IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

INC21.COM CORPORATION, JUMPAGE SOLUTIONS, INC., GST U.S.A., INC., ROY YU LIN, individually and as an officer and director of the corporate defendants; JOHN YU LIN, individually and on behalf of the corporate defendants,

Defendants,

and SHENG LIN,

Relief Defendant.
______________________________________/

No. C 10-00022 WHA

ORDER ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

INTRODUCTION

In this enforcement action involving millions of dollars in unauthorized charges tacked onto thousands of telephone bills, the Federal Trade Commission moves for summary judgment against corporate defendants Inc21.com Corporation, JumPage Solutions, Inc., and GST U.S.A., Inc., and individual defendants Roy Yu Lin and John Yu Lin for violations of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45, and the Telemarketing Sales Rule, 16 C.F.R. Part 310. The FTC also moves for summary judgment against relief defendant Sheng Lin — the father of defendants Roy and John Lin — to disgorge $434,000 in financial benefits he received from defendants' unlawful practices.

Finally, the FTC has provided clear and unrebutted evidence that relief defendant Sheng Lin received at least $434,000 in salary and cash bonuses from defendants' unlawful practices, despite having no involvement in defendants' LEC-billing scheme. Indeed, Sheng Lin's own admissions at his deposition confirm these allegations. Since relief defendant Sheng Lin has no legal title to these funds, disgorgement of these funds is warranted.

In their opposition brief, defendants put forth no affirmative evidence rebutting any of the material evidence confirming their liability. Whatever quibbles that defendants have raised over peripheral facts in the record are small compared to the sweeping themes established by the FTC. In short, the defense presented by defendants is like disagreeing over the size of the iceberg while ignoring the monumental fact that the Titanic sank.

For these reasons, the FTC's motion for summary judgment is **GRANTED**. Defendants' motion for summary judgment is **DENIED**. Defendants' unlawful LEC-billing and telemarketing practices will be permanently enjoined and restitution ordered in the amount of $37,970,929.57.

STATEMENT

1. DEFENDANTS ROY AND JOHN LIN

The story of Inc21.com Corporation and its sister companies sued herein begins with defendant Roy Lin. After moving with his family to the United States from Taiwan, Roy Lin completed his education and accepted a position at MCI Communications in 1996 selling international long-distance services (R. Lin Dep. 14–15, 23, 32–33). After a year with MCI, Roy Lin continued his work in the long-distance industry as an independent sales contractor using his parents' business entity, GST U.S.A., Inc. (*id.* at 34–36). GST U.S.A. — a defendant in this action — was originally incorporated by Roy Lin in 1995 for his parents' business ventures, which included a tandem of Bay Area restaurants (*id.* at 36–42).

In 1999, Roy Lin joined True America Communications, an international long-distance reseller. It was at True America that Roy Lin first learned about local exchange carrier billing, also known as "LEC billing" (*id.* at 33, 47–49). As will soon be explained in greater detail, LEC billing enables third-party vendors to charge their customers for products and services by tacking charges onto their local telephone bills (*id.* at 34; Walch Dep. 36–37). At True America, Roy Lin took the lead in setting up the company's entire LEC-billing operation. Much of Roy Lin's knowledge about the "ins and outs" of LEC billing was acquired during this time (R. Lin Dep. 50–55). After spending only one year at True America, Roy Lin left the company and started Inc21 (id. at 59).

Inc21.com Corporation was incorporated in California on November 17, 1999 (ibid.). At the time of incorporation, Roy Lin was Inc21's only officer — his brother, defendant John Lin, did not become involved with the company until January 2003 (id. at 60). Roy was (and remains) the sole owner of Inc21 (J. Lin Dep. 90). The company never assembled a formal board of directors (R. Lin Dep. 64). When Inc21 first opened its doors in January 2000, it provided "web design" services for small businesses. These businesses would pay Inc21 the traditional way — by checks and credit cards (id. at 71–77). Designing websites was not a profitable enterprise.

In January 2003, after struggling to keep his business afloat, Roy Lin shifted Inc21 towards a more familiar line of work — reselling long-distance services (id. at 78). Part of this shift was a change in the company's billing approach. Instead of accepting payment via checks and credit cards, 95 percent of Inc21's long-distance customers were billed via LEC billing (id. at 82). It was around this time that Roy Lin's brother, defendant John Lin, became involved with Inc21's operations. John Lin immediately began contributing his time and money to the business, lending the company approximately $50,000 and becoming both an officer and director of Inc21 (id. at 60, 64, 83). Despite their collaborative efforts, however, the long-distance reselling business proved to be even more unprofitable than designing websites.

In December 2003, Roy and John Lin changed the course of Inc21 yet again. Instead of reselling long-distance services, Inc21 began selling an "Internet advertising" product called "GlobalYP," which Roy Lin described at his deposition as "online yellow pages" (id. at 82–83, 111; Walch Dep. 17). These online yellow pages consisted of a website and a searchable online directory, and were supposed to help businesses "get extra exposure on the Internet" (R. Lin Dep. 111; Tran Dep. 13–14; Yakubova Dep. 12–13). Critically, the Lin brothers elected to retain a central aspect of their former long-distance reselling business when implementing this new business model: they continued to bill their customers using LEC billing (Walch Dep. 36–37).

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between them was which corporate entity "sold" them and where the revenue for each product flowed. All revenue generated by GlobalYP and NetOpus sales went into Inc21's checking account, while MetroYP revenue flowed directly into GST U.S.A's checking account (Walch Dep. 28).

Since these three "online yellow pages" products shared the same underpinnings, they also suffered from the same flaws. For example, all customers that "purchased" these products from defendants were randomly assigned a website template from a selection of twenty different designs (Nelson Dep. 36–39). As an illustration, a customer like Omni Hotels Los Angeles (an actual GlobalYP "customer") might be assigned a default website template that was intended for use by a restaurant or an auto repair shop (id. at 39). While businesses were supposed to be able to customize their websites to remedy these inconsistencies, it was impossible for defendants' "customers" to do so due to a "bug" in the underlying source code (id. at 46–47, 50–51). Instead, "customers" of GlobalYP, MetroYP, and NetOpus would have to call Inc21 customer support and open a "support ticket" just to update their default website information (id. at 40–41).

The Inc21 employee who was responsible for responding to these "support tickets" for GlobalYP, MetroYP, and NetOpus customers between July 2006 and March 2010 was Michael Nelson, Inc21's former systems administrator. According to Mr. Nelson's deposition testimony, he informed John Lin on "numerous, numerous occasions" of this "bug" in the source code that made it "impossible" for customers to make updates to their websites (id. at 43). Tellingly, despite this major product flaw, Mr. Nelson testified that very few of defendants' "customers" submitted support tickets. Indeed, between July 2006 and March 2010, Mr. Nelson received a total of only ten to twenty requests from customers seeking to update their websites (id. at 8, 19, 42). This staggeringly low number was consistent with an internal analysis performed by defendants in 2007 that revealed that only around two to five percent of GlobalYP, MetroYP, and NetOpus "customers" had ever attempted to modify their websites (id. at 48–50).[1]

[1] As part of their opposition to the FTC's motion, defendants submitted the declaration of another Inc21 employee who stated that the "online yellow pages" products were not as "broken" as Mr. Nelson claimed (Chien Decl. ¶¶ 8–10). Even if true, this does not create a material factual dispute for trial. Regardless of whether defendants' products "worked," the evidence is overwhelming that "customers" never bought them.

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around twenty different independent call centers to generate sales of GlobalYP, MetroYP,

bald and uncorroborated assertion that defendants' policy was to "always exclude" government agencies, schools, banks, and franchises from their telemarketing activities.

As further proof of this failure, in February 2010, defendants provided the FTC with an updated list of "current customers" showing the specific product that each customer had supposedly "purchased" (Wolfe Decl. ¶ 9, Att. HH).[3] The updated list showed that defendants had taken the initiative of "cancelling" the accounts for numerous "government agencies, schools, banks, and franchises" that they had been previously billing. For example, the first twelve pages of the February 2010 list revealed that defendants had been billing numerous locations of Office Max, the Gap, Autozone, and other franchises, as well U.S. Bank and Wachovia branches for its GlobalYP "online yellow pages" service. These targeted cancellations confirm that these entities could have been filtered out before-the-fact had defendants attempted to do so. Clearly, no such filtering had in fact occurred.

The only reasonable conclusion a jury could draw from this evidence is that, contrary to John Lin's bald and uncorroborated testimony, defendants did not perform any substantial filtering of the "business leads" that were distributed to its call centers. This resulted in many of defendants' "customers" being billed for services for which they had no use (J. Lin Dep. 132).[4]

ii. The "Scripted" Sales Pitches

Once these unfiltered leads were sent to defendants' call centers, the call-center agents would begin cold-calling prospective customers (Tran Dep. 25–26). When making these calls, the agents were supposedly required to follow pre-approved telemarketing sales scripts (Du Dep. 61–62). Agents supposedly could not edit the scripts and were barred from deviating from them. Call centers, however, were allowed to suggest changes to the scripts if they had a "more effective way of selling" defendants' products (*id.* at 62–63). While these proposed changes had to be "approved" by Roy Lin before being implemented by call-center agents, many changes that

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[3] The initial list produced by defendants in January 2010 did not specify the name of the product each customer had purportedly "purchased."

[4] The declarations submitted by former customers Ballard, Haney, Urso (Dkt. No. 36-50), and Weber (Dkt. No. 36-51) confirm that businesses that had no need for defendants' products were nonetheless magically "signed up" by defendants and billed. Additionally, Inc21's systems administrator testified at his deposition that he would routinely see large franchises being billed for defendants' products (Nelson Dep. 71–74).

In sum, not only did call-center agents deviate from telemarketing sales scripts, the scripts themselves were not always updated and contained terms that defendants knew were improper.

iii. Third-Party Verification

While telemarketing calls were not recorded in their entirety, portions of each phone call were supposedly recorded by defendants' call centers to enable third parties to verify that sales personally listened to" (Yakubova Dep. 31). The same employee provided a vivid example of one of the ways in which TPV recordings were manipulated by call centers (*id.* at 49–50):

> There was one way which I remember very well, and I was listening to a TPV and there was a — as you mentioned before, a series of questions and — and it did request at some point of time kind of like personal information to ensure that it was a customer who was indeed giving a consent, like, for example, last digits of — I don't know — Social Security number, for example. And I

[6] These declarations were submitted by customers Gold (Dkt. No. 36-33), Hartig (Dkt. No. 36-36), Koval (Dkt. No. 36-39), Morris-Meyer (Dkt. No. 36-43), Smerud (Dkt. No. 36-46), Weber (Dkt. No. 36-51), Winn (Dkt. No. 36-52, and Witt (Dkt. No. 36-53).

2967 WHA). Despite full knowledge of this fraud, however, defendant John Lin admitted at his deposition that defendants did *not* refund customers signed up by these call centers unless customers actually filed a complaint and requested a refund (J. Lin Dep. 174–77).

Even after defendants changed call centers in mid-2007, they continued to receive repeated warnings from their TPV provider that call centers were manipulating recordings and misrepresenting the 15-day "free" trial offer (Lutich Dep. 76–77; Wolfe Decl. Att. EE, FTC Exhs. 76, 79, 80, 87). Specifically, the 2008 and 2009 reports mentioned above were emailed to defendants by QCI every business day, and defendants were also given notice in verbal communications that their call centers were splicing tapes. At least one of these reports provided to defendants from QCI indicated that 100 percent of TPV recordings for "sales" of their products had "failed" — a perfect failure rate that QCI admitted was highly unusual (Lutich Dep. 99–102; Wolfe Decl. Att. EE, FTC Exh. 76).

Defendants' customer service personnel were also aware of the suspect veracity of TPV recordings. When investigating customer complaints, these employees would routinely listen to TPV recordings to determine if they sounded "good" (Tran Dep. 83–90). Even for those TPV recordings that sounded "good," however, the customer would "[m]ost of the time" dispute that they had given authorization (*id.* at 88). Specifically, customers would tell Inc21 employees that the TPV recording did not reflect what they had said in the telemarketing call, that the recording had been altered, and/or that the person who supposedly "authorized" the purchase did not work for their company (*ibid.*). Indeed, the record contains numerous declarations from defendants' "customers" who stated that they expressly *rejected* the telemarketing sales offer made to them, but ended up being billed anyway.[9]

The final layer of evidence demonstrating the ineffectiveness of the TPV process in separating "invalid" sales from "valid" sales is the fact that in January 2010, defendants asked QCI to re-examine the TPV recordings of 10,434 of their existing customers who had supposedly already been screened and "passed." QCI concluded that 4,616 of the recordings actually "failed"

[9] These declarations were submitted by customers Bryan (Dkt. No. 36-23), Cronk (Dkt. No. 36-26), Fogel (Dkt. No. 36-28), Rumphol (Dkt. No. 36-45), Winn (Dkt. No. 36-52), and Pesoat (Dkt. No. 52-1).

purchase the product. On average, only 3.3 percent of defendants' "customers" for their four telemarketed products had actually agreed to purchase defendants' products.

B. Defendants' Internet Marketing Practices

Unlike GlobalYP, MetroYP, NetOpus, and the JumPage product, the GoFaxer product was sold exclusively through a specific type of Internet marketing called co-registration (R. Lin Dep. 142–43, 174). Co-registration generates leads and sales via the Internet, often with the help of outside companies that specialize in such marketing (*id.* at 172). As described by former Inc21 employee Michael Nelson (and corroborated by Roy Lin himself), co-registration worked as follows (Nelson Dep. 27–28; *see also* R. Lin Dep. 177–78):

[12] As stated, some GoFaxer customers were billed via credit card (J. Lin Dep. 66). All GoFaxer customers obtained through “co-registration,” however, were billed via LEC billing (R. Lin Dep. 176). The small number of GoFaxer customers billed via credit card are not

will be briefly recapped. Four entities are typically involved in the LEC-billing process: (1) local exchange carriers (or "LECs"), (2) billing aggregators (also called "clearinghouses"), (3) third-party vendors (like defendants), and (4) customers. In exchange for fees, LECs allow pre-approved third-party vendors to place charges for their products and services onto their customers' telephone bills. Although charges from third-party vendors are listed separately on these telephone bills from LEC-related charges, the "total amount due" presented to customers *includes* third-party vendor charges (*see* Dkt. Nos. 7-3, 36-31, 36-35). Billing aggregators act like "middle men" in this process. They contract directly with third-party vendors to facilitate the placement of their charges onto customer telephone bills. They also aid in the collection of these charges from LECs (Lavino Dep. 16–17).[13] Customers pay third-party vendor charges directly to the LECs by simply paying the "total amount due" on their phone bills. After subtracting fees, the LECs then pass the payments along to the billing aggregators. The billing aggregators then pass the payments along to the appropriate third-party vendors, minus their own service fees.

As described below, defendants took full advantage of the weaknesses in this billing system to reap the benefits of the unauthorized sales generated by their marketers.

A. The 15-Day "Free" Trial

Customers who purportedly "agreed" to purchase defendants' products were provided with a 15-day "free" trial. If the customer did not cancel within the trial period, billing would immediately ensue (Tran Dep. 35–39).[14] Written notification of this 15-day "free" trial period was provided via a welcome letter or postcard that would be mailed to customers after their sales were "passed" by a TPV provider (*id.* at 35–36; Yakubova Dep. 39). This letter would tell customers about the product that they had "purchased," and would warn customers that failure to cancel within 15 days would result in immediate billing (Tran Dep. 37). If a welcome letter was returned as "undeliverable," Inc21 employees would attempt to locate a new mailing address using various third-party search services. If a new address was located, a second welcome letter

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[13] Defendants contracted with the following billing aggregators: Integretel, PaymentOne, The Billing Resource, BSG Clearing Solutions, and ILD (J. Lin Dep. 86–87, 160–61).

[14] According to defendant John Lin, defendants gave customers an additional five-day grace period to cancel. Thus, "customers" actually had 20 days to cancel their "purchases" (J. Lin Decl. ¶ 8).

would be sent. This second mailing would *not*, however, reset the trial period. Rather, the trial period would always begin running from the date of the telemarketing call (*id.* at 38–39).

The volume of "undeliverable" welcome letters — at its peak — reached between 100 to 200 per week (Yakubova Dep. 39–40). This was equaled by welcome letters that were mailed back to defendants with notes from customers stating "[p]lease cancel this" and "I did not sign up for this" (*id.* at 40–41). For customers where no welcome letter was ever successfully delivered, however, defendants would *still* bill those customers unless they complained or requested a refund (Tran Dep. 81–83). Of course, reaching defendants and obtaining refunds proved difficult for many of these "customers."

B. Complaints and Refunds

When Michael Nelson, the former systems administrator for Inc21, first set foot in defendants' offices in 2005, he "noticed right away that a lot of phones were ringing on the desks" and "there were people sitting there, but nobody was picking up the phones" (Nelson Dep. 74). When Mr. Nelson asked defendant John Lin, "Why doesn't anybody answer any of those phones?," John Lin replied, "Oh, they're just customers who need assistance. We never answer those phones" (*id.* at 75). Then, according to Mr. Nelson, John Lin *laughed*

Customers, however, were not amused. When defendants chose to answer phones, complaining customers faced an uphill battle in obtaining refunds. According to Selena Tran, who handled customer service for defendants' various business entities and products, defendants fielded an average of 90 complaints per week for unauthorized billing (Tran Dep. 91). To respond to these complaints, customer service representatives would listen to the TPV recordings of the complaining customers. If a recording sounded "bad," a full refund would be issued. If, however, the TPV recording sounded "good," defendants would then use the recording as ammunition against the customer, offering no refunds or only partial refunds even if the customer asserted that the recording had been falsified (*id.* at 88–91; Yakubova Dep. 60–61). Only if the customer threatened to contact the Better Business Bureau or the Attorney General's office would

[15] Many customers nevertheless lodged complaints with the Better Business Bureau and law enforcement agencies. These complaints were then communicated to defendants (Yakubova Dep. 34).

[16] These declarations were submitted by customers Abbate (Dkt. No. 36-19), Ballard, Bloom (Dkt. No. 36-21), Brown (Dkt. No. 36-22), Bryan (Dkt. No. 36-23), Beusing (Dkt. No. 36-24), Cronk (Dkt. No. 36-26), Gerber (Dkt. No. 36-31), Groppe (Dkt. No. 36-34), Hammond (Dkt. No. 36-35), Henningsen, Maklari (Dkt. No. 36-42), O'Neil (Dkt. No. 36-44), Rumphol (Dkt. No. 36-45), Smerud (Dkt. No. 36-46), Strickland, Thompson

Fourth, even in regions where defendants lacked authorization to use LEC billing (either because they had been suspended or had not yet been approved), defendants found ways to get their products onto telephone bills. Specifically, defendant Roy Lin conspired with another vendor, Jeff Lavino, who had access to the LEC-billing industry in regions where defendants did not. Through a contractual arrangement, defendants "sold" its GlobalYP, MetroYP, and JumPage

[18] The "sale" of customers to Mr. Lavino occurred on three occasions: (1) in 2005, after Verizon terminated GlobalYP's LEC-billing authorization (Lavino Dep. 22–24, 31–35; Wolfe Decl. Att. GG, FTC Exh. 133), (2) in 2008, after Qwest suspended billing for JumPage Solutions (Lavino Dep. 60–62; Wolfe Decl. Att. GG, FTC Exh. 142), and (3) when defendants had yet to receive LEC-billing authorization in regions where "customers" had already been acquired (Lavino Dep. 45–47).

[19] In its opening brief, the FTC stated that this figure was $43,824,970.45 (FTC's Br. 16). This was revised downward after the FTC acknowledged that its initial calculations contained an error (FTC's Reply 11). Defendants did not challenge any of the calculations performed by the FTC.

[20] In its opening brief, the FTC stated that defendants received at least $324,856.15 from Mr. Lavino, citing the declaration of David Sihota to support this amount (FTC's Br. 16). Mr. Sihota's declaration, however, expressly states that defendants received $331,346.54 from Mr. Lavino's business entities.

from defendants, not including the benefits he received from medical insurance, business loans, and the use of a GoFaxer credit card for his personal expenses (Walch Dep. 122–23, 126–30).

* * *

The FTC instituted this enforcement action on January 5, 2010 (Dkt. No. 1). This order follows the issuance of a temporary restraining order on January 19, a preliminary injunction on February 19, and an accelerated discovery schedule (granted at defendants' request) (Dkt. Nos. 28, 57–58). A hearing on the instant summary judgment motions was held on September 15.

ANALYSIS

Summary judgment may be granted if the pleadings and supporting documents, viewed in the light most favorable to the non-moving party, show that there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. FRCP 56(c). For a genuine issue of fact to be material, the evidence must be such that a reasonable jury could return a verdict for the non-moving party. A declarant's bald, uncorroborated, and conclusory assertions need not be credited to defeat summary judgment. *Villiarimo v. Aloha Island Air, Inc.*, 281 F.3d 1054, 1061 (9th Cir. 2002); *see also FTC v. Stefanchik*, 559 F.3d 924, 929 (9th Cir. 2009).

In the instant cross-motions for summary judgment, two sets of claims are in the spotlight: (1) claims brought under Section 5 of the Federal Trade Commission Act, and (2) claims brought under the Telemarketing Sales Rule (or TSR). Each set of claims will be addressed in turn.

1. T

consumers. "An act or practice is deceptive if 'first, there is a representation, omission, or practice that, second, is likely to mislead consumers acting reasonably under the circumstances, and third, the representation, omission, or practice is material.'" *FTC v. Gill*, 265 F.3d 944, 950 (9th Cir. 2001).

The undisputed record establishes that all three elements have been proven with respect to defendants' LEC-billing practices. *First*, the FTC has produced an avalanche of unrebutted evidence that defendants placed monthly charges for all five of their products on the telephone bills of consumers and collected over $37 million from this practice. This is true for both their telemarketed products (GlobalYP, MetroYP, NetOpus, and the JumPage product) and GoFaxer, which was "sold" exclusively through co-registration. The placement of these charges on consumer telephone bills (and the inclusion of those charges in the "total amount due" shown on these bills) constituted an affirmative representation by defendants that the consumer had *in fact* authorized the purchase and owed payment to defendants.

Second, the consumer survey conducted by Expert Marylander, an expert with qualifications that defendants did not challenge, revealed that — on average — nearly 97 percent of defendants' "customers" had not agreed to purchase the products for which they had been billed, 96 percent of these "customers" had not received any services from defendants, and only five percent of these "customers" were even aware that charges for defendants' products had been placed on their telephone bills. This survey, which carried a 95 percent confidence level and was conducted pursuant to what this order finds was a reliable methodology, provides compelling and unrebutted evidence in support of the FTC's argument that the placement of unauthorized charges on consumer telephone bills was deceptive, false, and likely to mislead almost any consumer acting reasonably under the circumstances. *See FTC v. Verity Int'l, Ltd.*, 443 F.3d 48, 63 (2d Cir. 2006) (affirming the district court's conclusion that the placement of adult entertainment charges on phone bills "capitaliz[ed] on the common and well-founded perception held by consumers that they must pay their telephone bills"); *see also Kemp v. AT&T*, 393 F.3d 1354, 1360 (11th Cir. 2004) (affirming the district court's conclusion that customers foreseeably believe that all phone bill charges have to be paid in order to maintain phone service). The deposition testimony of

i. The Reliability of the Marylander Survey

Defendants' criticisms of Expert Marylander's survey do not create any genuine issues of material fact for trial. In FTC v. Stefanchik, the United States Court of Appeals for the Ninth Circuit affirmed the district court's summary judgment order in an enforcement action involving deceptive marketing claims. Just like the instant case, the FTC in Stefanchik provided a collection of declarations from deceived consumers as well as survey evidence showing that 92 percent of Stefanchik's customers made no money from the mortgage-flipping scheme that he had marketed. To challenge the FTC's survey results, the defendants in Stefanchik produced two expert opinions criticizing the methodology of the survey. The Ninth Circuit affirmed the district court's conclusion that these expert criticisms did not create a genuine issue of material fact for trial, but were instead directed towards the admissibility of the FTC's survey evidence:

> Stefanchik and Beringer contest the methodology of the FTC's survey and assert that issues of fact exist, but they do not contest the truth or validity of the individual responses reported in the survey. They offered no competent affirmative evidence of their own, either in the form of survey results, contrary consumer declarations, sworn affidavits, or testimony, to identify consumers who were able to makt dhnstanriala muants of moneylusing thr Stefanchikimethol as claimearketing materias.
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argument made by defense counsel is that the Marylander survey did not account for "customers" who might have forgotten whether they had purchased defendants' products or had been billed by defendants. This is wrong. Expert Marylander's survey expressly allowed customers to answer "I don't know" and "I don't remember" to questions asked by interviewers (*id.* at ¶¶ 25, 28, 33). Tellingly, despite the availability of this option, nearly 97 percent of "customers" still stated that they had not agreed to purchase defendants' products.

Defense counsel's best argument is directed at the use of the phrase "Internet services" in

iii. The "Free" Trial and FCC Compliance

The two remaining arguments raised by defense counsel — that consumers were given fair warning of the 15-day "free" trial period and that all LEC-billed charges complied with FCC disclosure rules — miss the point for exactly the same reason. Even if true, these arguments do not rebut the FTC's showing that reasonable consumers were likely to have been misled (and were *in fact* misled) by defendants' LEC-billing practices. Given the compelling evidence of deception set forth in Expert Marylander's unrebutted survey, it is immaterial to liability whether consumers who never bought defendants' products in the first place were given a warning in the mail that they would be billed once their 15-day "free" trial expired. It is also immaterial to liability whether defendants' charges — 97 percent of which were unauthorized to begin with — were properly displayed on consumer telephone bills pursuant to FCC rules. What defense counsel is essentially arguing is that fraudulent sales and unauthorized charges can somehow be cleansed of impropriety through post-hoc disclosures. This order rejects such an argument.

Since there are no genuine issues of material fact as to whether defendants' billing practices were deceptive in violation of Section 5 of the FTC Act, the FTC's motion for summary judgment on this claim is **GRANTED**.

B. Claim Two: Unfair Billing Practices

Under Section 5 of the FTC Act, an unfair practice or act is one that "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." 15 U.S.C. 45(n). It is not a bar to liability if a violation is caused by more than one perpetrator. Rather, liability under the Act may be found if a business facilitated or provided substantial assistance to a deceptive scheme resulting in substantial injury to customers. *FTC v. Neovi, Inc.*, --- F.3d ----, 2010 WL 2365956, at *4 (9th Cir. 2010) (citation omitted).

As with the prior claim, the FTC has more than met its burden of proving each of these elements. *First*, while losses incurred by individual customers may have been relatively small, an act or practice can cause "substantial injury" by doing a "small harm to a large number of people[.]" *Id.* at *6 (citation omitted). Given that nearly 97 percent of defendants' tens of thousands of "customers" did not agree to purchase defendants' products and over $37 million in largely unauthorized charges flowed directly to defendants through LEC billing, a "substantial injury to consumers" has been proven.

Second, given the evidence that nearly 97 percent of defendants' "customers" never agreed to purchase defendants' products in the first place, it follows that these "customers" had no reason to scrutinize their telephone bills for defendants' fraudulent charges. Indeed, only five percent of defendants' "customers" ever noticed these charges appearing on their telephone bills. This unrebutted evidence supports a finding that the harm suffered by consumers was not reasonably avoidable. In their defense, defendants argue that their LEC-billing activities were compliant with FCC disclosure requirements and that customers could have reasonably avoided unauthorized charges by either disputing them or not paying them. This order declines to allow defendants to blame unsuspecting consumers for failing to detect and dispute unauthorized billing activity. As other courts have wisely concluded, the burden should not be placed on defrauded customers to avoid charges that were never authorized to begin with. *See, e.g.*, *FTC v. Kennedy*, 574 F. Supp. 2d 714, 720–21 (S.D. Tex. 2008); *FTC v. The Crescent Publishing Group, Inc.*, 129 F. Supp. 2d 311, 322 (S.D.N.Y. 2001). In sum, the FTC has met its burden of proving that these unauthorized charges were not reasonably avoidable by consumers.

Third, the record demonstrates that nearly all of defendants' "customers" received no countervailing benefits from defendants' billing practices. At the September 15 hearing, defense counsel argued that defendants invested heavily in providing benefits for their customers, such as spending over $350,000 in search-engine marketing fees for JumPage customers. This argument ignores, however, the unrebutted fact that nearly 97 percent of defendants' "customers" never wanted these "benefits" in the first place. Moreover, 96 percent of defendants' "customers" stated that they received shown that the injuries caused by defendants' billing practices were *not* outweighed by countervailing benefits to consumers or competition.

As with the prior claim, defendants have not shown that any genuine issues of material fact exist for trial. Defendants' best argument raised in their opposition brief is that the injuries suffered by consumers were reasonably avoidable because consumers could have mitigated their harm by cancelling and obtaining a refund once unauthorized charges were detected. This argument is rejected. In *FTC v. Neovi*, the United States Court of Appeals for the Ninth Circuit affirmed the district court's summary judgment order in an enforcement action involving fraudulent checks. In so holding, the Ninth Circuit agreed with the district court that it was "likely" that consumers never noticed the unauthorized activity on their accounts. Moreover, even if they did, the Ninth Circuit recognized that the hassle of obtaining reimbursements required substantial investments of time, trouble, aggravation, and money, especially since the defendants in *Neovi* were uncooperative in providing remedies to consumers. As such, the Ninth Circuit agreed with the district court's conclusion that consumers suffered unavoidable injuries that could not be fully mitigated. *Neovi*, 2010 WL 2365956, at *6–7.

The same rationale applies here. The undisputed record in the instant action shows that only five percent of defendants' "customers" were aware that they had been billed for defendants' products. For those customers that noticed the unauthorized charges on their telephone bills, the evidence also shows that defendants' approach towards "customer service" involved letting telephone calls go unanswered and making it difficult for complaining customers to obtain a complete refund. As in *Neovi*, the time, trouble, aggravation, and money lost by such consumers were unavoidable injuries that could not have been fully mitigated.

For these reasons, the FTC's motion for summary judgment that defendants engaged in unfair billing practices in violation of Section 5 of the FTC Act is **GRANTED**.

C. Individual Liability

To establish individual liability for equitable restitution under the FTC Act, an individual must have "participated directly in the deceptive acts or had the authority to control them" and "had *knowledge* that the corporation or one of its agents engaged in dishonest or fraudulent

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acquired and billed, but intentionally avoided uncovering the truth.[22] Finally, even after being suspended by various LECs for placing excessive unauthorized charges on consumer telephone bills, the Lin brothers found ways to exploit the weaknesses in the LEC-billing industry. They falsified LEC-billing applications and sold their "customers" to a third-party vendor so that LEC billing could continue ad infinitum The Lin brothers knew exactly what they were doing.

Because overwhelming, unrebutted evidence shows that both Roy and John Lin participated directly in the deceptive acts, had the authority to control them, and — at a minimum — were well aware of a high probability of fraud surrounding the "customers" that they were billing, this order finds that they can and are hereby held individually liable for equitable restitution under the FTC Act.

2. THE TELEMARKETING SALES RULE

Turning to the FTC's second set of claims, the Telemarketing Sales Rule was enacted due to a directive from Congress to "prescribe rules prohibiting deceptive telemarketing acts or practices and other abusive telemarketing acts or practices." 15 U.S.C. 1602(a)(1). The TSR prohibits "any seller or telemarketer" from misrepresenting "[a]ny material aspect of the performance, efficacy, nature, or central characteristics of goods or services that are the subject of a sales offer." 16 C.F.R. 310.3(a)(2)(iii). It further prohibits both sellers and telemarketers from "[m]aking a false or misleading statement to induce any person to pay for goods or services[.]" 16 C.F.R. 310.3(a)(4). Any violation of the TSR constitutes an unfair and deceptive practice in violation of Section 5 of the FTC Act. 15 U.S.C. 57a(d)(3), 6102(c)(b). The TSR, however, includes an important exemption relevant to the instant motions: it exempts "[t]elephone calls between a telemarketer and any business, except calls to induce the retail sale of nondurable office or cleaning supplies." 16 C.F.R. 310.6(b)(7). Curiously, while the TSR defines the terms "seller," "telemarketer," and "customers," it does not define the term "business."

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[22] This order rejects defense counsel's argument — raised at the September 15 hearing — that holding Roy and John Lin liable herein will discourage businesses from suing their own contractors for fraud. The Lin brothers undoubtedly had the power to cancel and issue refunds for each and every "sale" obtained by the marketers they sued. That would have been proper. Instead, they chose a different path. They chose to embrace many of these "sales" despite knowing that the process of acquiring them was laced with fraud.

The complaint alleged three distinct TSR violations: (1) failure to disclose the negative option feature of defendants' sales offer, (2) use of "preacquired account information" to charge customers without their "express informed consent," and (3) failure to obtain "express verifiable authorization" before placing charges on consumers' telephone bills. Due to the "business-to-business" exemption in the TSR, however, the FTC has limited its motion to telemarketing calls made to non-businesses.

Defendants have also moved for summary judgment with respect to the FTC's claims under the TSR. As defense counsel argued at the hearing, the products that were telemarketed by defendants — GlobalYP, MetroYP, NetOpus, and the JumPage product — were each intended to be sold exclusively to businesses. As such, defendants contend that they are entitled to summary judgment on all claims brought under the TSR because their telemarketing practices fall within the "business-to-business" exemption. All of these arguments are addressed below.

A. Claim Three: Failure to Disclose the Negative Option Feature

The TSR states that it is a deceptive telemarketing act to fail to disclose truthfully, and in a clear and conspicuous manner, all material terms of the negative option feature of an offer, including: (1) the fact that the customer will be charged unless affirmative steps are taken to avoid it, (2) the date(s) charges will be submitted for payment, and (3) the specific steps the customer must take to avoid being charged. *See* 16 C.F.R. 310.3(a)(1)(vii). A "negative option" is a provision in an offer or agreement under which a customer's failure to take an affirmative step to cancel is interpreted by the seller as an acceptance of the offer. 16 C.F.R. 310(t).

According to the FTC, there are no genuine issues of material fact regarding defendants' failure to inform non-business consumers about the negative option feature of defendants' 15-day "free" trial offer during telemarketing calls. As evidence of this claim, the FTC focuses on two customer declarations — one from an individual consumer, Roger Gerber, and one from an employee of a non-profit entity, Diane Haney (*See* Declarations of Gerber and Haney). Both Mr. Gerber and Ms. Haney stated in their declarations that no "material terms" or "offers" were ever mentioned to them during the telemarketing calls they received from defendants. Beyond these two declarations, the FTC provides no direct evidence in support of this claim except a list of defendants' "current customers" where individuals, public and government entities (*e.g*, schools, libraries, police departments), and churches have been marked. There is no survey evidence regarding the number of non-business "customers" that received telemarketing calls for defendants' products where the negative option feature was inadequately disclosed.

In their filings, defendants focus their challenge on the TSR's "business-to-business" exemption. Specifically, defendants argue that the "business-to-business" exemption must extend to any telemarketing call *intended* to be made to a business. Under this construction, defendants contend that all of their telemarketing calls fall under this exemption because defendants' "indisputably" intended to sell their telemarketed products solely to businesses. As a separate argument, defendants assert that a *di minimus* exemption also applies to TSR violations, and that the FTC's limited proof on its TSR claims should be rejected.

Both of defendants' arguments fail. *First*, the plain language of the TSR clearly and unambiguously states that the "business-to-business" exemption applies solely to "telephone calls" between telemarketers and businesses. Nowhere in this language are the subjective intentions of telemarketers referenced. *Second*, there is no *di minimus* exemption to violations of the TSR. Indeed, the FTC considered such an exemption prior to formally adopting the rule. *See* Notice of Proposed Rulemaking, 60 Fed. Reg. 8313, 8332 (Feb. 14, 1995) (proposing to exempt "solicitation of sales by any person who engages in fewer than ten (10) sales each year through the use of the telephone"). This proposal was rejected. *See* Revised Notice of Proposed Rulemaking, 60 Fed. Reg. 30406, 30423 (June 8, 1995) (deleting the proposed *de minimus* exemption). For these reasons, defendants' motion for summary judgment that the TSR is inapplicable to defendants' telemarketing activities *in toto* is

evidence the customer's authorization of payment for the services, as well as the customer's receipt of all the following information: (1) the number if charges (if more than one) to be submitted for payment, (2) the dates the charges will be submitted for payment, (3) the amount of the charges, (4) the customer's name, (5) the customer's billing information identified with sufficient specificity that the customer understands what account will be used to collect payment, (6) a telephone number for customer inquires that is answered during normal business hours, and (7) the date of the customer's oral authorization. 16 C.F.R. 310.3(a)(3)(ii)–(iii).

Like its claim targeting defendants' failure to disclose the negative option feature of their telemarketing offers, the FTC has provided clear evidence through the unrebutted declarations of Mr. Gerber and Ms. Haney that non-businesses were contacted by defendants' telemarketers and "express verifiable authorization" was not obtained. Accordingly, the FTC's motion for summary judgment on this claim is **Gnr**

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also gives courts broad equitable authority to "grant any ancillary relief necessary to accomplish complete justice," including ordering monetary judgment for restitution. *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1113 (9th Cir. 1982); *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1102 (9th Cir. 1994). In the instant action, the FTC seeks both a permanent injunction and monetary restitution. Each will be addressed below.

1. INJUNCTIVE RELIEF

The undisputed record provides compelling proof that defendants not only abused the privileges of LEC billing, but falsified information on LEC-billing applications, lied to LECs and billing aggregators regarding "action plans" to reduce unauthorized billing, and even went so far as to circumvent suspensions and the application process altogether by LEC-billing customers through an intermediary. Additionally, the FTC has produced mountains of evidence that defendants' telemarketing activities were laced with fraud. Telemarketers hired by defendants did not truthfully, clearly, and conspicuously disclose all material terms of the negative option feature of their sales offers, did not maintain recordings of entire sales transactions, and did not obtain express verifiable authorization for each and every phone call made to consumers. Defendants knew that these and other violations were occurring and knew that thousands of defrauded customers were being LEC-billed without authorization.

Given this record, the following permanent injunctive relief is **ORDERED**:

1. Defendants are permanently enjoined from billing customers, either directly or through an intermediary, by placing any charges on any telephone bill. This injunction also runs against any business or operation defendants Roy Lin and John Lin currently own or operate as well as any future endeavors.

2. Defendants are permanently enjoined from telemarketing any product or service to any consumers, including businesses, unless and until a plan of operation is approved by the Court. Any plan of operation must set forth a procedure that will ensure, with reasonable certainty, that the requirements of the TSR

4. The freeze on defendants' bank accounts as set forth in the preliminary injunction shall remain in place until the full restitution amount has been paid.

[23] These bank accounts include account numbers XXXXX01178 and XXXXX00093 in the name of Inc21.com at Far East National Bank, account numbers XXXXX07292 and XXXXX81306 in the name of GoFaxer.com at Chase, account numbers XXXXX08166 and XXXXX63560 in the name of Roy Lin at Chase, account number XXXX724039 in the name of John Lin at Chase, account number XXXX411-1 in the name of John Lin at HSBC, and account number XXXXXX4889 in the name of John Lin at Bank of America.

submitted at the same time as the declaration detailing refunds issued to defendants' customers.

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2. MONETARY RESTITUTION

The FTC Act was designed to protect consumers from economic injuries. As such, courts have often awarded restitution in the full amount of funds lost by consumers rather than limiting restitution solely to a defendant's profits. *See Stefanchik*, 559 F.3d at 931 (citing *FTC v. Febre*, 128 F.3d 530, 536 (7th Cir. 1997)). This is because equity may require a defendant to restore his victims to the *status quo*, even where the loss suffered by consumers exceeds the defendant's unjust enrichment. *FTC v. Figgie Int'l, Inc.*, 994 F.2d 595, 606–07 (9th Cir. 1993).

The FTC, however, is not required to prove that every individual consumer was injured to justify such an award. *See Stefanchik*, 559 F.3d at 929 n.12 (citation omitted). To require such individualized proof "would thwart effective prosecutions of large consumer redress actions and frustrate the statutory goals of [Section 13(b) of the FTC Act]." *Figgie Int'l*, 994 F.2d at 605 (citations omitted). As such, it is sufficient for the FTC to prove that misrepresentations were widely disseminated (or impacted an overwhelming number of consumers) and caused actual consumer injury. Importantly, the existence of some satisfied customers does *not* constitute a bar to liability or an award of restitution. *Stefanchik*, 559 F.3d at 929 n.12 (citation omitted). If the FTC can meet this burden, it must then "show that its calculations reasonably approximated the amount of customers' net losses[.]" Then, "the burden shifts to the defendants to show that those figures [are] inaccurate." *Febre*, 128 F.3d at 535.

The undisputed record shows that defendants' deceptive and unfair billing practices impacted an overwhelming number of consumers. Indeed, thousands of unauthorized charges were tacked onto telephone bills nationwide. The evidence also shows that consumers *paid* these unauthorized charges to defendants, despite the fact that nearly 97 percent of them never agreed to purchase defendants' products in the first place. This is sufficient, if not compelling, proof of actual consumer injury suffered by almost every "customer" acquired by defendants. Given this record, the FTC has proven its entitlement to an award of restitution in the full amount of funds lost by consumers. The inquiry now turns to calculating the amount that consumers paid to defendants as a result of the unlawful conduct. See *Gill*, 265 F.3d at 958.

The full amount that consumers paid to defendants as a result of the deceptive and unfair billing practices detailed herein may be measured from declarations and billing records submitted by the billing aggregators who funneled LEC-billing revenue to defendants. According to these billing records, defendants received $37,442,602.89 in net collections through LEC billing its "customers" from 2004 through 2009 (Wolfe Decl. Atts. M–Q). Importantly, these net collections account for refunds paid directly to consumers by the LECs and billing aggregators (R. Lin Dep. 314–16; Walch Dep. 48, 53, 55–57).

Defendants also received at least $331,346.54 from consumers through its "customer-sharing" agreement with Jeff Lavino (Sihota Decl. ¶ 11, Att. B). In collaboration with Mr. Lavino, defendants LEC-billed consumers in regions where their LEC-billing privileges had either been suspended or had not yet been authorized. Since the evidence shows that Mr. Lavino took a 50 percent "cut" of the net collections before depositing the remaining funds into GST U.S.A.'s checking account, the net losses suffered by the consumers billed through Mr. Lavino was at least double the amount that defendants received from this arrangement. In other words, a reasonable calculation of the harm to customers attributable to defendants' relationship with Mr. Lavino is $662,693.08. Adding this amount to the $37,442,602.89 that defendants received from their billing aggregators, a reasonable calculation of the total harm suffered by consumers is $38,105,295.97 (Wolfe Reply Decl. Att A).

While the burden falls squarely on defendants to show that these calculations are inaccurate, the FTC nevertheless acknowledges that the record contains some evidence that a handful of defendants' customers agreed to purchase their products. As stated, 36 customers returned the court-ordered notification form (mailed during the preliminary injunction stage of this litigation) indicating that they had authorized defendants' LEC-billing charges (FTC's Br. 24). Additionally, defendants' former systems administrator, Michael Nelson, testified that he had responded to as many as twenty requests from customers to update their website information between July 2006 and March 2010. Assuming that these twenty requests came from legitimate

Inc21 customers, this translates to a total of 56 valid customers from 2004 through 2009. Assuming that these 56 customers paid the maximum monthly fee charged by defendants between 2004 and 2009 (namely, $39.99 per month) for the entire 60-month period between 2004 and 2009, the FTC proposes that $134,366.40 be deducted from the restitution award to reasonably account for these "valid" sales.[24] Thus, according to the FTC, an award of $37,970,929.57 in restitution is reasonable and justified.

Defendants attack this calculation from three different angles. First, defendants argue that a three-year statutory limit on damages applies to the FTC's claims. Second, defendants assert

[24] 56 customers x $39.99 per month x 60 months = $134,336.40.

CONCLUSION

For the foregoing reasons, the FTC's motion for summary judgment is **GRANTED**. Defendants' motion for summary judgment is **DENIED**. The FTC shall ensure that a copy of this order is served upon any and all LECs, billing aggregators, and financial institutions who may be subject to the injunctive relief ordered herein. The Court will retain jurisdiction to enforce the terms of the permanent injunction. Judgment shall be entered accordingly.

IT IS SO ORDERED.

Dated: September 21, 2010.

[redacted]
UNITED STATES DISTRICT JUDGE