup> PX15 ¶¶13-14, Att. D, pp. 1905-05.

24           <sup>33</sup> PX15 ¶¶15-16, Att. E, pp. 1910-24.

25           <sup>34</sup> PX15 ¶¶13-14, Att. D, pp. 1905-06, ¶¶15-17, Att. F, pp. 1926-27.

1 via U.S. mail to an address Investigator Henry provided for M.S.<sup>35</sup> Another FTC investigator  
2 received the \$100 check from Qchex, deposited it into the undercover bank account for “M.S.,”  
3 and the check cleared the bank account on which it was drawn.<sup>36</sup> At no time during the  
4 transaction did Qchex require Investigator Henry to demonstrate that she was authorized to write  
5 checks drawn on the bank account she identified.<sup>37</sup> The fact that the name on the check, “Sydney  
6 Brazen,” did not match either the name on the bank account or the name of the credit card used  
7 to pay for Qchex’s services was no impediment. In fact, the address that Investigator Henry  
8 asked to have printed on the check from “Sydney Brazen” differed from the address on the bank  
9 account and the credit card account.<sup>38</sup>

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11 ***b. Complaints about Qchex’s Unverified Check Creation and  
Delivery Service and Defendants’ Response***

12 In 2005, Qchex experienced rapid growth.<sup>39</sup> At the same time, both the FTC and the  
13 FDIC received increasing complaints from individual and business consumers reporting that  
14 Qchex had created and delivered unauthorized checks.<sup>40</sup> In early July 2005, the FDIC attempted,  
15 with no success, to contact Qchex about these problems.<sup>41</sup> On July 12, 2005, the FDIC issued an  
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18 <sup>35</sup> PX15 ¶¶15-17, Att. F, pp. 1926-27.

19 <sup>36</sup> PX15 ¶¶17-18, Atts. G-H, pp. 1927a, 1928.

20 <sup>37</sup> PX15 ¶18.

21 <sup>38</sup> *See supra* notes 30 & 32.

22 <sup>39</sup> *See* PX9 ¶10, Att. E, p. 341.

23 <sup>40</sup> *See* PX13 ¶5 (bulk of the complaints came in 2005); PX9 ¶¶3, 5-6, Att. B, pp. 218-  
24 329.

25 <sup>41</sup> PX9 ¶4. Many consumers also had great difficulty contacting Qchex, if they were able  
26 to reach Qchex at all. *See infra* note 88.

1 alert to Chief Executive Officers of financial institutions about fraudulent checks from Qchex.<sup>42</sup>  
 2 After issuance of the alert, representatives of Qchex, including Defendants Danforth and  
 3 Villwock, met with FDIC staff to discuss the problems with the Qchex service.<sup>43</sup> During the July  
 4 2005 meeting with the FDIC, Defendant Danforth admitted that fraudulent checks had been  
 5 issued and that they were trying to implement some procedures to address the problems.<sup>44</sup>  
 6 Danforth reported that Qchex was processing thousands of transactions per week at the time.<sup>45</sup>

7 On July 20, 2005, in response to an inquiry from the FTC, Qchex stated, through  
 8 Danforth, that Qchex had received complaints.<sup>46</sup> Defendant Danforth stated that Qchex could not  
 9 authenticate the identities of persons who requested checks and that Qchex was not responsible  
 10 for the authentication of such information.<sup>47</sup> Danforth sent a follow-up letter to the FTC in which  
 11 he explained the reason that Qchex had decided not to implement processes to verify the  
 12 authority of its customers to draw checks on the bank accounts they identified, stating, among  
 13 other things, that:

14 . . . Qchex has evaluated many possible user authentication  
 15 methods. Unfortunately, no validation means (short of a DNA  
 16 finger print in the presence of the subscriber) exist to completely  
 17 prevent abuse of Qchex . . . without harming [Qchex's] attributes  
 and conveniences for legitimate users. . . . Extensive validation  
 attempts through online data collection are self-defeating and  
 intrusive, as concerned users are (rightfully) fearful of identity theft

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19 <sup>42</sup> PX9 ¶5, Att. A, pp. 216-17.

20 <sup>43</sup> PX9 ¶¶7-24, Att. D, p. 331.

21 <sup>44</sup> PX9 ¶¶13, 18-23, Att. E, p. 341.

22 <sup>45</sup> PX9 ¶14; *see also* PX15 ¶44, Att. T, p. 2014 (website states “[t]he use of the Qchex  
 23 system has drastically increased over the past couple of years and we are completing thousands  
 of transactions every week!”).

24 <sup>46</sup> PX15 ¶31.

25 <sup>47</sup> PX15 ¶32.

1 and should not supply nor be asked to supply extensive personal or  
2 business information to any online service, including Qchex.<sup>48</sup>

3 In fact, a Qchex representative admitted to one consumer that “anyone could open a  
4 Qchex account, provided the person has a valid bank account number, bank location, and bank  
5 name, without verifying that the person in fact is authorized to use the account.”<sup>49</sup> The Qchex  
6 representative further stated that because Qchex was not a financial institution, Qchex had no  
7 way to verify or investigate whether customers opening Qchex accounts were authorized to write  
8 checks on the bank accounts that they used to open the Qchex accounts.<sup>50</sup> As further evidence of  
9 Defendants’ acknowledgment of the problem, the Qchex website advised consumers:

10 [T]here are several reasons Qchex users enjoy additional  
11 protection against fraud, including:

- 12 ● Registering your bank accounts with Qchex ensures no  
13 one else can setup or access your account numbers on the  
14 Qchex system, ...<sup>51</sup>

14 *c. Qchex’s Purported “Micro-Deposit Validation” Procedure*

15 On or about September 5, 2005, Qchex implemented the “Qchex Validation System”  
16 (“QVS”).<sup>52</sup> Through QVS, Qchex required a customer to demonstrate access to the statements  
17 for bank accounts on which a check would be drawn. When a new customer attempted to pay the  
18 required fees for Qchex services, Qchex told the customer that he or she first would have to  
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21 <sup>48</sup> PX14 ¶3, Att. Q, p. 1988.

22 <sup>49</sup> PX5 ¶13.

23 <sup>50</sup> PX5 ¶13.

24 <sup>51</sup> PX15 ¶45, Att. U, p. 2051.

25 <sup>52</sup> PX15 ¶34 (statements of Lissa Jordan).



1 “validate” the identified bank account with QVS.<sup>53</sup> In the first step of QVS, Qchex made a  
2 nominal “micro-deposit” (approximately 3-20 cents) into the bank account identified by the  
3 customer.<sup>54</sup> After looking at the bank account statement (or accessing the account online), the  
4 customer then reported to Qchex the amount of the micro-deposit.<sup>55</sup> According to the procedure,  
5 only after the customer entered the correct amount of the micro-deposit on Qchex.com would  
6 Qchex allow the customer to pay Qchex for its services and subsequently be allowed to request  
7 checks.<sup>56</sup> In September and October 2005, Investigator Henry tested Qchex’s QVS and  
8 determined that the process worked as described.<sup>57</sup> Had Defendants retained this QVS procedure  
9 and applied it consistently, much of the potential for harm might have been substantially reduced.  
10 However, Defendants left two large holes in this micro-deposit system.

11 First, Qchex represented on its website that it would create and deliver checks by email  
12 without requiring QVS at all.<sup>58</sup> Thus, Qchex apparently continued to create and send unverified  
13 checks via email. Second, Qchex did not require QVS for checks requested from any Qchex  
14 account setup before September 2005 that had a prepaid balance.<sup>59</sup> In fact, Qchex created and  
15 delivered by U.S. Mail at least one check on a pre-existing account for an FTC investigator after  
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18 <sup>53</sup> PX15 ¶20, Att. I, pp. 1942-45, 1952-55.

19 <sup>54</sup> PX15 ¶35, *see also* ¶20, Att. I, pp. 1952-54.

20 <sup>55</sup> PX15 ¶35, *see e.g.*, ¶20, Att. I, pp. 1952-54, ¶¶26-28, Atts. N-O.

21 <sup>56</sup> PX15 ¶35.

22 <sup>57</sup> PX15 ¶35, *see e.g.*, ¶20, Att. I, pp. 1952-54, ¶¶26-28, Atts. N-O. In addition, Qchex  
23 stopped accepting credit card payments for its services and required pre-payment from the actual  
24 bank account that the customer had registered with Qchex. PX15 ¶37.

25 <sup>58</sup> PX15 ¶51, Att. AA, p. 2108.

26 <sup>59</sup> PX15 ¶37 (statement of Lissa Jordan).

1 September 5, 2005.<sup>60</sup> Qchex required no verification of the investigator's authority to write  
2 checks drawn on the identified bank account.<sup>61</sup>

3 *d. Qchex's Purported Voided Check Validation Procedure*

4 In May 2006, Qchex abandoned the limited QVS micro-deposit validation procedures and  
5 began implementing other procedures. In May and June 2006, the Qchex website stated that  
6 customers would be required to fax, mail, or upload a copy of a voided check from the identified  
7 bank account before Qchex would create checks for that customer.<sup>62</sup> In addition, Qchex stated  
8 that it required each of its customers to sign a "terms of use" agreement and to fax, upload, or  
9 mail the agreement to Qchex.<sup>63</sup> The signature on the agreement would become the digital  
10 signature that Qchex would place on checks created for that customer.<sup>64</sup>

11 As in the case with the by-then abandoned micro-deposit validation procedure, Qchex's  
12 new procedure did not apply to checks created and delivered by email, a service that Qchex  
13 offered for free at that time.<sup>65</sup> FTC Investigator Roberto Menjivar tested this voided check  
14 procedure by setting up two Qchex accounts in similar fashion to Investigator Henry's account.<sup>66</sup>

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16 <sup>60</sup> PX15 ¶¶23-24, Att. K, pp. 1971-72.

17 <sup>61</sup> PX15 ¶23.

18 <sup>62</sup> PX14 ¶4, Att. A, pp. 532-33; ¶16, Att. B, pp. 777-79, ¶22, Att. C, pp. 851, 857-70.

19 <sup>63</sup> PX14 ¶22, Att. C, pp. 851, 858-60.

20 <sup>64</sup> PX14 ¶22, Att. C, pp. 858-60.

21 <sup>65</sup> See PX15 ¶69, Att. SS, p. 2221-22 (Qchex email indicating these new validation  
22 procedures would be required for checks delivered via U.S. mail which required a paid Qchex  
23 account, not for those check sent by email, which was a free service).

24 <sup>66</sup> Investigator Menjivar created two Qchex accounts using fictitious names by supplying  
25 Yahoo email addresses, creating passwords, and providing the numbers for undercover bank  
26 accounts. PX14 ¶¶10-13, 17, Att. B, pp. 730-33, 786-804, ¶¶70-73, 77, Att. P, pp. 1264-65,  
1299-1317. The fictitious names were not authorized signatories on the bank accounts and were

(continued...)

1 On three different occasions, Investigator Menjivar requested checks be created on the identified  
2 bank accounts and sent by email to three undercover identities.<sup>67</sup> Qchex generated and sent the  
3 three checks with the fictitious names as the payors despite the fact that these fictitious names  
4 were not authorized signatories on the bank accounts Investigator Menjivar identified.<sup>68</sup> Posing  
5 as the recipients of the three checks, Investigator Menjivar received and printed the checks on  
6 plain white paper and had them deposited into undercover bank accounts.<sup>69</sup> The checks cleared  
7 the bank accounts on which they were drawn and funds were made available.<sup>70</sup> In one of these  
8 instances; Investigator Menjivar, without providing any information to demonstrate authority  
9 over the identified bank account, was able to create a new Qchex account, and, on the same day,  
10 successfully request creation of a check to be sent to another undercover email account.<sup>71</sup> At no  
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13 <sup>66</sup> (...continued)

14 not associated with the bank accounts. PX14 ¶¶17, 77.

15 <sup>67</sup> PX14 ¶¶40-41, Att. F, pp. 1042-54, ¶48, Att. G, p. 1129, ¶60, Att. L, pp. 1199-1203,  
16 ¶63, Att. L 1220, ¶¶78-79, Att. P, 1321-31, ¶84, p. 1371. Initially, Qchex would not allow  
17 Investigator Menjivar to request any checks on one of his undercover Qchex accounts, so  
18 Investigator Menjivar began the voided check validation process. PX14 ¶18, Att. B, pp. 807-08,  
19 ¶¶22, 25-33. Investigator Menjivar uploaded images of a voided check and the Terms of Use  
20 Agreement on Qchex.com as instructed, but he did not use an actual check from the checking  
21 account that he had identified. PX14 ¶¶28-33, Att. D, pp. 930, 933-37, Att. E, pp. 992-96.  
22 Rather, Investigator Menjivar uploaded a sample check from the Qchex website that he had  
23 altered slightly. *Id.* After uploading the images, the website stated that Investigator Menjivar's  
24 account was "waiting for approval" and "validation pending," but still allowed him to request two  
25 checks on this account. PX14 ¶36, Att. E, p. 996, ¶39, Att. F, p. 1042.

22 <sup>68</sup> PX14 ¶¶17, 77.

23 <sup>69</sup> PX14 ¶48, Att. G, p. 1129, ¶52, Att. I, p. 1168, ¶63, Att. L, p. 1220, ¶¶67-68, Att. N,  
24 pp. 1246-47, ¶84, Att. P, p. 1371, ¶87, Att. Q, p. 1400.

25 <sup>70</sup> PX14 ¶54, Att. K, p. 1172, ¶101, Att. W, p. 1577, ¶103, Att. Y, p. 1582.

26 <sup>71</sup> PX14 ¶¶72-73, 77-79, Att. P, pp. 1329-31.

1 time during these transactions did Qchex require Investigator Menjivar to demonstrate that he  
2 was authorized to write checks drawn on the bank accounts he identified.<sup>72</sup>

3 *e. Qchex's Most Recent Purported Validation Procedures*

4 Since the first week of July 2006, Qchex has announced yet another round of purported  
5 validation procedures on its website that it does not actually implement.<sup>73</sup> Recently, Qchex.com  
6 has stated that, before creating and delivering a check for a customer, Qchex will: (a) mail an  
7 authorization code to the (physical) mailing address provided by the customer and require the  
8 customer to enter this authorization code on the Qchex website, and (b) create and deposit a  
9 check drawn on the identified bank account to pay the fees for Qchex's services and wait for that  
10 check to clear before allowing a customer to create a check.<sup>74</sup> Defendants represent that as soon  
11 as the check clears, the Qchex account would be activated.<sup>75</sup>

12 The FTC has tested the recent procedures by establishing a new test account. On  
13 September 18, 2006, Qchex created and sent two checks on Investigator Menjivar's request – the  
14 first by email and the second by U.S. Mail.<sup>76</sup> Investigator Menjivar did not enter any kind of  
15 authorization code on Qchex.com, nor did he submit any payment, before Qchex created and sent  
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17  
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19 <sup>72</sup> See PX14 ¶¶10-41, 57-61, 70-79 (describing process of setting up two undercover  
20 accounts and asking Qchex to send three checks).

21 <sup>73</sup> PX14 ¶92, Att. T, pp. 1496-97 (email notification); PX15 ¶69, Att. SS, pp. 2223-24  
(same); see also PX13 ¶17, Att. J, p. 448 (new procedures on website).

22 <sup>74</sup> PX14 ¶126, Att. EE, p. 1766. At one point, a telephone call was listed as a third  
23 validation step, but apparently was not implemented. PX 14 ¶118, Att. BB, p. 1680; PX14  
24 ¶¶119-20, Att. BB, p. 1703; PX14 ¶122, Att. CC, p. 1719.

25 <sup>75</sup> PX14 ¶126, Att. EE, p. 1766.

26 <sup>76</sup> PX19 ¶¶7-8, 10.

