No. 15-56730

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FEDERAL TRADE COMMISSION,
Plaintiff-Appellee

v.

NEOVI, INC.,
Defendant-Appellant,

On Appeal from the United States District Court
for the Southern District of California
No. 06-cv-01952-JLS-JMA
Hon. Janis L. Sammartino

ANSWERING BRIEF OF THE FEDERAL TRADE COMMISSION

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INTRODUCTION

In 2009, the district court found that appellant Thomas Villwock and his co-defendants violated the Federal Trade Commission Act by running a check creation website that enabled fraudsters to generate unauthorized checks totaling hundreds of millions of dollars. Villwock knew of the fraud yet failed to stop it.

The district court ordered Villwock to protect against such fraud when he sold any check creation products or services in the future. Specifically, Villwock must (1) verify the identity of the user and the user's control over the checking account; and (2) ensure that any check generated using his products or services includes his contact information. This Court affirmed those requirements. *FTC v. Neovi, Inc.*, 604 F.3d 1150 (9th Cir. 2010).

Villwock nevertheless continued to offer a slew of check creation products and services that failed to comply with the protective requirements. He offered these products through a changing array of corporations intended to conceal his involvement.

In late 2009, the FTC asked the district court to hold Villwock and the other defendants in contempt, which it did in 2012. Even then the violations continued. In September 2015, the district court concluded that defendants remained in contempt of the original order and were not making even token efforts to comply.

The court imposed coercive and compensatory sanctions and banned Villwock from selling blank check paper and ink.

Villwock now challenges both the underlying judgment and five separate district court orders holding him in contempt and fashioning contempt sanctions. (He has not appealed from two other orders issued by the court in the course of the contempt proceeding.) As we show below, his claims are meritless. The record fully supports the district court's detailed and well-reasoned decisions.

JURISDICTION

The district court had jurisdiction over the FTC's original complaint under 28 U.S.C. §§ 1331, 1337(a), and 1345 and 15 U.S.C. § 53(b). The district court had inherent authority to enforce its injunctive decree through contempt. *See*, *e.g.*, *Spallone v. United States*, 493 U.S. 265, 276 (1990); *Reebok Int'l Ltd. v. McLaughlin*, 49 F.3d 1387, 1390 (9th Cir. 1995). Villwock seeks review of six rulings of the district court: the underlying judgment entered on January 7, 2009; a contempt order issued July 11, 2012; three separate contempt-related orders entered on September 9, 2015; and a post-judgment order issued May 27, 2016.

The Court lacks jurisdiction over the appeal of the 2009 judgment. That judgment became final in 2009 and has already been reviewed and upheld by this Court; the time for appeal has long passed.

The Court has jurisdiction over the remaining appeals under 28 U.S.C. § 1291. Notice of appeal was timely filed on November 5, 2015, of the 2012 and 2015 orders.[1] An amended notice of appeal was timely filed on June 7, 2016, adding the 2016 post-judgment order.

QUESTIONS PRESENTED

1. Whether the district court abused its discretion when it found that Villwock could have complied with the injunction but that he did not.

2. Whether Villwock's challenge to the district court's award of compensatory sanctions is moot because a co-defendant has paid that entire judgment and Villwock no longer faces any sanction.

3. Whether the district court improperly adopted an order using the form proposed by the FTC.

4. Whether the district court had clear and convincing evidence of contempt.

5. Whether alleged public policy considerations can justify overturning a well-supported order of contempt.

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[1] This Court dismissed *sua sponte* an earlier appeal and cross-appeal relating to the July 11, 2012 contempt order for lack of jurisdiction because that order did not impose final sanctions. Dkt. 309 [SER-177-178]. (Citations to "Dkt." refer to docket entries in the underlying district court action.) This 2012 order only became final and appealable when the court imposed sanctions in September 2015.

STATEMENT OF THE CASE

A. The FTC's Original Action Against Villwock and Qchex.com.

Villwock and a group of individual and corporate co-defendants operated the website Qchex.com, which enabled users to create and deliver checks online. Qchex users could open an account merely by providing a name, e-mail address, and supporting bank account information. Once a Qchex account was open, its owner could send a check drawn on the underlying account to any payee. *FTC v. Neovi, Inc.*, 598 F. Supp. 2d 1104, 1107-09 (S.D. Cal. 2008).

Bank account information is easy to obtain (it is typically listed on all checks drawn on an account), and Qchex.com not surprisingly became a haven for the unscrupulous, who used the website to defraud consumers both by creating unauthorized checks to draw on the victims' accounts and through more elaborate schemes. *See id.* at 1109, 1111; *see also Neovi*, 604 F.3d at 1154, 1158 n.6. Although Villwock and his partners knew of this fraud, they took only limited and ineffective steps to stop it. Qchex.com accounts ultimately were responsible for nearly 155,000 unauthorized checks drawn on individuals' and entities' bank accounts (including the FTC's) totaling more than $402 million. 604 F.3d at 1154.

In 2006, the FTC sued Villwock and a group of corporate and individual co-defendants for violating the prohibition on "unfair practices" in the FTC Act, 15 U.S.C. § 45. Dkt. 1. Villwock owned and served as CEO and President of Neovi,

Inc., which operated Qchex.com. He also controlled G7 Productivity Systems, which operated a service that printed and mailed checks created through Qchex.com. *Neovi*, 598 F. Supp. 2d at 1107-08.

After finding that defendants' practices were unlawful and that there was a "significant likelihood of future violation," 598 F. Supp.2d at 1112-17; *FTC v. Neovi, Inc.*, No. 06CV1952 JLS (JMA), 2009 WL 56130, at *8 (S.D. Cal. Jan. 7, 2009), the district court ordered monetary relief of $535,358 and entered an injunction prohibiting Villwock and the other defendants from creating or delivering checks for customers without first taking specified protections against fraud. Dkt. 118 at 4-7 [ER 007-010]. We refer to that decree as the "Injunction." Villwock could have complied completely with the Injunction by refraining from creating and delivering checks, but if he chose to continue in that line of business the Injunction required the following precautions:

1. *Identity Verification Procedures*. The Injunction directed Villwock to engage a monitor or other outside party to verify the identities of prospective customers. Dkt. 118 at 4-5, 6 [ER 007-008, 009].

2. *Account Control Verification Procedures*. The Injunction directed Villwock to verify a customer's authority to draw funds on a financial account. To do so, he could either retain a monitor or other outside party (which could be the same entity that verified identities), or he could use "micro-deposits," which

involve making deposits of less than one dollar, the precise amount of which the customer then must confirm to demonstrate control over the account. Dkt. 118 at 5-6 [ER 008-009].

3. Disclosure of Contact Information. The Injunction required that Villwock's contact information—including postal address, telephone, website and e-mail address—appear on each check delivered, directly or indirectly, through his services. Dkt. 118 at 7 [ER 010]. That requirement allowed monitoring of compliance and made it easier for consumers to register complaints. Without the information, it would be impossible to trace back to Villwock any checks improperly generated by his services.

In 2007, while the case was still ongoing, Neovi declared bankruptcy, ceased operations, and shut down the Qchex.com website. 598 F. Supp. 2d at 1107. The very next day, however, Villwock established a new corporation, iProlog, that replaced the functions of Neovi, hired its employees, used its equipment, and operated out of its location. *Id.* at 1108; Dkt. 272 at 5 [ER 022].

In December 2007, Villwock launched a website called FreeQuickWire.com that offered check creation and delivery services much like Qchex.com. 598 F. Supp. 2d at 1108. The website is owned by FreeQuick Wire Corporation, a new corporation controlled by Villwock and others. Dkt. 272 at 6 [ER 023]. Villwock

served as President and his daughter Diana served as the sole director. *Id.* Villwock's company iProlog provided software services for the enterprise.

B. The Contempt Proceedings

Villwock's new website did not verify either the identity or account control of the payors and did not provide contact information on the checks it created, as the Injunction requires. Dkt. 156 [SER-319-322]; Dkt. 156-1 at 15-19 [SER-343-347]. In October 2009, the FTC moved to hold Villwock and others in contempt of the Injunction. Before a hearing could occur, however, defendants appealed the Injunction, and the district court stayed the contempt proceeding. After this Court affirmed the Injunction in May 2010, contempt proceedings resumed. *Neovi*, 604 F.3d 1150; Dkt. 179 [SER-317].

Meanwhile, the FTC had identified even more violations of the Injunction. The FTC showed that Villwock had introduced a 2010 version of a check-creation computer program called VersaCheck, which allowed users to print checks using their own computers and printers. Dkt. 182 at 7 & n.7 [SER-309]. VersaCheck 2010 did not perform the identity and account control verifications required by the Injunction and did not provide the required contact information on checks it created. *Id.* at 9-10 [SER-311-312]. Further, VersaCheck 2010 connected with FreeQuickWire.com and enabled users to deliver checks online, also without the required verifications and information. *Id.*. Defendants later disseminated newer

versions of VersaCheck, including a 2012 version and subsequent version called VersaCheck X1. Dkt. 210-1 at 5 [SER-294]; Dkt. 272 at 5 [ER 022]; Dkt. 261 at ¶¶ 583-629 [SER-230-234].

The district court held an evidentiary hearing on April 27-28 and August 31-September 1, 2011. Among other evidence, the court received declarations from multiple FTC witnesses; deposition testimony of Villwock, his co-defendants, and their corporations; live testimony from an FTC investigator and from Villwock, his daughter, and other defendants; documents; and consumer complaints and depositions. Dkt. 272 at 6-7 [ER 023-024].

C. The First Contempt Finding: The 2012 Contempt Order

On July 11, 2012, the district court held Villwock and his co-defendants in contempt of the Injunction. Dkt. 272 [ER 018-037]. We refer to the July 11 ruling as the "2012 Contempt Order." The court found that Villwock and the others had failed (1) to implement identity and account control verification procedures in VersaCheck and (2) to ensure that their contact information appeared on each check, as required by the Injunction.[2] *Id.* at 14-18 [ER 031-035].

[2] The court's analysis focused on VersaCheck because defendants had shut down FreeQuickWire.com during the pendency of the contempt proceedings. *See* Dkt. 272 at 12 [ER 029].

The district court rejected Villwock's claims that compliance with the Injunction was impossible. First, the court rejected the claim that he could not verify a user's identity through VersaCheck because it was a standalone software product (as opposed to a website). The court recognized that VersaCheck necessarily connected to the internet and therefore could verify identities. Dkt. 272 at 16 [ER 033]. Second, the court rejected Villwock's claim that once the VersaCheck software was released to the public, it was out of his control. The court held instead that Villwock "cannot seriously contend that it is impossible to upgrade or patch already existing software (or, at worst, to recall it)." *Id.* Third, the court dismissed the argument that compliance would render the software unmarketable, finding that the Injunction was based on "well-accepted and widely used" industry methods and that consumers would actually prefer software with fraud protections. *Id.* at 16-17 [ER 033-034].[3] Finally, the court found that the software failed to disclose Villwock's contact information. *Id.* at 17-18 [ER 034-035].

Having found Villwock in contempt of the Injunction, the court agreed with the FTC that sanctions were appropriate. Although the FTC asked the court to

[3] The court also rejected Villwock's claims that FreeQuickWire and VersaCheck were outside of his control and that the Injunction applied only to web-based systems like Qchex.com. Dkt. 272 at 12-14 [ER 029-031]. Villwock does not challenge these holdings in this appeal.

award $9 million in compensatory sanctions—Villwock's net receipts from the sale of check creation software and accompanying products since the Injunction—the court chose to "focus[] instead on the award of substantial coercive sanctions intended to motivate [Villwock's] complete and prompt compliance." *Id.* at 19 n.3 [ER 036].

The court thus directed Villwock and the other defendants to purge their contempt within 30 days. If they did not comply, the court ordered that on the 31st day they would be fined $10,000 for every day they failed to comply with the required verification procedures and $5,000 for each day they failed to disclose their contact information on checks created with their software. *Id.* at 19-20 [ER 036-037]. The court also imposed a compensatory "fine" of $100,000 for the violations of the contact disclosure provisions, explaining that this sanction was "to attempt restitution for consumer losses suffered as a result of [defendants'] utter disregard of this core and relatively non-burdensome provision of the [Injunction]." *Id.* at 20 [ER 037].

D. The Second Contempt Finding: The January 2014 Order

On January 10, 2014, the court found, after additional hearing and briefing, that Villwock and the others had failed to purge their contempt. Dkt. 336 [ER 038-062]. Villwock does not appeal the January 2014 order.

With respect to the newest software version, VersaCheck X1, the court determined that the software nominally met the requirements of having identity and account control verification procedures and disclosing defendants' contact information.[4] *Id.* at 11, 14-15, 23 [ER 048, 051-052, 060]. But verification relied on contractors employed by Villwock's wholly-owned company iProlog. The court thus held that it did not satisfy the Injunction's requirement that the third parties performing verification not be "related to, controlled by, or owned by any of the Defendants." *Id.* at 12-13 [ER 049-050]. Further, the court identified a 28-day period between August 10, 2012 and September 6, 2012, when the account verification process—which relied on micro-deposits—was noncompliant because users were not required to confirm the micro-deposits into their accounts. *Id.* at 13-15 [ER 050-052].

The court held that the 2010 and 2012 versions of VersaCheck software did not perform identity and account control verification and that Villwock had failed

[4] The court nevertheless expressed a concern that the identity verification procedures were inadequate because they simply asked the customer to re-confirm identifying information he had already provided. Dkt. 336 at 11 [ER 048]. The court otherwise found that VersaCheck X1 sufficiently complied with the contact disclosure provisions because defendants had in fact been contacted by recipients of the checks. *Id.* at 22-23 [ER 059-060]. The court did not directly address whether the older versions of VersaCheck sufficiently met this requirement, but otherwise found that this software remained noncompliant. Dkt. 336 at 18-21 [ER 055-058].

to take sufficient steps to upgrade them or remove them from the market. *Id.* at 18-21 [ER 055-058]. Despite these findings, the court granted Villwock another thirty-day grace period to purge the remaining areas of contempt. *Id.* at 23-24 [ER 060-061].

E. The Third Contempt Finding: The September 2015 Orders

Instead of bringing the existing products into compliance, Villwock continued to sell VersaCheck software and, in 2014, chose to issue two new check creation products: an online service called ChecksXpress and a software package based on VersaCheck called Instant Checks. Dkt. 385-1 at 12-15 [SER-163-166]. He also continued to change corporate forms, now doing business as "Global Biz Force," "Global BIZZ Force," and "Real Asset Solutions," all of which were alter egos of or successors to prior Villwock-owned businesses. Dkt. 385-1 at 7-8 [SER-158-159]; Dkt. 401 at 1-4 [SER-111-114]; Dkt. 409 at 2-3 [SER-031-032]. ChecksXpress did not even attempt to comply with the Injunction; it lacked any identity or account control verification process or contact disclosures, as confirmed by an undercover purchase made by an FTC investigator. Dkt. 414 at 11-12 [ER 472-473]; *see also* Dkt. 415 at 6-7 [ER 496-497].

On December 1, 2014, the FTC asked the court to modify the Injunction by (1) banning Villwock from participating in the check creation and delivery business entirely; and (2) imposing enhanced compliance monitoring measures.

Dkt. 385-1 at 1 [SER-152]. On September 9, 2015, the district court issued three more orders addressing the FTC's motion to modify and Villwock's continuing non-compliance.[5]

1. Modification Order

The first order responded to multiple cross-motions filed by the parties, including the FTC's motion to modify the Injunction (Dkt. 385) and a counter motion by Villwock to vacate both the Injunction and the court's earlier findings of contempt (Dkt. 393). *See* Dkt. 414 [ER 462-490].

The court addressed the FTC's motion first, finding that a failure to comply with the terms of a court order could justify modifying a final judgment. *Id.* at 11 [ER 472] (quoting *Labor/Cmty. Strategy Ctr. v. L.A. Cty. Metro. Transp. Auth.*, 564 F.3d 1115, 1120-21 (9th Cir. 2009)); *see also* Fed. R. Civ. P. 60(b)(5); *Horne v. Flores*, 557 U.S. 433, 447 (2009). The court noted Villwock's "continued, flagrant disregard for the Court's [Injunction,]" including marketing "no fewer than eight separate violative products and services" "in the six years since the [Injunction]." Dkt. 414 at 11, 13 [ER 472, 474]. His violations included, most recently, the failure of ChecksXpress to verify the customer's identity or account

[5] In the interim, James Danforth—the last remaining individual defendant other than Villwock himself—settled with the FTC, paid $100,000 in compensatory sanctions, and agreed to injunctive relief. Dkt. 413 [SER-017-028].

control and to disclose contact information on the checks presented, and the use of ever-shifting corporate forms to evade responsibility for his noncompliance. *Id.* at 11-12 [ER 472-473].

Turning to the FTC's proposed modification of the contempt order, the court determined that a ban on the sale of blank check paper and ink—and not a complete ban from the industry as sought by the FTC—was better tailored to Villwock's failure to comply. *Id.* at 19-20 [ER 480-481]; *see also id.* at 17 [ER 478] (citing *United States v. Holtzman*, 762 F.2d 720, 726 (9th Cir. 1985)). The court explained that the partial ban would lessen the illegitimate use of VersaCheck and reduce Villwock's motivation to create new check services. A tailored ban protected the public because Villwock's extensive failures to comply with the Injunction showed that his noncompliance would continue without such a ban. Dkt. 414 at 19-20 [ER 480-481].

The court then turned to Villwock's requests to vacate the Injunction. The court applied Rule 60(b)(5) to determine if there were significant changes to Villwock's circumstances, and it found none. *Id.* at 21-25 [ER 482-486].

The court rejected Villwock's claim that it was not possible to comply with the Injunction. Villwock had asserted that he could not discontinue the supply and distribution of check creation tools or prevent existing or future consumers from using such tools and that, despite his best efforts, he had "not been able to develop

a single product, which would allow the creation and delivery of 'verified' checks, as defined by the [Injunction]." *Id.* at 23 [ER 484] (citation omitted). He also claimed that the impossibility of compliance placed him in a "state of perpetual contempt." *Id.* The court rejected this, finding that Villwock's own conduct was the "sole reason" he remained in contempt because he "refus[ed] to do all that is necessary to comply with the Court's demands." *Id.* at 24 [ER 485]. As the court found, Villwock remained able to comply with the Injunction, including by ceasing to offer check creation products. As the court stated, "Villwock . . . always had [the] option of simply exiting the check creation industry. That option remains in place today such that Villwock's argument that the [Injunction] can never be complied with is unpersuasive." *Id.*

2. 2015 Contempt Order

In its second order, the court determined that Villwock had not purged the contempt identified in the 2012 Contempt Order and confirmed in the January 2014 Order. Dkt. 415 [ER 491-504].

In particular, Villwock's most recent products, Instant Checks and ChecksXpress, neither verified the user's identity nor disclosed Villwock's contact information. *Id.* at 6-7 [ER 496-497]. Indeed, the new products did not even attempt to comply with the Injunction—Villwock admitted that he was "no longer

pursuing acceptable [identity] verification procedures."[6] *Id.* at 7 [ER 497]. The court found unconvincing Villwock's excuse that he could not identify an independent verification service and thus "it was simply impossible for him to comply" with the Injunction. *Id.* The court explained:

> Villwock's argument that he is unaware of anyone with the abilities to implement such procedures is insufficient to warrant a finding of impossibility. [C]ertainly there are third party vendors who specialize in [identity] verification processes that [Villwock] could have hired six years ago had [he] wanted to come into compliance with the [Injunction]. Further, Villwock has only made conclusory arguments as to impossibility; he has not explained to the Court the steps he has taken, or tried to take, with respect to finding a third party verifier. There is also no indication that [Villwock] ever attempted to utilize the monitor option outlined in the [Injunction].

Id. at 8 [ER 498].

Villwock's older products, the 2010 and 2012 versions of VersaCheck, also failed to comply with the Injunction. Villwock nevertheless claimed to have addressed the failure by having VersaCheck upgrade users to the newest version, which he claimed was compliant. *Id.* Specifically, on January 14, 2014, Villwock

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[6] The court referred to these as "account" verification procedures, but it clearly meant "identity" verification. *See* Dkt. 415 at 7 [ER 497]. The context of the discussion and the pleadings at issue both make clear, however, that Villwock was not complying because the third parties performing identity verification were not sufficiently independent, and Villwock stopped such identity verification because he allegedly could not find replacements. *See id.* at 6-7 [ER 496-497]; *see also* FTC Renewed Motion to Modify Final Order, Dkt. 385-1 at 8-9 [SER-159-160]; Villwock's Counter Motion to Vacate, Dkt. 393-2 at 6-7 [ER 388-389].

had asked VersaCheck to encourage users to stop using older versions of VersaCheck and upgrade to the newer version.[7] *Id.* Aside from that modest step, however, Villwock claimed that it was impossible for him to stop consumers from using older versions of the software. Users are beyond his control, he claimed, and attempts to remotely upgrade or disable the software would "interfere with and be harmful to users." *Id.* at 10 [ER 500].

The court rejected that claim because Villwock could have deployed mandatory upgrades or patches that would have brought older versions of the software into compliance. *Id.* Indeed, Villwock had failed to employ steps suggested by the court itself:

> In its January 10, 2014 Order, the Court explicitly identified some actions [Villwock] could take to appease the Court, namely (1) issuing a recall to third-party retailers who may still have inventory of noncompliant versions of VersaCheck, and (2) giving free software *in exchange for* noncompliant versions of VersaCheck. However, [Villwock] elected to take neither of these actions. Encouraging people to use newer versions of VersaCheck over older versions is certainly a step in the right direct[ion], but the FTC is correct that the actions [Villwock has] taken do nothing to dispose of the noncompliant versions of VersaCheck, which is the Court's ultimate concern.

[7] VersaCheck did establish a free upgrade program that it publicized with a press release in February 2014. Dkt. 415 at 8 [ER 498]. The court found the program flawed because it did not ensure that consumers stopped using the older, noncompliant versions. *Id.* at 9-11 [ER 499-501].

Id. at 11 [ER 501] (emphasis in original; citations omitted). Villwock therefore remained in contempt of the Injunction.

3. Sanctions Order

The court's third order determined the sanction for Villwock's contempt. The court recognized that it possessed "wide latitude" in that regard, particularly "where a federal agency seeks enforcement in the public interest." Dkt. 416 at 2 [ER 506] (citing *SEC v. Wencke*, 622 F.2d 1363, 1371 (9th Cir. 1980)). Sanctions could include coercive or compensatory sanctions, or both. *Id.* (citing *United States v. United Mine Workers of Am.*, 330 U.S. 258, 303-04 (1947)).

The FTC urged the Court to impose the full sanction of $15,000 per day for the period between the 2012 Contempt Order and the January 10, 2014 Order, and increase the sanction to $25,000 per day for the period after the January 10, 2014 Order. *Id.* at 3-4 [ER 507-08]. The court found it "inequitable" to impose anything other than limited sanctions for contempt prior to the January 14, 2014 Order. *Id.* at 5 [ER 509]. The court thus levied the following sanctions:

$280,000 ($10,000 per day for 28 days). The court imposed this coercive sanction for the 28-day period from August 10 to September 6, 2012, when defendants had implemented neither account control nor identity verification procedures in the VersaCheck X1 product. Dkt. 416 at 5 [ER 509]; *see also* Dkt. 336 at 15 [ER 052]. In the 2012 Contempt Order, the court had stated it was

imposing a daily fine "to motivate . . . complete and prompt compliance." Dkt. 272 at 19 n.3 [ER 036].

$100,000. The court re-imposed this compensatory sanction, which it had imposed initially in the 2012 Contempt Order "to attempt restitution for consumer losses suffered as a result" of defendants' failure to disclose their contact information on the checks they produced, a "core and relatively non-burdensome provision" of the Injunction. Dkt. 416 at 5 [ER 509]; *see* also Dkt. 272 at 20 [ER 037].

$20,000 per day starting as of the date the Sanctions Order was docketed. The court imposed ongoing daily sanctions until Villwock purged his contempt due to Villwock's repeated contumacious conduct and lack of "good faith." Dkt. 416 at 5-7 [ER 509-511]. These sanctions remain ongoing.

F. Post-Contempt Proceedings

Villwock appealed each of the September 2015 orders, the Injunction and the 2012 Contempt Order. He did not appeal the January 10, 2014 order. *See* Dkt. 423 [ER 001-003].

At the same time, Villwock also filed several motions before the district court, which the court treated respectively as a motion for reconsideration, a motion to vacate the Modification Order, and a motion to stay the September 2015 orders. *See* Dkts. 417-1 [ER 521-547], 421 [ER 551-593], 424-1 [ER 594-604].

On May 27, 2016, the court denied all of these motions. Dkt. 440 [ER 605-616]. That same day, the court entered a supplemental Injunction, which it based on a proposed order submitted by the FTC. Dkt. 441 [ER 512-520]. Villwock appealed the court's May 27, 2016 order but did not appeal the supplemental Injunction. *See* Dkt. 443 [ER 617-632].

SUMMARY OF ARGUMENT

Villwock was first held in contempt of the Injunction in 2012 and since then has barely tried to comply with it, despite having been given multiple chances to do so by the district court. He now asks this Court to overturn the district court's detailed and thorough review of his contumacious conduct set forth in three separate findings of contempt, largely on the grounds that compliance with the court's order was impossible and that his token compliance efforts were sufficient. Enough is enough. Villwock's arguments are meritless, and this Court should put to rest his nearly five years of evasion.

Villwock has appealed six separate district court orders issued over the course of this case; he does not challenge the remaining two orders. We note at the outset that the arguments raised in his brief concern only four of those six orders (the 2012 Contempt Order, the Modification Order, 2015 Contempt Order, and the Sanctions Order); he raises no genuine challenge to the remaining two (the Injunction and the 2016 order denying Villwock's various motions for

reconsideration). Moreover, his first argument (Br. 18-19) pertains to the supplemental Injunction, which he did not appeal. And while Villwock purports to appeal the original Injunction, that order has already been appealed and upheld by this Court in *Neovi*, 604 F.3d 1150; it is no longer subject to review. To the degree Villwock presents arguments challenging appealable orders, the claims fail.

1. Villwock's principal claim is that it was not possible to develop a check creation product that would comply with the Injunction's verification requirements. The claim falls flat because Villwock always had the option to simply cease offering noncompliant check creation products and services. Having deliberately chosen to engage in activity that violated the Injunction, Villwock must face the consequences of his action. Moreover, the district court identified specific steps Villwock could have taken to comply with the Injunction.

Villwock did not substantially comply with the Injunction. He has continuously failed to disclose his contact information. He has persistently failed to engage in identity and account verification. His multiple attempts to evade the Injunction by offering new products and changing his corporate forms demonstrate "little real conscientious effort" to abide by the Injunction.

2. Villwock's challenge to the $100,000 compensatory sanction is moot. The court imposed the sanction jointly and severally upon Villwock and his co-defendants; one of them has now paid the entire amount, and Villwock is free of

liability for the sanction. Even if his challenge remained live, ample evidence of consumer loss supported the sanction.

3. Villwock is wrong that the district court's supplemental Injunction impermissibly "rubberstamped" a form of order submitted by the FTC. Villwock does not even appeal that order, but it properly incorporates by reference the district court's earlier Modification Order, which rested on substantial factual findings. Indeed, the court issued detailed factual findings throughout this proceeding.

4. The district court had convincing evidence of Villwock's contempt. The record included in-court and deposition testimony based on personal knowledge, including that of Villwock himself. Villwock objects to some of that evidence on hearsay grounds, but he does not identify which hearsay he objects to. No matter, because the district court carefully determined which hearsay statements were admissible and which were not, and Villwock offers no ground for questioning its determinations. Even if it erred—which it did not—the district court also considered extensive documentary and other evidence, more than sufficient to provide "clear and convincing evidence" of contempt.

5. Finally, Villwock's "public policy" claim fails. There is no public policy that protects users of software from upgrades. But even if there were, it could not

excuse noncompliance with an injunction. Public policy favors consumer protection and obedience to district court orders.

STANDARD OF REVIEW

This Court reviews a civil contempt order for an abuse of discretion. *FTC v. EDebitPay, LLC*, 695 F.3d 938, 943 (9th Cir. 2012) (citing *FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1239 (9th Cir. 1999)). The district court abuses its discretion only if it commits legal error or makes clearly erroneous factual findings. *EDebitPay*, 695 F.3d at 943; *Affordable Media*, 179 F.3d at 1239. This Court also reviews for clear error a district court's findings that compliance with an injunction was possible. *Affordable Media*, 179 F.3d at 1239. Deference to a district court's exercise of discretion is heightened where the district court has overseen compliance with the injunction for a long period of time. *Cf. Stone v. City and County of San Francisco*, 968 F.2d 850, 856 (9th Cir. 1992).

ARGUMENT

I. VILLWOCK COULD HAVE COMPLIED WITH THE INJUNCTION, BUT HE DID NOT.

Villwock's principal claim is that he should be excused from complying with the Injunction because compliance is impossible. Br. 19-21. He argues in the alternative that he has substantially complied with the Injunction. Br. 23-26. The district court found to the contrary no fewer than three times, and nothing in Villwock's brief undermines those sound conclusions.

The Injunction required Villwock to fulfill two principal requirements: (1) that any check-creation services he provided to others must verify the identity of the user and the user's control over the checking account; and (2) that any check generated using his products or services include his contact information.[8] Villwock's products repeatedly violated the second requirement, *see e.g.*, Dkt. 272 at 17-18 [ER 034-035] (VersaCheck 2010, 2012, X1); Dkt. 414 at 12 [ER 473] (ChecksXpress), and he contends neither that complying with it was impossible nor that he substantially complied. That unchallenged violation of the Injunction is in itself sufficient to uphold the district court's contempt judgment. Should the Court reach his other arguments, however, they are meritless.

A. Compliance With The Injunction Was Possible.

Villwock claims that it was not possible for him to comply with the identity verification requirements of the Injunction. To succeed on the claim, he must demonstrate impossibility "categorically and in detail." *Affordable Media*, 179 F.3d at 1241 (citation omitted). And because the district court found multiple times that compliance was possible, he must also show that those determinations

[8] Villwock's argument heading contends that the injunction is "vague" but he makes no actual argument to that effect. "Generally, an issue is waived when the appellant does not *specifically* and *distinctly* argue the issue in his or her opening brief." *United States v. Kama*, 394 F.3d 1236, 1238 (9th Cir. 2005) (emphasis added). In any event, the injunction's specific requirements are not at all vague.

were clearly erroneous. *EDebitPay*, 695 F.3d at 943; *Affordable Media*, 179 F.3d at 1239. Villwock comes nowhere near either showing.

To begin with, compliance was not "impossible" as that term is used in the law of contempt. Villwock flouted the Injunction by deliberately distributing VersaCheck software that did not verify identity or account control as the Injunction required. Nothing required him to create and distribute the software; he could have avoided contempt entirely by not doing so. It therefore was not "impossible" to comply with the Injunction, a conclusion that the district court itself reached in rejecting Villwock's argument that he languished in a "state of perpetual contempt." Dkt. 414 at 24 [ER 485]. Impossibility defenses can be valid when an injunction requires actions that cannot be carried out. In *United States v. Rylander*, 460 U.S. 752 (1983), for example, the Supreme Court recognized that contempt would be unwarranted for failure to produce records that the defendant did not in fact possess. *Id*. at 757; *accord Falstaff Brewing Corp. v. Miller Brewing Co.*, 702 F.2d 770, 781 (9th Cir. 1983). No such circumstance exists here. Having deliberately chosen to distribute software that violated the Injunction, Villwock must face the consequences of his action. The district court's rulings may be sustained on that ground alone.

In any event, Villwock's products could have verified users' identities. The district court found that such verification is "well-accepted and widely used" in the

financial industry. Dkt. 272 at 17 [ER 034]. Indeed, in its January 2014 order, the district court found that Villwock had in fact at least nominally complied with the identity verification requirements (although Villwock nevertheless violated the Injunction by using verifiers within his control). Dkt. 336 at 10-15 [ER 047-052]. The fact that Villwock previously could—and did—verify user identities disproves his claim of impossibility.

The district court also found third-party verification was possible. "[T]here are third party vendors who specialize in [identity] verification processes," the court explained, yet Villwock failed to show "the steps he has taken, or tried to take, with respect to finding a third party verifier." Dkt. 415 at 8 [ER 498]. Even now, Villwock contends in his brief not that third-party validation was impossible, but that it was "not affordable." Br. 20. Moreover, Villwock did not even "attempt[] to utilize the monitor option outlined in" the Injunction. Dkt. 415 at 8 [ER 498]. Instead, he "made conclusory arguments as to impossibility." *Id.* Indeed, by the time of the September orders, Villwock's conduct had regressed. His most recent services, Instant Checks and ChecksXpress, abandoned all attempts at identity verification. *Id.* at 6-7 [ER 496-497].

Furthermore, Villwock also could have remedied the earlier versions of the VersaCheck software that did not verify identities. As early as 2012, the district court found that Villwock "cannot seriously contend that it is impossible to

upgrade or patch already existing software." Dkt. 272 at 16 [ER 033]. In its later orders, the court identified still further steps Villwock could have taken, including "issuing a recall to third-party retailers who may still have inventory of noncompliant versions," or "giving free software *in exchange for* noncompliant versions of VersaCheck." Dkt. 415 at 11 [ER 501] (emphasis in original) (citing Dkt. 336 at 18-19 [ER 055-056]). But Villwock instead did "nothing to dispose of the noncompliant versions of VersaCheck." Dkt. 415 at 11 [ER 501].

Villwock does not respond directly to the district court's rejection of his impossibility defense. Instead, he makes two claims of impossibility, neither of which meets his burden of providing a detailed explanation of impossibility and showing that the district court clearly erred in finding otherwise.

First, he claims that he could not prevent customers from using blank checks, inks, and software to create unverified checks. Br. 20-21. That claim is irrelevant and shows no error by the district court. The court held Villwock in contempt for offering *check creation and delivery products and services*, such as VersaCheck, Instant Checks, and ChecksXpress, that allowed users to create unverified checks.[9] Dkt. 272 at 15-17 [ER 032-034]; Dkt. 415 at 6-11 [ER 496-501]. Villwock plainly controlled those products, and he does not contend

[9] As we discuss below, these findings rested on copious evidence, including live and deposition testimony and documents. *See* section III.B. *infra*.

otherwise. The district court did *not* hold him in contempt for selling paper or ink. It thus does not matter that a user could have created unverified checks using software obtained from a source other than Villwock.

Second, Villwock contends that "[d]espite his greatest efforts," he has remained unable to implement identity verification. Br. 20. But, as he did before the district court, he fails to indicate what those "efforts" were—and he admits that validation was possible and contends merely that it was "not affordable." *Id*. Moreover, as the district court found, Villwock does not claim that he even "attempted to utilize the monitor option" provided in the Injunction. Dkt. 415 at 8 [ER 498]. Villwock's claims do not nearly reach the level of showing impossibility "categorically and in detail." *Affordable Media*, 179 F.3d at 1241. Nor do they show any clear error by the district court.[10]

B. Villwock Did Not Substantially Comply With The Injunction.

In tension with the claim that it was impossible to comply with the Injunction, Villwock also contends that he in fact substantially complied with it.

[10] Villwock mistakenly relies on *Gates v. Shinn*, 98 F.3d 463 (9th Cir. 1996), for the proposition that where "reasonable minds can differ" over the extent of noncompliance, contempt is unwarranted. Br. 21. *Gates* does not support that proposition because it did not involve the question of substantial compliance. It addressed whether the terms of an injunction sufficiently described the conduct to be restrained. *See Gates*, 98 F.3d at 467-68, 472. Villwock has not made such a claim here, *see* n.8, supra, and it would fail if he did.

Br. 23-26. To succeed on the claim, Villwock must show that he has taken "all reasonable steps" to comply with the Injunction. *Gen. Signal Corp. v. Donallco, Inc.*, 787 F.2d 1376, 1379 (9th Cir. 1986) (citation omitted). Substantial compliance is *not* shown where a party demonstrates "little [real] conscientious effort" to comply. *Stone*, 968 F.2d at 857 (quoting *Sekaquaptewa v. MacDonald*, 544 F.2d 396, 406 (9th Cir. 1976)). A history of noncompliance and the failure to comply despite a pending contempt motion demonstrate a lack of effort. *Stone*, 968 F.2d at 857.

Villwock did not substantially comply with the Injunction. As described above, with a single exception, none of Villwock's products ever provided the contact information required by the Injunction. That alone defeats any claim of substantial compliance and proves Villwock's disregard for the mandates of the Injunction. Moreover, despite the clear requirement that Villwock verify the identity of check-issuers, VersaCheck 2010 and 2012, Instant Checks, and ChecksXpress had no identity verification processes at all. Indeed, even after the FTC first moved to hold him in contempt, Villwock continued to introduce new products that did not comply. Such persistent defiance in the teeth of a contempt motion defeats a claim of substantial compliance. *See Stone*, 968 F.2d at 857. Villwock's shifting corporate structures likewise demonstrate an intent to evade the Injunction, also defeating a claim of compliance. Dkt. 272 at 19 [ER 036]

(finding that Villwock "creat[ed] a shifting maze of corporations to mask [his] violations"); *Sekaquaptewa*, 544 F.2d at 406-07 (holding that "conscious foot dragging" and "meager efforts" showed "little real conscientious effort" to comply).

Villwock similarly failed to take readily available steps to comply, such as seeking a monitor (an option provided by the Injunction) or adopting any of the court's suggested measures. Dkt. 415 at 8, 10-11 [ER 498, 500-501]. Indeed, he conceded that he eventually stopped even trying to comply with the Injunction. Dkt. 415 at 6-8 [ER 496-498].

Villwock claims that he substantially complied in two ways. First, he contends that he "hired a team of experts" to implement identity verification. Br. 23-25. But the team was unsuccessful, not because of technical inability, but because the Injunction required the individuals or entities undertaking this service to be outside of his control, which Villwock's team was not. Dkt. 336 at 12-13 [ER 049-050]. Villwock has never explained—either to the district court or this Court—why he could not find independent third party verifiers able to do exactly what his team could. Nor does he claim that he engaged (or attempted to engage) an outside monitor, as the Injunction allowed him to do. At most, Villwock may have attempted to comply, but he did not comply, fully or substantially. And his claimed attempts ring hollow in light of his shifting corporate identities, his total

failure to comply with other parts of the Injunction, and his numerous products and websites that made no compliance efforts at all.

This Court has found that far more genuine efforts than Villwock's to comply with an injunction do not amount to substantial compliance. In *Stone*, the Court held that the City of San Francisco's spending of $30 million on prison programs was insufficient to comply with an injunction to reduce inmate overcrowding. 968 F.2d at 857-59. In *Sekaquaptewa*, the Court held that the Navajo nation's multiple attempts to comply with an order limiting grazing and construction on reservation lands were insufficient where overgrazing and construction continued. 544 F.2d at 404-07.

Second, Villwock claims that he took substantial steps to remove older versions of VersaCheck that violated the Injunction. Br. 25. Of course, his having created noncompliant check-writing software in the first place demonstrates his unwillingness to obey the Injunction. His half-hearted efforts to remove the noncompliant software simply ratify his contempt. Villwock claims that he "sent a letter" to VersaCheck asking it to "encourage" users to update their noncompliant programs. He fails to acknowledge that he in fact controlled VersaCheck, Dkt. 414 at 9-10 [ER 470-471], and thus plainly could have done more than ask the company by letter to comply with the Injunction. In particular, as the district court held, and Villwock does not dispute, he could have deployed mandatory patches or

upgrades, recalled unsold inventory, or provided free exchanges. Dkt. 415 at 10-11 [ER 500-501]. Instead, the district court held, Villwock did "nothing to dispose of the noncompliant versions of VersaCheck." *Id.* at 11 [ER 501]. Villwock does not attempt to demonstrate any error in that finding, which negates his claim of substantial compliance.

II. VILLWOCK'S CHALLENGE TO THE AWARD OF COMPENSATORY SANCTIONS IS MOOT.

In a one-paragraph argument, Villwock asserts that the district court's award of $100,000 in compensatory sanctions should be vacated because it cannot be traced to consumer loss. Br. 27.[11] The claim is moot. The court imposed the sanction jointly and severally upon Villwock and his co-defendants. Because co-defendant James Danforth has now paid the entire $100,000 sum as part of his separate settlement with the FTC, Dkt. 413 at 5 [SER-021], Villwock himself no longer faces any liability and therefore "has no stake in an appeal arising out of these sanctions." *Lasar v. Ford Motor Co.*, 399 F.3d 1101, 1108 (9th Cir. 2005).

Even if Villwock's claim were live, it would lack merit. Compensatory sanctions must be limited to "actual losses," *Gen. Signal Co.*, 787 F.2d at 1380, and the $100,000 sanction is directly tied to such losses. The court sanctioned

[11] Villwock asks the Court to vacate the sanctions award "in its entirety," Br. 27, but he makes no argument concerning the coercive sanctions, which account for the bulk of the judgment.

Villwock for failing to disclose his contact information on checks generated through his services. Dkt. 272 at 20 [ER 037]. At the 2011 evidentiary hearings, the FTC offered evidence that one consumer had been duped into using VersaCheck to issue what she believed to be payroll checks. In truth, the consumer was unknowingly generating checks without authorization from other accounts. Plaintiff's Proposed Findings of Fact in Support of Contempt, Dkt. 261 at ¶¶ 718-721, 754-758 [SER-244, 248]. She ultimately (albeit unwittingly) created 79 checks totaling $279,450 that were drawn on the accounts of others. Dkt. 261 at ¶¶ 745, 749 [SER-247]. The district court's $100,000 compensatory sanction award—highly lenient in view of the established amount—is directly traceable to this loss.

III. VILLWOCK'S PROCEDURAL AND EVIDENTIARY ARGUMENTS LACK MERIT.

A. The District Court Made Detailed Findings Supporting Its Contempt Rulings.

In its supplemental Injunction, the district court adopted the FTC's proposed form of order. Villwock claims that the order therefore is an impermissible "rubberstamp[]." Br. 18-19; *see also* Dkts. 419 [SER-001-016], 441 [ER 512-

520]. But Villwock did not appeal from the supplemental Injunction, so he cannot complain about it now.[12]

Even if the supplemental Injunction were before this Court, Villwock's challenge to it would fail. To be sure, this Court discourages district courts from adopting a party's proposed findings verbatim in some circumstances. *See Unt v. Aerospace Corp.*, 765 F.2d 1440, 1444-45 (9th Cir. 1985); *Lumbermen's Underwriting All. v. CanCar, Inc.*, 645 F.2d 17, 18-19 (9th Cir. 1980). But— as Villwock concedes (Br. 18)—a court may properly do so where the findings are supported by the record and where the record itself is sufficient to permit appellate review. *Unt*, 765 F.2d at 1444-45. The supplemental Injunction meets both of these conditions. It explicitly relies on the Modification Order (Dkt. 414) and thus incorporates the detailed factual findings rendered by the court in that order. *See* Dkt. 441 at 2 [ER 513]. And more generally, the district court made extraordinarily detailed and thorough findings in multiple orders since 2012, all of which confirm that Villwock has *never* fully complied and in fact has been in continuous contempt since 2012. *See*, *e.g.*, Dkts. 272 [ER 018-037], 336 [ER 038-062], 415 [ER 491-504]. This record is more than sufficient to permit review.

[12] Villwock's last amended notice of appeal specified docket number 440, the district court's denial of his various motions for reconsideration of the September 2015 orders. Dkt. 443 [ER 617-632].

B. The District Court's Finding Of Contempt Was Supported By Clear And Convincing Evidence.

An order of contempt must be supported by "clear and convincing evidence." *Affordable Media*, 179 F.3d at 1239 (quoting *Stone*, 968 F.2d at 856 n.9). Villwock claims that the court did not have such evidence before it because the FTC offered no witness testimony based upon personal knowledge and because the FTC improperly relied on hearsay. Br. 22. Both of these claims are wrong, but even if they were true, the court still had ample documentary and other evidence to support its contempt finding.

The 2012 Contempt Order, which followed extensive briefing and two evidentiary hearings on April 27-28, 2011 and August 31-September 1, 2011, outlines the evidence on which it rests, including "live testimony, deposition testimony, declarations, and other exhibits." Dkt. 272 at 6 [ER 023]. The evidence included the following—all based on personal knowledge:

- Declarations from FTC employees Leslie Lewis, Ronald Lewis, William Burton, Bernadette Harding, Denise Owens, and Janet Wright;
- Deposition testimony under oath from both Villwock himself and defendant James Danforth;[13]

[13] This evidence also included deposition testimony from corporate entities G7 and iProlog. Dkt. 272 at 6 [ER 023].

- In-court testimony from Villwock himself, James Danforth, Diana Villwock, Dan Fisher, and FTC employee Ronald Lewis;
- Third-party consumer complaints from numerous consumers;
- Third party depositions under oath from consumers Christina Keheley, Audrey O'Neil, Kristy Smith, Melva Talley, Joseph Cassidy, and Christine Andrews.

Dkt. 272 at 6-7 [ER 023-024]. The court plainly heard substantial evidence of contempt based on personal knowledge, including testimony by Villwock himself.

Villwock's hearsay challenge identifies no specific statement that he claims was impermissibly admitted. *See* Br. 22. The claim fails on that ground alone. *Nw. Acceptance Corp. v. Lynnwood Equip., Inc.*, 841 F.2d 918, 923 (9th Cir. 1988) (citing Fed. R. App. P. 28(a)(4)). Villwock may be referring to consumer complaint evidence (exhibits 526 and 527) introduced by the FTC at the April 2011 evidentiary hearings to which he objected on hearsay grounds. If so, the court properly admitted that evidence. It applied the residual hearsay exception in Fed. R. Evid. 807 to admit some of the complaints while excluding others, an approach approved by this Court. Dkt. 272 at 7-8 [ER 024-025] (citing *FTC v. Figgie Int'l, Inc.*, 994 F.2d 595, 608-09 (9th Cir. 1993)); *see also* 4/27/11 Tr. at 177-85 [SER-275-283]; 4/28/11 Tr. at 197-99 [SER-268-270]. Villwock offers no reason why the court's approach was incorrect.

Even if Villwock could show that the court's decision was error, it was harmless at most because other evidence established Villwock's contempt by a wide margin. The court also considered exhibits and information in the form of "[o]ther documents, including website printouts, receipts, checks, reports, emails and letters, catalogs and instructions, and corporate document such as employee lists, sales summaries, tax returns and other records and filings[,]" "Qchex website printouts[,]" and VersaCheck software. Dkt. 272 at 6-7 [ER 023-024]. Villwock does not make even a token attempt to argue against the overwhelming weight of that evidence, which was plainly sufficient to establish his contempt.

IV. "PUBLIC POLICY" CONSIDERATIONS DO NOT JUSTIFY VILLWOCK'S CONTEMPT.

Finally, Villwock claims in passing that the Injunction and the 2015 Contempt Orders should be reversed because they require him to engage in acts that violate "public policy." The contention is that to comply with the Injunction (presumably by updating or patching older versions of VersaCheck, *see* Dkt. 415 at 10-11 [ER 500-501]), Villwock must "interfere[]" with consumers' use of his products, which would "infringe[]" their "rights." Br. 26. The argument is frivolous.

For starters, updating software in no way amounts to "interference" with "rights." Software updates are commonplace, and as the court noted, most

consumers would likely welcome such protective measures. Dkt. 272 at 17 [ER 034]. Furthermore, Villwock provides no source for his alleged "policy."

More fundamentally, Villwock provides no reason why his preferred policies should trump the consumer protection requirements of the FTC Act or the inherent authority of district courts to compel obedience to their orders. *See United Mine Workers*, 330 U.S. at 330-31 (Black and Douglas, JJ., concurring in part and dissenting in part); *see also Shillitani v. United States*, 384 U.S. 364, 370 (1966). Villwock violated the FTC Act and then spent years flouting the plain requirements of the district court's remedial order. Contempt is amply justified here.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be affirmed.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B)(i) in that it contains 8,548 words, excluding the parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and the signature block, as prepared using the Microsoft Word word-processing system.

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CERTIFICATE OF SERVICE

I hereby certify that on January 19, 2017, I electronically filed the "Answering Brief for the Federal Trade Commission" and "Supplemental Excerpts of Record" with the Clerk of Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system. I certify that all participants in the case are registered CM/ECF users, and thus service will be accomplished by the appellate CM/ECF system.

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