





## I. SUMMARY

Plaintiff, the Federal Trade Commission (“FTC” or “Commission”) brings this case to halt a scam involving unauthorized telephone billing – often referred to as “cramming.” The FTC seeks a temporary restraining order (“TRO”) to stop the defendants from causing consumers to be billed for, and misrepresenting to consumers that they are obligated to pay for, “adult” entertainment services they never purchased. Defendants operate three web sites through which they sell sexually explicit “videotext” services – Internet-based visual entertainment. These web sites are known by the domain names “pornpictures.com,” “cartoonporn.com,” and “alienporn.com.” Visitors to these web sites who wish to gain access to the videotext services can pay by credit card, debit drafts to checking accounts, 900 number charges, or downloading software.

This case focuses on the software-download payment option. Under this option, the fees for purchasing the “adult” entertainment services are charged to telephone line subscribers’ phone bills based solely on the fact that defendants’ videotext services were accessed from a certain telephone line, whether or not the line subscriber purchased or authorized the purchase of the videotext services. Defendants’ billing is based solely upon an automatic number identification system similar to “caller ID” that identifies only the telephone line from which a call is made, not the person who downloaded the software that caused the call to be placed. Acting without telephone line subscribers’ authorization, defendants cause the charges to appear on their phone bills in the guise of an international, long-distance call to Madagascar, not as a purchase of videotext services.

Defendants’ practice of billing the telephone line subscriber is unfair and deceptive in violation of Section 5 of the FTC Act, 15 U.S.C. § 45, because, in many instances, the line subscriber neither received the videotext services nor authorized charges for them. Defendants’

unauthorized billing is unfair because it results in substantial injury to consumers that is not outweighed by countervailing benefits to consumers or competition and because consumers cannot reasonably avoid the harm. Defendants' unauthorized billing is deceptive because it causes line subscribers' telephone bills to misrepresent that the charges are for international long-distance calls, not for the purchase of videotext services.

Plaintiff, Federal Trade Commission ("FTC"), brings this action under Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), for preliminary and permanent injunctive relief and other equitable remedies, including restitution and disgorgement of ill-gotten gains. Plaintiff seeks to enjoin defendants from causing charges to be placed on consumers' telephone bills without authorization in violation of Section 5(a) of the Federal Trade Commission Act, 15 U.S.C. § 45(a). The FTC seeks a temporary restraining order to put an immediate halt to defendants' unfair and deceptive practices and a preliminary injunction to halt those practices pending trial on the merits. The defendants are located outside the United States, but have done business in the United States and have injured United States consumers.

Billing to international telephone numbers is an unfair and deceptive practice in violation of Section 5(a) of the FTC Act. The final relief sought by the Commission is a permanent injunction barring collection of unlawful charges, prohibiting similar practices in the future, and requiring restitution to victims of the scheme who have paid unauthorized charges and disgorgement of defendants' ill-gotten gains.

## **II. PARTIES**

### **A. Plaintiff**

The FTC is an independent agency of the United States Government created by the FTC Act, 15 U.S.C. § 41 *et seq.* The FTC enforces Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), which prohibits unfair or deceptive acts or practices in or affecting commerce. Section 13(b) of

the FTC Act, 15 U.S.C. § 53(b), authorizes the Commission to initiate court proceedings to enjoin violations of the FTC Act and to secure such equitable relief as may be appropriate in each case. *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1110-13 (9th Cir. 1982).

## **B. Corporate Defendants**

Defendant **Virtualynx Internet, Inc.** (“Virtualynx”), is a Canadian corporation incorporated in British Columbia on April 3, 1996.<sup>1</sup> It is headquartered at 555 W. Hastings Street, Vancouver, British Columbia.<sup>2</sup> It also lists its address as 1502 - 1166 Alberni Street, Vancouver, British Columbia.<sup>3</sup> Virtualynx provides domain services for the pornopictures.com web site to defendant B.C. Ltd. Domain services may include: (1) operating the computer “server” that supplies the content of a web site; (2) providing e-mail accounts for the web site operator; and (3) registering the domain name (e.g., “pornopictures.com”) for the web site operator. Virtualynx also provides domain services to Ty Anderson for cartoonporn.com and alienporn.com.<sup>4</sup> It transacts or has transacted business throughout the United States.

Defendant **583 665 B.C. Ltd.** (“B.C. Ltd.”), is a Canadian corporation incorporated in British Columbia, Canada, on April 16, 1999.<sup>5</sup> It is headquartered at Suite 218 - 470 Granville St., Vancouver, BC V6C1V5.<sup>6</sup> B.C. Ltd. does business as Porno Pictures and is the entity that operates the pornopictures.com web site.<sup>7</sup> It transacts or has transacted business throughout the

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<sup>1</sup> Leigh Declaration Exhibits (hereafter cited as “TRO Exh.” followed by the appropriate exhibit number and internal exhibit reference), TRO Exh. 6, p. 274.

<sup>2</sup> TRO Exh. 5, p. 273.

<sup>3</sup> TRO Exh. 6, p. 274.

<sup>4</sup> TRO Exh. 10, pp. 281-82; TRO Exh. 11, pp. 283-84.

<sup>5</sup> TRO Exh. 7, p. 275.

<sup>6</sup> TRO Exh. 7, p. 275.

<sup>7</sup> TRO Exh. 22, p. 409.

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<sup>8</sup> TRO Exh. 8, p. 277-78; TRO Exh. 10, pp. 281-82; TRO Exh. 11, pp. 283-84.

<sup>9</sup> TRO Exh. 8, p. 278.

<sup>10</sup> TRO Exh. 10, p. 281.

<sup>11</sup> TRO Exh. 10, p. 281; TRO Exh. 11, p. 283.

<sup>12</sup> TRO Exh. 10, p. 281; TRO Exh. 11, p. 283.

are visual information and entertainment services, sometimes including audio, that are offered over the Internet through individual web sites.

The web sites have a common method of operation: through sexually explicit pictures and statements, they attempt to entice consumers to purchase a trial membership or a monthly membership. Viewers are presented with four payment options for accessing defendants' videotext services. The sign-up pages at defendants' web sites prominently display three of the payment options: credit card and online check payments at \$29.95 for one month and 900 number charges at \$34.95 for one month.<sup>15</sup> On the same sign-up pages, defendants also offer a fourth means of access. Appealing to viewers who have no credit card or checking account or whose telephone lines may have 900-number blocks, these web sites entice viewers to use the software-download option with the following come-on: "No credit card? No check? No problem! Download Our Sex Software For Instant Access."<sup>16</sup> The computer user who wants to access the entertainment services from one of defendants' web sites is told to download a "dialer" software program from the web site.<sup>17</sup> When individuals use the software, a scroll-down box displaying a lengthy licensing agreement appears on their computer screens.<sup>18</sup> The text in the scroll-down box explains how the computer user's modem will be disconnected and reconnected to defendants'

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<sup>15</sup> TRO Exh. 2, p. 38; TRO Exh. 3, p. 117-18; TRO Exh. 4, p. 203.

<sup>16</sup> TRO Exh. 2, p. 38; TRO Exh. 3, p. 117-18; TRO Exh. 4, p. 203.

<sup>17</sup> Declaration of Patricia Leigh ("Leigh Dec."), p. 26, ¶¶ 8; TRO Exh. 2, pp. 89-93; Leigh Dec., p. 29, ¶ 22; TRO Exh. 3, pp. 177-81; Leigh Dec., p. 30, ¶ 24; TRO Exh. 4, pp. 250-54; TRO Exh. 23, p. 415, ¶¶ 3-4 and CD-Rom attachment.

<sup>18</sup> Leigh Dec., p. 27, ¶¶ 12-15; TRO Exh. 2, p. 97; Leigh Dec., p. 29, ¶ 22; TRO Exh. 3, p. 185; Leigh Dec., p. 30, ¶ 24; TRO Exh. 4, p. 258; TRO Exh. 23, p. 415, ¶¶ 3-4 and CD-Rom attachment.

entertainment services through a long-distance telephone call to Madagascar.<sup>19</sup> It also warns that the web site contains sexually explicit material and that computer users must be 18 to access defendants' services.<sup>20</sup> After the user clicks on an "I accept" button, the dialer software program is downloaded.<sup>21</sup> It causes the computer user's modem to disconnect from the computer user's usual Internet Service Provider and dial a Madagascar telephone number.<sup>22</sup> Upon completing the call, the dialer program reconnects the consumer's modem to the Internet and is apparently intended open at a site providing the promised adult entertainment services.<sup>23</sup>

When the computer user activates the dialer program, an automatic number identification system ("ANI") is used to capture the telephone number from which the call is placed and identify the line subscriber associated with that number. Line subscribers are billed for the call regardless of whether they or someone they authorized actually placed it and accessed the web site. As long as the computer modem is connected to the entertainment site via this telephone connection, fees mount up at \$3.99 or more per minute. From January 2000 through late July 2000, all calls to access defendants' videotext services were carried by AT&T and appeared on line subscribers' monthly telephone bills as long-distance calls to Madagascar. During this time period, line subscribers were billed for access to defendants' videotext at a rate of \$5.59 to \$7.39 per minute.

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<sup>19</sup> Leigh Dec., p. 27, ¶ 14; TRO Exh. 2, pp. 99-103; Leigh Dec., p. 29, ¶ 22; TRO Exh. 3, pp. 187-91; Leigh Dec., p. 30, ¶ 24; TRO Exh. 4, pp. 260-64.

<sup>20</sup> *Id.*

<sup>21</sup> Leigh Dec., pp. 27-28, ¶¶ 12-20; TRO Exh. 2, pp. 97-111; Leigh Dec., p. 29, ¶ 22; TRO Exh. 3, pp. 185-99; Leigh Dec. p. 30, ¶ 24; TRO Exh. 4, pp. 258-72; TRO Exh. 23, p. 415, ¶¶ 3-4, and CD-Rom attachment.

<sup>22</sup> *Id.*

<sup>23</sup> TRO Exh. 23, p. 415-16, ¶¶ 4-5, and CD-Rom attachment; Leigh Dec., p. 28, ¶¶ 16-20; TRO Exh. 2, pp. 107-11; Leigh Dec., p. 29, ¶ 22; TRO Exh. 3, pp. 195-99; Leigh Dec., p. 30, ¶ 24; TRO Exh. 4, pp. 268-72.



In late July, AT&T stopped carrying videotext access calls to Madagascar, and as of late August 2000, the Madagascar number dialed to access defendants' videotext changed. Defendants currently charge line subscribers \$3.99 per minute.

Defendants arranged to have these fees charged to the telephone line subscriber's local telephone bill, disguised as a long-distance telephone call to Madagascar.<sup>24</sup> These charges appear on the line subscriber's telephone bill with a warning that "non-payment of toll charges may result in disconnection of local service, and other services may be restricted if not paid."<sup>25</sup> There is no hint on the line subscriber's telephone bill that the charges are not for long-distance calls to Madagascar and consumers who complained about the charges to AT&T, the long-distance carrier for these charges, were told that they were obligated to pay the charges.<sup>26</sup>

Defendants have caused hundreds – and perhaps thousands – of consumers' telephone bills to include charges for access to defendants' adult-entertainment services.<sup>27</sup> Samples of these bills are attached to the consumer declarations in the volumes of exhibits in support of this motion. These bills identify the charges as international long-distance calls to Madagascar and attach a call detail sheet showing the time, duration, and charges for each call.<sup>28</sup> Line subscribers

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<sup>24</sup> TRO Exh. 2, p. 100; TRO Exh. 3, p. 188; TRO Exh. 4, p. 261; TRO Exh. 24, p. 417; TRO Exh. 25, pp. 420, 423; TRO Exh. 26, p. 426; TRO Exh. 27, p. 430; TRO Exh. 28, p. 431; TRO Exh. 29, pp. 433, 439; TRO Exh. 30, p. 441; TRO Exh. 31, p. 443; TRO Exh. 32, pp. 446-47, 449; TRO Exh. 33, pp. 450-51; TRO Exh. 34, pp. 453, 457; TRO Exh. 35, pp. 460, 464.

<sup>25</sup> TRO Exh. 25, p. 423; TRO Exh. 29, p. 439; TRO Exh. 34, p. 457; TRO Exh. 32, p. 449.

<sup>26</sup> TRO Exh. 24, p. 418; TRO Exh. 25, p. 421; TRO Exh. 26, p. 427; TRO Exh. 29, p. 435; TRO Exh. 30, p. 442; TRO Exh. 31, p. 444; TRO Exh. 32, p. 447; TRO Exh. 33, p. 451; TRO Exh. 34, p. 454.

<sup>27</sup> TRO Exh. 15, pp. 335-53.

<sup>28</sup> TRO Exh. 25, p. 423; TRO Exh. 29, p. 439; TRO Exh. 32, p. 449; TRO Exh. 34, p. 457; TRO Exh. 35, p. 464.

were billed for charges as high as \$1,305.83.<sup>29</sup>

Defendants' unauthorized telephone billing generated massive consumer complaints to AT&T, which has made "adjustments" to line subscribers' phone bills equal to 24% of total billings.<sup>30</sup> Consumers assert that they did not make or authorize the calls billed by defendants. Eleven consumers have executed declarations that they did not make or authorize the calls accessing the services billed by defendants.<sup>31</sup> According to AT&T records, AT&T issued adjustments to almost 1,000 line subscribers through July of this year.<sup>32</sup> Line subscribers whose telephone bills included charges for international long distance calls to Madagascar frequently say they knew nothing about the origin of the charges and did not authorize the charges.<sup>33</sup> In many instances, the line subscriber has discovered that a minor in the line subscriber's household, or another individual who does not have the line subscriber's authorization, has accessed defendants' web sites.<sup>34</sup> In other instances, neither the line subscriber nor anyone in the line subscriber's household has ever used the line subscriber's computer modem to call a telephone number in Madagascar.<sup>35</sup> The computer user may even have been someone who hacked into the line subscriber's telephone line from outside the home.<sup>36</sup> Some declarants were physically unable to

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<sup>29</sup> TRO Exh. 15, p. 350.

<sup>30</sup> TRO Exh. 16, p. 354.

<sup>31</sup> TRO Exhs. 24-35, pp. 417-464.

<sup>32</sup> TRO Exh. 16, p. 354.

<sup>33</sup> TRO Exh. 24, p. 417; TRO Exh. 25, p. 420; TRO Exh. 26, p. 427; TRO Exh. 28, p. 431; TRO Exh. 29, p. 433; TRO Exh. 31, pp. 443-44; TRO Exh. 32, pp. 446-47; TRO Exh. 33, pp. 450-51; TRO Exh. 34, pp. 453-54; TRO Exh. 35, pp. 460-61.

<sup>34</sup> TRO Exh. 26, p. 427; TRO Exh. 29, p. 434; TRO Exh. 30, p. 441.

<sup>35</sup> TRO Exh. 24, pp. 417-18; TRO Exh. 25, pp. 420-21; TRO Exh. 28, pp. 431-32.

<sup>36</sup> TRO Exh. 35, pp. 461-63.

make the alleged calls because they were not at home when the calls were made.<sup>37</sup>

Although AT&T stopped carrying videotext access calls to Madagascar in July 2000, this did not put an end to defendants' unauthorized telephone billing. They simply changed the Madagascar telephone number called by their dialer software and enlisted Verity International, Ltd., to bill line subscribers directly.<sup>38</sup> The Commission recently brought a Section 13(b) action charging Verity and affiliated companies with violations of Section 5 of the FTC Act. *FTC v. Verity Int'l, Ltd.*, Civ. No. 00 CIV 7422 (S.D.N.Y. TRO issued Oct. 2, 2000) (complaint alleged unfair practice to bill consumers for unauthorized long-distance charges caused by downloading software from adult-entertainment web sites).<sup>39</sup>

The three web sites operated by defendants are closely related. Computer users who select the dialer software option from all three sites dial the same Madagascar number and are given the option of accessing either the pornopictures or cartoonporn material.<sup>40</sup> In addition, cartoonporn members are offered a "Free AlienPorn.com Pass."<sup>41</sup>

## **IV. ARGUMENT**

### **A. Jurisdiction and Venue**

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<sup>37</sup> TRO Exh. 31, p. 443; TRO Exh. 35, p. 461.

<sup>38</sup> TRO Exh. 2, p. 100; TRO Exh. 3, p. 188; TRO Exh. 4, p. 261; TRO Exh. 34, pp. 454, 458-59.

<sup>39</sup> *See* TRO Exh. 17, pp. 355-60.

<sup>40</sup> The alienporn videotext is apparently a subset of the cartoonporn material.

<sup>41</sup> TRO Exh. 3, p. 117.

Subject matter jurisdiction is proper pursuant to 28 U.S.C. §§ 1331, 1337(a), and 1345.

Personal jurisdiction and venue are both appropriate in the Western District of Washington.

Federal statutes that permit service of process wherever the defendant may be found, such as

Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), authorize nationwide service of process.<sup>42</sup>

Federal courts have routinely held that such provisions authorize the exercise of personal

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<sup>42</sup> Although the courts have yet to interpret the service of process provisions of Section 13(b), the language of this statute is virtually identical to language in other federal statutes, such as the Securities Exchange Act, 15 U.S.C. § 78aa, where courts have applied the minimum national contacts analysis. *See Securities Investor Protection Corp. v. Vigman*, 764 F.2d 1309, 1314-16 (9th Cir. 1985).

Here, defendants' contacts with the United States far exceed the constitutional minimum. Defendants intentionally target U.S. residents. They offer a telephone number to U.S. residents through AT&T.<sup>43</sup> Charges for defendants' services were billed to thousands of U.S. consumers through their local – U.S. – phone companies.<sup>44</sup> Defendants registered their domain names with a U.S. domain name registrar.<sup>45</sup> They arranged with a Florida company to handle credit card and online check billing<sup>46</sup> and offered online check billing and 900 number billing only to U.S. residents.<sup>47</sup> Defendants even listed a phony address in Blaine, Washington,<sup>48</sup> perhaps to reassure U.S. consumers. Under these circumstances, defendants have purposely availed themselves of the privilege of doing business in the United States and can reasonably expect to be haled into court in the United States.

Venue in this district is also proper. The defendants have transacted business throughout the United States. As “aliens,” defendants may be sued in any district court. 28 U.S.C. § 1391(d).<sup>49</sup> Many Western Washington consumers have been billed for defendants' services on their local phone bills.<sup>50</sup> The Western District of Washington is the venue that is most convenient to the defendants, who are located in British Columbia. Defendants also represent through the

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<sup>43</sup> TRO Exh. 23, p. 416; TRO Exh. 25, p. 423; TRO Exh. 27, p. 430; TRO Exh. 29, p. 439; TRO Exh. 32, p. 449; TRO Exh. 34, p. 457; TRO Exh. 35, p. 464.

<sup>44</sup> TRO Exh. TRO Exh. 27, pp. 429-30; TRO Exh. 29, pp. 436-39; TRO Exh. 34, pp. 456-57.

<sup>45</sup> TRO Exh. 9, pp. 279-80; TRO Exh. 10, pp. 281-82; TRO Exh. 11, pp. 283-84.

<sup>46</sup> TRO Exh. 2, p. 46; TRO Exh. 3, p. 135; TRO Exh. 4, p. 223.

<sup>47</sup> TRO Exh. 2, p. 59; TRO Exh. 3, p. 148; TRO Exh. 4, p. 218.

<sup>48</sup> TRO Exh. 9, p. 279; TRO Exh. 12, pp. 285, 297; TRO Exh. 22, p. 407.

<sup>49</sup> An alien is a person who is not a citizen of the United States or is a corporation incorporated under the laws of a foreign country.

<sup>50</sup> TRO Exh. 15, pp. 336, 339, 340.

phony Blaine, Washington address that pornopictures.com is headquartered in the Western District.

**B. Section 13(b) of the FTC Act Authorizes This Court to Grant the Requested Relief**

The FTC seeks a permanent injunction to halt defendants' unfair and deceptive practices and equitable relief to redress the injury to consumers caused by defendants' unlawful practices. To prevent defendants from committing further law violations pending resolution of this action, plaintiff also seeks a temporary restraining order and a preliminary injunction. This Court has the authority to grant such preliminary and permanent relief pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), the All Writs Act, 28 U.S.C. § 1651(a), and Rule 65(a) of the Federal Rules of Civil Procedure.

Section 13(b) of the FTC Act specifically authorizes a district court to grant permanent injunctions to enjoin violations of the Act in "proper cases."<sup>51</sup> A "proper case" includes any matter involving a violation of a law enforced by the FTC. *Singer*, 668 F.2d at 1113. A district court may grant the FTC preliminary injunctive relief "[u]pon a proper showing that, weighing the equities and considering the [FTC's] likelihood of ultimate success, such action would be in the public interest." 15 U.S.C. § 53(b). Incident to their authority to issue permanent injunctive relief, district courts in Section 13(b) actions have the inherent equitable power to grant all temporary and preliminary relief necessary to accomplish complete justice, including a preliminary injunction to prevent future wrongful conduct. *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1102 (9th Cir.), *cert. denied*, 514 U.S. 1083 (1995); *FTC v. Amy Travel Serv., Inc.*, 875 F.2d 564, 571-72 (7th

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<sup>51</sup> The FTC proceeds here under the second proviso of Section 13(b). Injunctive relief sought under this proviso is not conditioned on the initiation of an administrative proceeding. *Singer*, 668 F.2d at 1110-13.

Cir.), *cert. denied*, 493 U.S. 954 (1989); *Singer*, 668 F.2d at 1113.

In similar circumstances, the FTC often seeks and obtains *ex parte* TRO provisions freezing defendants' assets and granting the FTC immediate access to defendants' business records that might otherwise be destroyed. *See, e.g., FTC v. World Wide Factors, Ltd.*, 882 F.2d 344, 346-47 (9th Cir. 1989) (affirming district court's power to freeze assets and appoint receiver); *Singer*, 668 F.2d at 1113 (affirming preliminary injunction and personal and corporate asset freeze). Here, the FTC seeks issuance of a temporary restraining order to stop defendants immediately from unlawfully billing consumers for services they did not purchase or authorize and misrepresenting their obligation to pay for those services. In this case, however, the FTC does not proceed *ex parte* or seek an order freezing assets or granting immediate access to defendants' records because defendants are located in Canada. If plaintiff discovers that the defendants have assets in the United States, we may seek issuance of an asset freeze to preserve the possibility of effective final relief including restitution for consumers.

### **C. Applicable Standard for Entry of a Preliminary Injunction Is Met**

To obtain a preliminary injunction, the FTC must show a likelihood of success on the merits and that the equities weigh in favor of granting the temporary relief. *FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1233 (9th Cir. 1999); *World Wide Factors*, 882 F.2d at 346-47. Section 13(b), therefore, "places a lighter burden on the [FTC] than that imposed on private litigants by the traditional equity standard; the [FTC] need not show irreparable harm to obtain a preliminary injunction." *Affordable Media*, 179 F.3d at 1233 (quoting *FTC v. Warner Communications, Inc.*, 742 F.2d 1156, 1159 (9th Cir. 1984)). A federal agency need only demonstrate "some chance of probable success on the merits" to obtain preliminary relief. *United States v. Odessa Union Warehouse Co-op*, 833 F.2d 172, 176 (9th Cir. 1987). Further, "when a district court balances the hardships of the public interest against a private interest, the

public interest should receive greater weight.” *World Wide Factors*, 882 F.2d at 346-347; *see also Affordable Media*, 179 F.3d at 1236. As discussed below, the Commission easily meets the standard in the present case.

**1. The Evidence Shows That the FTC is Likely to Succeed on the Merits**

As described above and documented in the materials attached to this Memorandum, defendants have caused consumers to be billed for adult entertainment services they neither purchased nor authorized. Defendants have also misrepresented to consumers that they are liable for these charges. These practices are unfair and deceptive and violate Section 5 of the FTC Act.

**a. Defendants’ Billing of Line Subscribers Who Did Not Use Defendants’ Dialer Program to Access Web Sites is Unfair**

Defendants’ billing of line subscribers who did not purchase or authorize access to web sites using defendants’ dialer program is an unfair practice in violation of Section 5 of the FTC Act. An act or practice is unfair under the FTC Act if it causes injury to consumers that: (1) is substantial; (2) is not outweighed by countervailing benefits to consumers or competition; and (3) consumers themselves could not reasonably have avoided. *See* 15 U.S.C. § 45(n); *see also Orkin Exterminating Co. v. FTC*, 849 F.2d 1354, 1363-66, *reh’g denied*, 859 F.2d 829 (11th Cir. 1988), *cert. denied*, 488 U.S. 1041 (1989); *American Fin. Servs. Ass’n v. FTC*, 767 F.2d 957, 972-78 (D.C. Cir. 1985), *cert. denied*, 475 U.S. 1011 (1986). Courts have found that false billing schemes are unfair practices. In *FTC v. J.K. Publications, Inc.*, 99 F.Supp.2d 1176, 1201 (C.D.Cal. 2000), the court found that the practice of placing unauthorized charges on consumers’



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<sup>52</sup> See also *FTC v. Crescent Publ'g Group, Inc.*, Civ. No. 00CIV 6315 (S.D.N.Y. complaint filed Aug. 23, 2000) (complaint in Section 13(b) action alleged unfair practice of placing unauthorized charges on credit cards for “free”

## (1) Substantial Injury

Defendants' unauthorized billing for videotext services as international, long-distance telephone calls has caused substantial injury to consumers. Line subscribers billed by the proposed defendants have been injured because they were billed for services they never ordered. The extent of defendants' unauthorized billing is suggested by the dollar value of adjustments to line subscribers' telephone bills. AT&T data for the Madagascar telephone number dialed from defendants' web sites between January 2000, when the number became operational, and July 2000 shows line subscribers were billed a total of \$440,390 for connections to this number for this period. For the same period, AT&T issued \$109,210 in "adjustments" to 988 line subscribers, an adjustment rate of 24%.<sup>55</sup> Many line subscribers billed by defendants never accessed defendants' web sites, never used defendants' dialer program, and never authorized anyone else to do so. Eleven consumers have executed declarations that they did not make or authorize the calls accessing the services billed by defendants. Although the charges incurred by some line subscribers were for small amounts, "an injury may be substantial if it does a small harm to a large number of people." *Orkin Exterminating Co.*, 108 F.T.C. 263, 362 (1986). In fact, the charges to individual line subscribers were often quite large, totaling many hundreds of dollars in many instances. The telephone line subscribers did not bargain for or agree to these purchases. *See*

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bill consumers whose telephones were used by someone else to access and purchase defendants' entertainment services by dialing non-blockable toll-free numbers); *Phone Programs, Inc.*, 115 F.T.C. 977 (1992) (consent order) (complaint alleged unfair practice to induce children to dial 900 number without providing any reasonable means for persons responsible for payment to exercise control over the transaction); *Audio Communications, Inc.*, 114 F.T.C. 414 (1991) (consent order) (same).

<sup>55</sup> AT&T issued these adjustments in response to consumer complaints. When line subscribers called to complain, AT&T representatives frequently told them that AT&T would remove the charge for the unauthorized call accessing defendants' videotext services "this time," but warned that AT&T would not remove such charges if they persisted. *E.g.*, TRO Exh. 24, p. 418; TRO Exh. 25, p. 421; TRO Exh. 29, p. 435.

*J.K. Publications*, 99 F.Supp.2d at 1201; *Windward Mktg.*, 1997 U.S. Dist. LEXIS 17114, at \*31 (substantial injury may be established by showing that consumers “were injured by a practice for which they did not bargain”).

In addition to those who obtained adjustments from AT&T, it is likely that many line subscribers paid their phone bills without seeking adjustments because they were unaware of the distinction between unauthorized charges for tariffed telecommunications, which they are obligated to pay, and unauthorized charges for videotext services, which they are not obligated to pay.<sup>56</sup> This would not be unreasonable, given the threat of losing telephone service, the absence of the clear billing rights and dispute-resolution mechanisms that exist for other payment mechanisms such as credit cards and 900-numbers, and the uncertain costs involved in challenging the charges on telephone bills.

## (2) No Countervailing Benefit

The injury to consumers here is not outweighed by benefits to consumers or competition. No credible benefit to consumers or to competition could arise from defendants’ practice of billing a consumer (*i.e.*, the line subscriber) for videotext services purchased by someone else. A billing mechanism that lacks adequate safeguards to ensure that the proper person is billed and results in erroneous billing in a substantial number of cases cannot provide benefits to consumers or competition as a whole. *See J.K. Publications*, 99 F.Supp.2d at 1201 (second prong of unfairness test is easily satisfied “when a practice produces clear adverse consequences for consumers that are not accompanied by an increase in services or benefits to consumers or by

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<sup>56</sup> Under the filed rate doctrine, a telephone line subscriber is obligated to pay for common carrier transmission services, *i.e.*, long-distance toll calls. The filed rate doctrine does not apply to transmissions of videotext. *See Letter dated September 1, 1995, to Ronald J. Marlowe of Cohen, Berke, Bernstein, Brodie, Kondell & Laszlo, from John B. Muleta, Chief, Enforcement Division, Common Carrier Bureau, FCC, 10 FCC Rcd. 10945, 1995 FCC LEXIS 5897. See TRO Exh. 21, pp. 404-06.*

benefits to competition); *Windward Mktg.*, 1997 U.S. Dist. LEXIS 17114, at \*32 (same).

**(3) Harm Not Reasonably Avoidable**

Line subscribers cannot reasonably avoid the harm from defendants' billing practices. The focus in this prong of the unfairness test is on "whether consumers had a free and informed choice that would have enabled them to avoid the unfair practice." *Windward Mktg.*, 1997 U.S. Dist. LEXIS 17114, at \*32; *see also J.K. Publications*, 99 F.Supp.2d at 1201. The evidence

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<sup>57</sup> TRO Exh. 28, p. 431; TRO Exh. 30, p. 440; TRO Exh. 35, p. 460.

or practice that is likely to mislead consumers acting reasonably under the circumstances, and that representation, omission or practice is material to consumers' payment decisions. *See Pantron*, 33 F.3d at 1095. Reasonable consumers are not required to doubt the veracity of express representations, and the court may presume express claims to be material. *Id.* at 1095-96. Generally, misrepresentations are material if they involve facts that a reasonable person would consider important in choosing a course of action. *Windward Mktg.*, 1997 U.S. Dist. LEXIS 17114, at \* 27.

Defendants cause charges for their services to appear on line subscribers' phone bills as long-distance charges, which – if they were for basic telecommunications calls – the line subscribers would be legally obligated to pay. This deceives line subscribers, especially the large number who did not access defendants' services or authorize access by others. Defendants routinely cause telephone line subscribers to be billed based solely on the assertion that the purchase of services was made through the line subscriber's telephone line; the automatic number identification technology they use to "capture" the telephone number merely identifies the number of the telephone line from which the call was made. This automatic system does not identify the person using the line to purchase videotext or other information or entertainment services. Defendants employ no verification methods to confirm that the line subscriber is the person accessing their videotext services.<sup>58</sup>

By causing fees for their adult entertainment services to be placed on consumers'

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<sup>58</sup> Defendants are likely to argue that consumers agree to be billed by this international telephone billing mechanism because the computer user must click on an "I accept" button at the web site to trigger the software download. The lengthy subscription agreement that accompanies the "I accept" button warns prospective customers that they must be at least 18 and that there will be a charge for an international call to defendants' services. However, even if computer users carefully read this subscription agreement, defendants' argument misses the point: the computer users are, in many instances, not the same persons as the line subscribers who are being billed and this warning is not a sufficient basis for billing the line subscribers.

telephone bills in the guise of charges for long-distance calls to Madagascar, based solely on ANI, defendants' billing practices ignore the important distinction drawn by the Federal Communications Commission ("FCC") between "basic telecommunications services," such as ordinary voice telephone calls, and "enhanced services," such as videotext and audiotext services. *See Amendment of Section 64.702 of the Commission's Rules and Regulations ("Computer II")*, Tentative Decision and Further Notice of Inquiry and Rulemaking, 77 FCC 2d 384, 420 ¶¶ 97, 120 (holding that vendors of enhanced services, defined as anything more than basic transmission service, were not common carriers), *reconsidered*, 84 FCC 2d 50 (1980), *further reconsidered*, 88 FCC 2d 512 (1981), *aff'd sub nom. Computer and Communications Industry Ass'n v. FCC*

establish an arrangement.

*Letter, June 15, 1994, from Gregory A. Weiss, Acting Chief, Enforcement Division, Common Carrier Bureau, FCC, to Randal R. Collett, Ass'n of College & Univ. Telecomm. Adm'rs*, 9 FCC Rcd. 2819; *see also In re Policies and Rules Implementing the Telephone Disclosure & Dispute Resolution Act*, 9 F.C.C.R. 6891 ¶¶ 18-19 (1994).

The Federal Trade Commission has taken the same position in previous lawsuits<sup>59</sup> and in its current Pay-Per-Call rulemaking:

A merchant is not entitled to presume that the line subscriber has agreed to pay for a good or service merely because that subscriber's telephone was used to order a product or service. A consumer is no more obligated to pay for a non-blockable telephone-billed purchase made from his or her telephone than the consumer is obligated to pay for any other purchase (for example, a purchase of a sweater from a clothing catalog) that just happened to be made from that consumer's telephone.

63 *Fed. Reg.* 58549 (Oct. 30, 1998).

Defendants' representation that line subscribers are liable for charges for adult information services they did not purchase or authorize is false and therefore inherently likely to mislead consumers. *See Thompson Medical Co.*, 104 F.T.C. 648, 816 (1984), *aff'd*, 791 F.2d 189 (D.C. Cir. 1986). This representation is express and is presumed material. *Cliffdale Associates, Inc.*, 103 F.T.C. 110, 182, *appeal dismissed sub nom. Koven v. FTC*, No. 84-5337 (11th Cir. 1984). Even absent the presumption, however, materiality is obvious: the representation would likely influence consumers' decision whether to pay or dispute a bill. Consumers reasonably interpret

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<sup>59</sup> *FTC v. Communication Concepts & Invs., Inc.*, Civil Action No. 98-7450 (S.D. Fla. 2000) (stipulated permanent injunction) (complaint alleged deceptive claims that telephone line subscribers were responsible for charges for audiotext services they did not authorize); *see also FTC v. Lubell*, No. 3-96-CV-80200 (S.D. Iowa 1997) (stipulated permanent injunction) (complaint alleged that defendants misrepresented cost of audiotext services, *i.e.*, telephone-based entertainment programs).

not order defendants' videotext services have no practical way of figuring out that charges identified as long-distance calls are actually for entertainment services ordered and/or received by someone else. The billing statements provide no information that could assist such consumers in seeking a refund or credit for the cost of the unordered services, since the billing statement not only fails to identify the service accurately, but also fails to identify the name of any party who is actually responsible for placing the charge on the bill. Therefore, defendants' representations are deceptive, in violation of Section 5 of the FTC Act.

**2. Defendants Anderson and Barbosa are Individually Liable**

Defendants Ty Anderson and Charlo Barbosa share responsibility for defendants'

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<sup>60</sup> TRO Exh. 10, p. 281; TRO Exh. 11, p. 283.



injunctive relief for corporate misconduct under the FTC Act if they participated directly in the wrongful acts or practices or had authority to control the corporations. *See FTC v. Publishing Clearing House, Inc.*, 104 F.3d 1168, 1170 (9th Cir.1997); *Amy Travel*, 875 F.2d at 573.

“Authority to control the company can be evidenced by active involvement in business affairs and the making of corporate policy, including assuming the duties of a corporate officer.” *Id.* *See also Publishing Clearing House*, 104 F.3d at 1170; *FTC v. Five-Star Auto Club, Inc.*, 97 F.Supp.2d 502, 535-36 (S.D.N.Y. 2000); *Affordable Media*, 179 F.3d at 1234. As discussed above, B.C. Ltd. and Virtualynx have violated the FTC Act by causing charges to be placed on line subscribers’ telephone bills that they did not authorize and by misrepresenting these unauthorized charges as ones the line subscribers are obligated to pay. As the president and secretary of B.C. Ltd., and president, secretary, and owner of Virtualynx, Barbosa has the authority to control these practices.

Both individuals can also be held liable for restitution to consumers. Anderson can be held individually liable for restitution for his direct violations of the FTC Act. Barbosa can also be held individually liable for restitution for the corporate defendants’ FTC Act violations. To hold an individual liable for restitution for a corporate defendant’s violations, the FTC must show that the individual defendant knew or should have known that the corporation or one of its agents engaged in the wrongful acts or practices. *Publishing Clearing House*, 104 F.3d at 1171. Knowledge in this context is defined as actual knowledge of material misrepresentations, reckless indifference to the truth or falsity of a misrepresentation, or an awareness of a high probability of fraud along with an intentional avoidance of the truth. *Affordable Media*, 179 F.3d at 1234; *see also Publishing Clearing House*, 104 F.3d at 1171, *citing FTC v. American Standard Credit Sys., Inc.*, 874 F. Supp. 1080, 1089 (C.D. Cal. 1994), and *Amy Travel*, 875 F.2d at 574. The FTC is not required to show that the individual defendants intended to defraud consumers in order to

hold them personally liable. *Affordable Media*, 179 F.3d at 1234; *Publishing Clearing House*, 104 F.3d at 1171. “The extent of an individual’s involvement in a fraudulent scheme alone is sufficient to establish the requisite knowledge for personal restitutionary liability,” *Affordable Media*, 179 F.3d at 1235, and “[a]n individual defendant’s participation in corporate affairs is probative of knowledge.” *Windward Mktg.*, 1997 U.S. Dist. LEXIS 17114 at \* 39. The evidence of Barbosa’s role and knowledge of this scheme is considerable. He is involved in operating the web sites, including registering domain names with Network Solutions and acting as administrative, billing, and technical contact. B.C. Ltd. and Virtualynx each has just a handful of employees and Barbosa is the sole owner of both.

### **3. The Equities Favor Granting Preliminary Relief**

As discussed above, preliminary relief is appropriate if, once the FTC establishes the likelihood of its ultimate success, the Court finds the equities weigh in favor of granting the relief sought. Where public and private equities are at issue, as in a case alleging violation of the FTC Act, the public equities receive greater weight. *World Wide Factors*, 882 F.2d at 347. In this

undertaken to bill consumers through the dialer program without clear evidence that they were billing the proper person. This is particularly so when defendants had available to them other billing mechanisms – credit cards, checks, and 900 number charges – that do not pose the same huge risk of billing someone who did not make or authorize the purchase.

The private equities in this case are not compelling. Compliance with the law is hardly an unreasonable burden. There is no oppressive hardship to defendants in requiring them to comply with the law and refrain from fraudulent representations. *See World Wide Factors*, 882 F.2d at 347. The evidence demonstrates that the public equities – protection of innocent consumers and effective enforcement of the law – weigh heavily in favor of granting the preliminary relief requested in this case.

#### **V. REQUESTED RELIEF**

The FTC seeks a temporary restraining order to enjoin the defendants' law violations immediately. Defendants persisted in defrauding consumers, even after AT&T stopped carrying videotext access calls to Madagascar, by employing Verity and its affiliates to bill consumers directly for unauthorized charges. Even though the FTC has obtained temporary relief against the defendants in the *Verity* case, nothing short of an order of this Court will stop the defendants here from finding yet another willing accomplice for their scheme.

In addition to prohibiting the defendants from using unfair and deceptive billing practices, the proposed TRO includes provisions directed at third parties to ensure that the defendants cannot continue to defraud consumers during the pendency of the litigation. Thus, Paragraph XI of the proposed TRO would direct local and long-distance telephone companies to prohibit defendants from withdrawing or otherwise disposing of any accounts or assets held by the telephone company, to ensure that funds are available for restitution to consumers. This provision is narrowly targeted to cover only the proceeds of defendants' unauthorized billing activities.

Paragraph XII would direct any party hosting defendants' web sites to take the steps necessary to make the sites inaccessible to the public pending determination of the FTC's request for a preliminary injunction. Paragraph XIII would direct Network Solutions, Inc., and any other domain name registrar to suspend the registration of the pornpictures.com, cartoonporn.com and alienporn.com domain names.

## **VI. CONCLUSION**

The defendants have caused and are likely to continue to cause great injury to consumers through their unlawful practices in violation of the FTC Act. The relief the plaintiff seeks is necessary to prevent further consumer injury. For the foregoing reasons, the FTC requests that the court issue a temporary restraining order and an order to show cause why a preliminary injunction should not issue.

Dated: \_\_\_\_\_

DEBRA VALENTINE  
General Counsel

CHARLES A. HARWOOD  
Regional Director

PATRICIA A. HENSLEY  
THOMAS P. ROWAN

Attorneys for Plaintiff  
FEDERAL TRADE COMMISSION

By: \_\_\_\_\_  
Patricia A. Hensley