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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

FEDERAL TRADE COMMISSION,)
)
 Plaintiff,)
)
 v.)
)
 J.K. PUBLICATIONS, INC., et)
 al.,)
)
 Defendants.)

Case No. 99-0044 ABC (AJWX)

FINDINGS OF FACT AND
 CONCLUSIONS OF LAW

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I. ISSUES TRIED¹

This case arises out of the defendants' participation in a
 billing scheme by submitting unauthorized credit and debit card

¹ On April 7, 2000, the Court granted Plaintiff Federal Trade Commission's ("FTC") motion for summary judgment on the issue of liability against Defendants J.K. Publications, Inc. ("JKP"), Herbal Care, Inc. ("Herbal Care"), MJD Services Corp. ("MJD"), Kenneth H. Taves ("Ken Taves" or "Taves") and Teresa Callei Taves ("Teresa Taves"). The Court held that the undisputed facts demonstrate these defendants are liable for unfair practices committed in violation of Section 5 of the FTC Act, 15 U.S.C. § 45(a). However, the Court concluded that a triable issue of fact existed with respect to the amount of damages. Particularly, the Court determined that the FTC's damages calculation was dependent on the information contained in the "ATS Historical Database" (referred herein as the "Historical Database CD-ROM") which David Goldfarb ("Goldfarb"), on behalf of Automated Transaction Services ("ATS"), maintained and produced. Based on some of the evidence submitted in connection with the summary judgment motions, the Court had concerns about the credibility of Goldfarb, which, in turn, cast some doubt upon the reliability of the ATS database produced in this case.

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1 charges for processing. The damages phase was tried before the
2 Honorable Audrey B. Collins from June 15, 2000 through June 16,
3 2000. The FTC called two witnesses: Goldfarb, the former Chief
4 Operating Officer of ATS, and Brick Kane ("Kane"), a principal
5 with Receiver Rob Evans & Associates. The defendants did not
6 call any witnesses. Having considered the evidence presented at
7 trial, the testimony of witnesses, and the arguments of counsel,
8 the Court enters the following Findings of Fact and Conclusions
9 of Law pursuant to Federal Rule of Civil Procedure 52(a):

10 **II. FINDINGS OF FACT²**

11 **A. Background**

12 1. Defendants Ken Taves and Teresa Taves, husband and
13 wife, were the owners, officers and directors of JKP and Herbal
14 Care. In 1998 alone, Ken and Teresa Taves were each paid a
15 salary of at least \$1.7 million for their services for JKP.
16 (Order at 7.)

17 2. Defendants Herbal Care, JKP, MJD and TAL Services, Inc.
18 ("TAL") operated out of the same suite of offices in Malibu,
19 California, shared the same employees, officers and the same
20 customers or "book of business". (*Id.* at 6-7, 14, 22-23, 24-25,
21 50.)

22 3. JKP and MJD operated 14 adult-content Internet web
23 sites from at least June 1997 through December 1998. The regular

24
25 ² The Court restates some of its factual findings from
26 the summary judgment proceedings to provide background for the
27 damages dispute. In addition, the Court relies on some of its
28 prior factual findings insofar as (1) certain facts are relevant
to the damages issue; (2) none of the parties re-presented those
facts at the two-day trial; and (3) those facts were not disputed
by the witnesses' trial testimony.

1 membership fee for these web sites was \$19.95 a month. (Order at
2 16.)

3 4. Some of the web sites offered a trial membership --
4 \$1.95 for one month -- to promote the web site. (Kane, Vol. III
5 at 44.)³

6 5. The server that hosted the defendants' web sites was
7 located in San Diego. (Kane at 175).

8 6. From at least June 1997 through December 1998, JKP and
9 MJD used five different fictitious business names to conduct
10 their businesses: Netfill, N-Bill, Webtel, Online Billing and
11 Assist Online. (Order at 6.)

12 7. Using these fictitious business names, the defendants
13 obtained different merchant accounts⁴ at different banks,
14 including Humboldt Bank ("Humboldt"), Charter Pacific Bank
15 ("Charter Pacific") and Heartland Card Services (or Heartland
16 Bank) ("Heartland"). (Order at 16-17, 20-21,23; Ex. 15.)

17 8. In November 1997, JKP/Netfill purchased access to
18 various databases from Charter Pacific, including "Positive
19

20 ³ References to "Goldfarb" or "Kane" in the citations
21 shall refer to those portions of the trial transcript which
22 recorded their respective testimonies. References to "Vol. III"
23 shall refer to the reporter's transcript for the second day of
24 trial (June 15, 2000). There are two volumes of transcripts for
25 the first day of trial, one for the "A.M." portion and the other
26 for the "P.M." portion. The Court need not distinguish between
27 those two volumes because the page numbering makes the
28 distinction obvious (e.g., Vol. I contains pages 1 through 96 and
Vol. II contains pages 97 through 185). Because the transcript
for the second day of trial (transcribed by a different court
reporter) starts anew with page 1, the Court shall refer to "Vol.
III" to avoid confusion.

⁴ A merchant account is a bank account that is used to
accept credit and debit cards as payment for the sale of products
or services. (Order at 11.)

1 Database File #2," (the "Charter Database") (Order at 10-12.)

2 9. The Charter Database contained the date of sale, card
3 number and dollar amount of every Visa and Mastercard transaction
4 processed through any merchant of Charter Pacific during the
5 previous 11 months for which there had been no chargebacks or
6 credits issued. This database contained no information about the
7 card holder. (Order at 17.)

8 10. JKP was able to download the Charter Database
9 electronically. JKP continued to pay for and had access to the
10 Charter Database through at least December 31, 1998. (Order at
11 17, 21.)

12 11. As a result, from November 1997 through December 31,
13 1998, the defendants had access to more than 3.6 million valid
14 Visa and Mastercard credit card numbers from the Charter
15 Database. (Order at 21.)

16 12. ATS processed credit and debit card transactions for
17 (a) JKP from January 1995 through the end of 1998, (b) MJD in
18 1998, and (c) TAL from late 1998 to January 1999. (Goldfarb at
19 13; Order at 16.)

20 13. Initially, subscriptions to the defendants' web sites
21 were transmitted to ATS by HTML post. In other words, customers
22 would input the necessary data (e.g., their credit or debit card
23 information) on a form generated by their Internet browsers, hit
24 the "submit" button, and transmit the data directly to ATS's
25 server for authorization. (Order at 17 n.28; Goldfarb at 13-15.)

26 14. The ATS computer server identified the HTML posts'
27 originating merchant by way of an identifying field code called

28 //

1 Mer_Id or ATS_Id, also known as the "merchant ID". (Goldfarb at
2 14-15.)

3 15. The merchant IDs, at least the ones at issue in this
4 case, consist of a series of numbers (e.g., 11733) or combination
5 of numbers and letters (e.g., NP001). (Ex. 3.)

6 16. In late 1997 or early 1998, coinciding with JKP's
7 access to the Charter Database, Ken Taves, first on behalf of JKP
8 and later on behalf of MJD, began transmitting charge requests to
9 ATS by e-mail (with attached text files). Ken Taves transmitted
10 these e-mail files once or twice a month through the end of 1998.
11 The text files, containing up to thousands of credit and debit
12 card numbers, omitted customer names, customer e-mail addresses
13 and card expiration dates. (Order at 17-18; Goldfarb at 13-14.)

14 17. In 1997, a total of \$4,977,219 was deposited into
15 JKP/Netfill's merchant accounts at Humboldt and Charter Pacific.
16 (Ex. 15.)

17 18. In 1998, a total of \$49,417,142.94 was deposited into
18 JKP and MJD's various Charter Pacific and Heartland merchant
19 accounts. Of this total, \$7,300,000 in chargebacks and credits
20 have been processed through February 2000. (Kane, Vol. III at
21 11, 24-25; Exs. 4, 17).

22 19. The JKP/Netfill merchant account at Charter Pacific
23 initially came to the attention of Visa USA's chargeback
24 monitoring program because of excessive chargebacks in November
25 and December 1997. In late 1997 and throughout 1998, the
26 chargeback rate which triggered Visa USA's monitoring was an
27 overall rate of 2.50 percent or more per month or a consumer
28 dispute chargeback rate of 1 percent or more. According to Visa

1 USA's records, the monthly chargeback rates for JKP and MJD's
2 various merchant accounts at Charter Pacific and Heartland
3 repeatedly exceeded Visa USA's guidelines throughout 1998.
4 (Order at 18-24.)

5 20. The defendants maintained scant business records
6 related to their Internet business. They certainly maintained
7 none of the records one would ordinarily associate with a
8 legitimate business, much less a high volume credit/debit card
9 dependent Internet business. For example, they maintained no
10 records, whether stored in computer files or on hard copies, of
11 (1) customer names and addresses (including e-mail addresses); or
12 (2) authorized transactions (e.g., record showing credit/debit
13 card numbers linked with customer names, authorization codes and
14 web sites used). (Order at 31-32, n.32.)

15 21. The computer records produced by ATS are the only
16 existing records of the defendant corporations' debit and credit
17 card transactions. (Order at 31-32.)

18 22. In 1998, an untold number of cardholders called the
19 corporate defendants' customer service department to complain
20 about unauthorized charges. At one point, the corporate
21 defendants received thousands of complaint calls a day. More
22 than 50 percent of the calls were from people who said they did
23 not order anything from the defendants and had no idea why they
24 were billed. A shocking 40 to 50 percent of the calls were from
25 people who said they did not have a computer and had not given
26 their card numbers to anyone. (Order at 27-28.)

27 23. In January 1999, after the Receiver took over control
28 of the defendant companies, people acting under the direction of

1 the Receiver answered some of the consumer complaint calls.
2 Those consumers were asked to submit written complaints to the
3 Receiver. (Kane, Vol. III at 45.)

4 24. At some point, the Receiver changed the outgoing
5 message on the defendants' voice mailbox. The message asked
6 consumers with complaints of unauthorized charges to fax a
7 written complaint to the Receiver. (Kane at 59-60.)

8 25. To date, the Receiver has identified 3000 to 5000
9 consumers who have submitted written complaints (mailed, faxed or
10 e-mailed) to it concerning unauthorized charges by the
11 defendants. The average amount of the complained of charge is
12 \$19.95. (Kane, Vol. III at 43-44.)

13 **B. Background of ATS's Relationship with Taves**

14 26. Goldfarb testified about ATS's relationship with Taves,
15 Goldfarb's interactions with Taves, the process by which ATS
16 maintained its clients' transaction records, and the process by
17 which ATS produced the databases at issue in this trial. In all
18 relevant respects, Goldfarb was a credible witness.

19 27. ATS was an Internet credit and debit card processing
20 company, also known as a "PSP" for payment service provider. It
21 was located at 12424 Wilshire Boulevard, Suite 1170, Los Angeles,
22 California. Before its sale to another company in June 1999, ATS
23 was jointly owned by Goldfarb and Bill Parodi ("Parodi").
24 (Goldfarb at 11, 12, 30, 83.)

25 28. ATS began its relationship with Taves in 1995. In
26 November 1995, Ken Taves, on behalf of "Netfill," executed a
27 contract with ATS pursuant to which ATS processed not only

28 //

1 Netfill's credit and debit card transactions, but also Ken Taves'
2 other companies' transactions.⁵ (Ex. 2.)

3 29. The November 1995 contract is the only written
4 agreement that exists between ATS and the defendants during the
5 pendency of their relationship. (Goldfarb at 45, 124-25; Ex. 2.)

6 30. Pursuant to the contract, ATS was Netfill's "exclusive
7 agent for the collection of monthly or other periodic charges . .
8 . or 'one time' transactions from all those persons ('consumers
9 and businesses') who have properly agreed to make such payments."
10 (Ex. 2.)

11 31. Among other things, the contract provides that "Client
12 warrants that he will properly warehouse all authorizations
13 obtained from consumers or businesses and will provide such
14 authorizations for inspection by ATS or any regulatory body
15 governing these types of transactions." (Ex. 2.)

16 32. Goldfarb was in charge of handling the Taves account.
17 (Goldfarb at 89-91.)

18 33. According to Goldfarb's testimony, both the method by
19 which ATS received payment of its fees and the method by which
20 ATS's fees were calculated changed over ATS and Taves' three-year
21 business relationship.

22 34. ATS obtained payment for its services by automatically
23 debiting its clients' bank accounts. Ordinarily, it was ATS's

24
25 ⁵ Goldfarb did not always make a distinction between
26 working for Taves versus working for the defendant companies.
27 See, e.g., Goldfarb at 68 ("It was another system that we
28 designed for Mr. Taves so that his customer service department
could handle calls . . .") (emphasis added). The Court
understands that Goldfarb's testimony concerning "Taves" often
also includes "Taves' companies," i.e., JKP, MJD and TAL. (See
Goldfarb at 31-32, 89-90.)

1 practice to debit the clients' bank accounts on a daily basis.
2 (Goldfarb at 44-45.)

3 35. As a result of various discussions initiated by Taves
4 during the course of their relationship, ATS (via Goldfarb)
5 agreed to change the frequency by which Taves' bank account was
6 debited and the method of computing ATS's fees. (Goldfarb at
7 45.)

8 36. Goldfarb recalled that ATS began debiting Taves'
9 account on a weekly instead of daily basis after Taves explained
10 that weekly debits would be easier for him from an accounting
11 standpoint. Later, ATS switched from weekly to bi-weekly debits.
12 Ultimately, ATS debited Taves' account only once a month.
13 (Goldfarb 45-46, 50.)

14 37. Under the initial fee arrangement with Taves, which
15 applied ATS's "retail starting standard fee", ATS received (a)
16 \$1.00 for each credit card transaction and (2) 1½ percent or
17 \$1.50 per transaction, whichever was higher, for each electronic
18 check (or debit) transaction. (Goldfarb at 43-44, 48-49; Ex. 2.)

19 38. At some point in the relationship, the method by which
20 its fees were calculated also changed. Instead of calculating
21 the fee on a per transaction basis, ATS agreed to receive 10
22 percent of "the net." This net figure was derived from a formula
23 that used the total sales processed each month minus total
24 credits and total chargebacks. Goldfarb testified that "there
25 could be more" to the arrangement, but he was unable to recall
26 all of the details. (Goldfarb at 50-51.)

27 39. Goldfarb and Taves calculated ATS's 10 percent each
28 month during a telephone call. As Goldfarb explained, he knew

1 the monthly total sales figure based on the dollars that ATS
2 processed for Taves. He also knew the amount of credits that
3 were processed because the credits went through ATS's system.
4 Taves provided the chargeback figures,⁶ the accuracy of which was
5 always accepted by Goldfarb. (Goldfarb at 72-73, 85-86.)

6 40. This 10 percent fee agreement was in effect up until
7 the day Taves stopped doing business with ATS. (Goldfarb at 50-
8 51.)

9 41. ATS's percentage fee agreement with Taves was not
10 unique. ATS had similar agreements with other adult-oriented
11 Internet clients, ranging anywhere from 10 to 15 percent of "the
12 net." (Goldfarb at 75-76.)

13 42. Although the fee arrangement between ATS and Taves
14 changed over their three-year business relationship, none of the
15 modifications to the contract (or new agreements) were
16 memorialized in writing. (Goldfarb at 45.)

17 43. However, it was not unusual for ATS to have oral
18 agreements with its clients. Goldfarb testified that ATS had
19 oral agreements with some of its other adult-oriented web site
20 business clients. (Goldfarb at 81.)

21 44. It was also not unusual for ATS's fee agreements with
22 its clients to change over time, depending on the volume
23 processed and the relationship ATS maintained with the particular
24 client. (Goldfarb at 43.)

25 45. Goldfarb candidly admitted that ATS's fees were driven
26 by volume and dollar amounts of sales, i.e., the more charges it

27 ⁶ ATS was "not in the loop" of the credit card chargeback
28 process. (Goldfarb at 37.)

1 processed for its clients, the more money it made. (Goldfarb at
2 47.)

3 46. Ken Taves and/or his companies paid ATS total fees in
4 the vicinity of \$2.35 to \$2.7 million for services rendered in
5 1998 (and perhaps also 1997). (Kane, Vol. III, at 21-21, 79; see
6 Order at 18.)⁷

7 47. ATS processed credit and debit card transactions for
8 over 2,000 clients in 1998. Of those clients, "[a] couple
9 hundred" merchants were involved in adult-oriented Internet web
10 sites. Most of the merchants had multiple web sites. ATS's
11 business with Taves accounted for approximately 15 percent of
12 ATS's business in 1998. (Goldfarb at 11-12, 40, 63.)

13 48. The Court recognizes that the percentage fee agreement
14 creates an incentive for ATS to process as many transactions as
15 possible. However, the Court does not find that this fact casts
16 doubt on Goldfarb's credibility as a witness.⁸ Even if the Court

17
18 ⁷ The undisputed evidence submitted in the summary
19 judgment proceeding showed that in 1998, ATS was paid
20 approximately \$2.35 million -- \$1.25 million in checks to ATS and
21 \$1.3 million in wire transfers to Goldfarb and Parodi's personal
22 account at Euro Bank in the Cayman Islands. (Order at 18, n.
23 30.) On cross-examination during trial, Goldfarb could not
24 recall the "total" amount that Taves paid ATS and defense counsel
25 did not specify whether "total" includes the entire November 1995
26 through 1998 period or just 1998. (Goldfarb at 53-54.) Kane
27 recalled that the accounting records for 1998 show a total of
28 approximately \$2.6 to \$2.7 million was paid to ATS by the
defendants. (Kane, Vol. III at 20-21, 78-79.) But Kane stated
that this total figure could include some of the payments made in
1997. (Kane, Vol. III at 78-79.)

25 ⁸ Defendants contend that Goldfarb is not credible
26 because of the financial incentive created by the percentage fee
27 agreement. Defendants suggest that this financial incentive
28 could have caused Goldfarb/ATS to process unauthorized
transactions through the defendants' account without the
knowledge of the defendants. (see Vol. III at 139-40). But many
forms of compensation inherently create an incentive for fraud.

1 considers the actual amount of money earned by ATS -- the \$2.35
2 to \$2.7 million⁹ -- in combination with that financial incentive,
3 the Court does not find that these facts show Goldfarb (or ATS)
4 processed unauthorized transactions without the knowledge of the
5 defendants.¹⁰

6
7 One that comes immediately to mind is the "billing by the hour"
8 method typically used by civil attorneys. The existence of an
9 incentive for fraud, without more, cannot support a finding of
10 fraud. The defendants have offered no evidence of fraud on the
11 part of Goldfarb or ATS.

12 ⁹ The defendants also theorize that the amount of money
13 the defendants paid ATS shows Goldfarb and ATS were involved in
14 the defendants' unlawful activities. (See Vol. III, at 139-40
15 [Defense closing argument] ("Why would Mr. Goldfarb receive \$2.6
16 million for a process that can run . . . 'Even in his sleep.' It
17 does not require the level of input of human resources that would
18 warrant a \$2.6 million payment for the services that ATS
19 rendered."). Again, this is merely a theory with no proof. The
20 defendants offered no evidence that shows Goldfarb's involvement
21 in the defendants' fraudulent scheme. It is true that the
22 payment to ATS is significant. However, the defendants have
23 offered no evidence, particularly in the form of expert
24 testimony, that shows ATS's fees for the services that it
25 provided the defendant companies were so outrageous that, at
26 minimum, the arrangement must support an inference of complicity
27 in the scheme. Indeed, this amount may very well be within the
28 ball park of the fees payment service providers such as ATS earn
from high volume Internet merchants. Having nothing before it
but speculation, the Court declines to find that Goldfarb was
involved in the unlawful activities based solely on the amount of
money ATS earned from the defendant companies.

21 ¹⁰ Nor will the Court draw any negative inference from the
22 fact that Goldfarb had a 15 percent ownership interest in Word
23 Bank Card Associates ("WBCA"), a company engaged in the business
24 of referring merchants to merchant banks for the purpose of
25 establishing merchant accounts. (Goldfarb at 92-93.) WBCA
26 obtained income in the form of commissions from the merchant
27 banks during the entirety of the merchant-and-bank relationship.
28 (Id. at 93.) WBCA was responsible for placing Taves' companies
with Heartland Bank. (Id.) Goldfarb did not know how the
defendant companies were placed, what percentage commission
agreement WBCA reached with Heartland, or how much money WBCA
received as a result of this placement. (Id. at 101-03.)
Goldfarb and Parodi were only passive investors in the company.
(Id. at 93.) Goldfarb received dividends from WBCA at the end of
each year. (Id. at 103.)

1 49. A little over 50 percent of the total fees earned by
2 ATS -- the \$2.35 to \$2.7 million -- was paid to ATS with checks
3 drawn from the defendants' U.S. bank accounts. ATS deposited
4 those checks in its Bank of America business account. Taves paid
5 the remainder of ATS's fees by wire transfers from Taves' Cayman
6 Island bank account to a Cayman Island bank account jointly held
7 by Goldfarb and Parodi. (Goldfarb at 51-52, 85; Kane, Vol. III
8 at 79; see Order at 18, n.30.)

9 50. At first blush, the fact that Goldfarb and Parodi
10 maintained a personal Cayman Island account and accepted payment
11 in that account for services rendered by their company, ATS,
12 suggests that something shady was going on, e.g., they were
13 either hiding assets from the IRS or accepting "under the table"
14 payments from Taves for processing unauthorized transactions.
15 But nothing in the evidence supports such a conclusion.

16 51. First, Goldfarb testified that he has declared the
17 income he received in the Cayman Island account to the IRS. ATS
18 was set up as an S corporation, which required him and Parodi to
19 file individual tax returns. (Goldfarb at 77-78, 80.)¹¹

20
21 Goldfarb's testimony was credible. The defendants did not
22 call any witnesses for impeachment purposes, and nothing in the
23 evidence shows that Goldfarb was untruthful. Like the percentage
24 fee agreement between ATS and Taves, Goldfarb's ownership
25 interest in WBCA appears to create a financial incentive for
26 Goldfarb to commit fraud, i.e., to process unauthorized charges
27 through the defendants' accounts without the defendants'
28 knowledge. However, because there is simply no evidence that
29 even suggests that Goldfarb/ATS actually committed such fraud,
30 the Court rejects the defendants' contention that Goldfarb's
31 ownership interest in WBCA casts doubt on Goldfarb's credibility.

32
33 ¹¹ "An S corporation is a small business corporation that
34 is taxed like a partnership, with income passed through to the
35 shareholders on a pro rata basis." Ding v. C.I.R., 200 F.3d 587,
36 589 (9th Cir. 1999) (citing I.R.C. §§ 1361(a)(1), 1363(a),

1 Defendants offered no evidence to contradict this testimony.

2 52. Second, Goldfarb explained that he and Parodi had
3 opened the Cayman Island account at Taves' request. (Goldfarb at
4 53-54.)

5 53. Goldfarb did not know why Taves wanted two separate
6 accounts. Taves told Goldfarb that he did a lot of business in
7 the Cayman Islands and preferred to have some of the funds
8 deposited through wire transfer to a Cayman Island account. As a
9 result of having been "burned a few times" by "disappear[ing]"
10 merchants in the adult-oriented Internet business, Goldfarb
11 explained that he and Parodi "endeavored to do whatever [they]
12 could to make sure [they] got paid" by Taves each month. In
13 short, Goldfarb and Parodi accommodated Taves to diminish their
14 change of "getting burned." (Goldfarb at 78-80, 123-24.)

15 54. Again, the defendants offered no evidence to contradict
16 this testimony.

17 55. Goldfarb's explanation for why he and Parodi opened and
18 maintained the Cayman Island account and accepted split payments
19 appears credible. The Court is mindful of the fact that the FTC
20 and the Receiver, through no help from the defendants, have
21 discovered that Taves hid tens of millions of dollars in numerous
22 off-shore accounts held in his name or under his control. (See
23 Order at 36-37.) That Taves would want to maintain a limited
24 amount of funds in U.S. accounts or hide the fact that he had
25 control over additional funds stashed away in off-shore accounts
26 certainly makes sense. Goldfarb's testimony is consistent with

27
28 _____
1366(a) and 1371(a)(1)).

1 the Court's understanding of the defendants' efforts to transfer
2 and hide their ill-gotten gains.

3 56. Since the commencement of this lawsuit, ATS has
4 submitted a claim to the Receiver for \$73,000 in unpaid fees for
5 services rendered to TAL. (73, 126.)

6 **C. ATS's Databases**

7 57. ATS maintained a historical record of the transactions
8 it processed for all of its clients. That record was stored in
9 ATS's central server system in its data center. (Goldfarb at
10 12.)

11 58. This historical record, also referred to as the
12 "historical database," contains a snapshot of the history of
13 authorizations for ATS's clients. The snapshot includes the card
14 number, transaction number, transaction date and time,
15 transaction amount, approval code, and the credits that were
16 processed through the authorization network. (Goldfarb at 23,
17 65, 66, 123; see Order at 30.)

18 59. The historical database did not record the names or
19 addresses of any card holders whose accounts were billed. (Order
20 at 30; cf. Goldfarb at 123.) Nor did it record chargeback data.
21 (Goldfarb at 67.)

22 60. A transaction is recorded in ATS's historical database
23 after ATS receives authorization from the credit/debit card
24 authorization network. (Goldfarb at 15.)

25 61. Once any transaction was recorded in the historical
26 database, that record was never changed or altered by ATS.
27 (Goldfarb at 19.)

28 //

1 62. The authorization process was completely automated if a
2 transaction request reaches ATS by HTML post. (Goldfarb at 14-
3 15.)

4 63. When the request "hits" ATS's server, ATS's computer
5 system was programmed to automatically "profile" that data. This
6 profiling process would identify the originating merchant (based
7 on the Mer_ID that was associated with the data), the
8 authorization network associated for that merchant, and the
9 merchant bank associated for that merchant. (Goldfarb at 14-15,
10 117.)

11 64. ATS's system also automatically filtered the data
12 against a "negative database" maintained by ATS, which was a
13 database of credit card numbers that consumers have charged back
14 against merchants. By filtering out card numbers found in its
15 negative database (e.g., not sending those requests forward to
16 the authorizing networks) ATS aimed to help its clients reduce
17 the number of chargebacks. (Goldfarb at 17-18, 35-36.)

18 65. Next, ATS's system automatically routed the transaction
19 request to the appropriate authorization network for approval.
20 If the return code showed that the transaction was approved, the
21 transaction would be recorded in ATS's historical database. If
22 the transaction was declined, it would not be recorded in ATS's
23 historical database. (Goldfarb at 14, 117-18.)

24 66. If transaction requests were submitted to ATS via e-
25 mailed text files containing batches of transactions, human
26 intervention took place in the form of pulling up the attached

27 //

28 //

1 file, assigning Mer_IDs to those transactions,¹² and running the
2 information through a computer program to filter for duplicates¹³
3 or matches against the negative database. Then, the person would
4 "drop" or import the data into ATS's system (with the use of a
5 program that transfers the data into a file format used by ATS's
6 system). The rest of the processing would be automatic.
7 (Goldfarb at 15-18, 88, 115-17.)

8 67. Apart from the historical database, ATS also maintained
9 a "customer database" for those merchants with repeat billings
10 for recurring customers. This database contained recurring
11 profiles, which included customers' names, customers' e-mail
12 addresses, and the frequency of the billings/transactions. Like
13 the historical database, the customer database also did not
14 contain chargeback records. (Goldfarb at 62, 65, 67, 123.)

15 68. Additionally, ATS designed and maintained a "customer
16 service database" only for Taves' companies. This database
17

18 ¹² Because counsel did not ask follow up questions to
19 clarify this issue, it is not clear to the Court how the ATS
20 personnel usually determined which Mer_IDs to assign. It is
21 clear, however, that Ken Taves or his co-defendant Dennis
Rappaport called ATS to request that particular MER_IDs be
assigned to particular transactions listed in the files.
(Goldfarb at 16-17.)

22 ¹³ ATS's system was programmed to catch (and not process)
23 duplicate transactions that come through by HTML post when
24 consumers hit the "submit" button more than once. ATS's system
25 considers these multiple "submits" duplicates if the consumer
26 hits the "submit" repeatedly from the same site. On the other
27 hand, if someone submits the same credit card number on-line from
28 different sites, ATS's system would not recognize the multiple
transactions as duplicate transactions. Thus, if a particular
credit card number was not already in the negative database and
was submitted to ATS via different HTML-posts from different
computers, ATS's system would submit those requests to the
authorizing networks for processing. (Goldfarb at 35-36, 59-60,
119-20.)

1 contained chargeback data to assist the defendant companies'
2 customer service department to process credits and refunds more
3 efficiently and avoid chargebacks. The customer service database
4 was essentially a negative database that contained credit card
5 transactions previously charged back by Taves' customers.
6 (Goldfarb at 68-69.)

7 **D. The Missing Customer Database**

8 69. In December 1998, ATS received notice to cease
9 processing for MJD. (Goldfarb at 64.)¹⁴

10 70. On January 4, 1999, three days before the service of
11 the complaint and temporary restraining order in this case,
12 Goldfarb sent a letter to Lee Sacks ("Sacks"), former counsel for
13 Taves and his companies. The letter advised Sacks that ATS "no
14 longer want to maintain any of [MJD's] data on [its] computer
15 system nor be responsible for its content" because ATS was no
16 longer processing for MJD. (Ex. 1.)

17 71. Enclosed with the letter to Lee Sacks was a "CD ROM of
18 the entire database for MJD." Goldfarb also advised Sacks that
19 ATS has "taken that database off of [its] system completely"
20 (i.e., the data was purged) and was "forwarding the complete
21 database to [Sacks] for safe keeping and or return to the proper
22 personnel at MJD." (Ex. 1; Goldfarb at 64.)

23 72. Even though the January 1999 letter referred to "the
24 entire database for MJD," Goldfarb testified that the CD ROM sent

25
26 ¹⁴ On December 3, 1998, following a four-day period in
27 late November when the MJD/Webtel account processed approximately
28 \$4.7 million, MasterCard contacted Heartland to report that it
had received calls from three credit card issuing banks regarding
possible fraud by Webtel. On December 7, 1998, Heartland
terminated the MJD/Webtel account. (Order at 24.)

1 to Sacks contained a copy of MJD's customer database only).¹⁵
2 ATS did not purge the historical records relating to MJD from its
3 historical database. (Goldfarb at 63-64, 122.)

4 73. It is undisputed that Goldfarb sent the only existing
5 copy of the MJD/JKP customer database to Sacks on January 4,
6 1999.

7 74. It is also undisputed that the CD-ROM containing that
8 database has since disappeared.

9 75. During Sacks' deposition, Sacks testified under oath
10 that he returned this CD-ROM to the defendants by leaving it on
11 the desk of Randall (aka Randi) Ball, Taves' office
12 administrative assistant from January 1997 to January 1999.
13 (Order at 8 n.11, 31.)

14 76. However, during Ms. Ball's deposition, she testified
15 that she never received the CD-ROM. She also testified that she
16 never had a conversation with Sacks concerning the delivery of
17 the missing CD-ROM prior to this action. (Order at 31.)

18 77. When the Receiver entered the defendants' business
19 premises on January 7, 1999, it did not find the CD-ROM or any
20 other documents or files that contained a listing of JKP and
21 MJD's customers. (Order at 31.)

22 78. It is clear that the last known person to observe and
23 handle the missing CD-ROM was former defense counsel Sacks.

24 //

25

26 ¹⁵ Since MJD had purportedly purchased JKP's book of
27 business earlier in 1998, (Order at 22), this customer database
28 presumably contained recurring customer profiles for both JKP and
MJD. (See Order at 31 (noting that the CD-ROM sent on January 4,
1999 contained customer database for JKP and MJD.)

1 **E. The ATS Floppy Disks**

2 79. In January 1999, the Receiver Robb Evans & Associates
3 (and Robb Evans) initiated contact with ATS. (Kane, Vol. III at
4 50-51.)

5 80. Some time in January 1999, the first meeting between
6 the Receiver and ATS took place at ATS's office. Several people
7 from the Receiver's office, including Kane, attended the meeting.
8 Taves, Goldfarb, Parodi, and Sacks, among others, were also
9 present. (Kane, Vol. III at 50-51; Goldfarb at 125.)

10 81. Kane recalled that Goldfarb stated, at this first
11 meeting, that he had removed a client database from ATS's system,
12 copied the data onto a CD-ROM and mailed the CD-ROM to Sacks.
13 (Kane, Vol. III at 51.)

14 82. Either at this first meeting or sometime shortly
15 thereafter, Goldfarb responded to the Receiver's request for data
16 relating to the defendants by turning over some 3" x 5" floppy
17 disks. (Kane, Vol. III at 52.)

18 83. The information in the floppy disks included merchant
19 IDs (or MER_IDS) associated with the defendants and dollar
20 amounts processed for the defendants. (Kane at 148 & Vol. III at
21 50.)

22 84. The data in the floppy disks was stored in Microsoft
23 Excel spreadsheet format. The data was sorted by merchant IDs.
24 (Kane, III at 53.)

25 85. After reviewing the data contained in the floppy disks,
26 Kane determined that the information was incomplete because
27 records for most of the last three months of 1998 were missing.
28 (Kane at 158 & Vol. III at 55.)

1 86. The Receiver's office had subsequent conversations with
2 Goldfarb regarding the production of additional data on
3 transactions ATS processed for the defendants. (Kane at 150.)

4 87. Kane testified that he relied on the information
5 contained in the floppy disks to render his opinions for this
6 case. Particularly, the floppy disks contained merchant ID
7 numbers and associated merchant names. The database that ATS
8 subsequently produced to the Receiver, the CD-ROM containing
9 historical records (discussed below), only contained merchant ID
10 numbers. Kane matched the merchant names (from the floppy disks)
11 to the merchant ID entries on the historical database. (Kane at
12 171.)

13 88. Unfortunately, Goldfarb, who testified the day before
14 Kane testified, did not mention the production of these floppy
15 disks to the Receiver. The first records he recalled turning
16 over to the Receiver were those on the CD-ROM containing the
17 historical database discussed below. Based on the Court's
18 observations of Goldfarb's day-long testimony, particularly his
19 demeanor and responses to cross-examination, the Court finds that
20 Goldfarb's failure to mention the floppy disks does not cast
21 doubt upon his credibility as a witness.¹⁶

22 //

23
24 ¹⁶ In order for the Court to draw any negative inference
25 from this gap in testimony, as defendants suggest, the Court must
26 speculate that Goldfarb deliberately omitted reference to the
27 floppy disks in an effort to hide relevant evidence. It was just
28 as likely that Goldfarb forgot about an event that occurred about
a year and a half ago. Neither FTC's counsel nor defense counsel
attempted to refresh his recollection. The Court notes that the
defense had an opportunity to recall Goldfarb as a witness after
Kane completed his testimony, but the defense chose not to do so.

1 **F. The Creation of the Historical Database CD-ROM**

2 89. In February 1999, former defense attorney Harvey
3 Saferstein ("Saferstein") requested that ATS provide defendants
4 with a copy of those portions of the ATS historical database that
5 concern transactions ATS processed for the corporate defendants.
6 (Goldfarb at 19-21.)

7 90. Because ATS maintained a single historical database for
8 all of its clients' historical records, ATS had to extract from
9 that database those records pertaining to the defendant
10 companies. (Goldfarb at 62.)

11 91. Pursuant to Goldfarb's instruction, Tim Rider, one of
12 ATS's engineers, extracted all of the records pertaining to the
13 corporate defendants from ATS's historical database. (Goldfarb
14 at 21, 24-25.)

15 92. ATS generated this database of the defendants'
16 historical records for the first time in response to Saferstein's
17 request. (Goldfarb at 64.)

18 93. To ensure that no other merchants' transactions were
19 included, the query used to extract the defendants' records was
20 based on card IDs associated with the defendants. (Goldfarb at
21 25.)¹⁷

22 94. At Goldfarb's request, Tim Rider burned the extracted
23 data onto a CD-ROM (the "Historical Database CD-ROM"). (Goldfarb
24

25 ¹⁷ A card ID is ATS's identifier of a particular banking
26 relationship between a merchant and its merchant bank, as well as
27 the authorizing network associated with that banking
28 relationship. A merchant could have more than one card ID
because it could have more than one "banking relationship", e.g.,
more than one merchant bank. But a merchant would never share
any card ID with another merchant. (Goldfarb at 23-24.)

1 at 21, 24-25.)

2 95. It is undisputed that once data is burned onto a CD-
3 ROM, there is no way to alter that data on the CD-ROM. (Goldfarb
4 at 24.)

5 96. After Tim Rider burned data onto the CD-ROM, Goldfarb
6 examined the data on the CD-ROM to ensure that it was accurate.
7 He spent about 10 minutes checking the ATS_IDs (or MER_IDs)
8 identified in the CD-ROM and making sure that the right fields
9 were in place. (Goldfarb at 70.)

10 97. Goldfarb testified that he did not review every single
11 one of the millions of transactions recorded on the CD-ROM. He
12 was satisfied from his 10 minute examination that the CD-ROM was
13 accurately prepared. (Goldfarb at 70.)

14 98. Goldfarb shipped the Historical Database CD-ROM to
15 Saferstein by Federal Express on February 19, 1999. (Goldfarb at
16 24; Order at 31.)¹⁸

17 99. Shortly thereafter, Goldfarb provided a copy of the
18 same Historical Database CD-ROM to the Receiver. (Goldfarb at
19 26, 70-72.)

20 100. The Receiver received the CD-ROM (exhibit 13) by
21 overnight mail on February 23, 1999. (Kane at 151.)

22 101. Exhibit 13 is the CD-ROM that Goldfarb sent to the
23 Receiver. Goldfarb recognized his handwriting on the CD-ROM. He
24 has a specific recollection of writing "created on" in black ink
25 in front of the notation "2/17" (which was written in red ink by
26 Tim Rider) before shipping the CD-ROM. (Goldfarb at 142-44.)

27 _____
28 ¹⁸ Around the same time, ATS also produced to Saferstein a
copy of the customer database for TAL. (Goldfarb at 69.)

1 102. Kane testified that Exhibit 13 is the CD-ROM that the
2 Receiver received from ATS. (Kane at 150-51.)

3 103. The Receiver received the CD-ROM about a month after
4 the Receiver received the floppy disks from ATS. (Kane, Vol. III
5 at 72.)

6 104. Kane believed that ATS produced the CD-ROM as a result
7 of the Receiver's requests for more complete data from ATS.
8 (Kane at 150.)

9 105. The Court finds no evidence that Goldfarb manipulated
10 the data on the Historical Database CD-ROM.¹⁹

11 106. In addition, nothing in the evidence shows that the
12 incompleteness of information on the floppy disks was the result
13 of some deliberate bad act on the part of Goldfarb.

14 107. Moreover, based on the Court's recollection of the
15 history of this case, the Court does not find the one month delay
16 in turning over the Historical Database CD-ROM unreasonable or
17 inexplicable, as the defendants suggest.²⁰ In the beginning of
18 this litigation, Goldfarb was a witness for the defendants. ATS,
19

20 ¹⁹ Because Goldfarb produced the Historical Database CD-
21 ROM to the Receiver approximately a month after producing floppy
22 disks that contained incomplete data, when it "presumably took a
23 matter of moments and was really an automated process," the
24 defendants contend that Goldfarb must have manipulated the data
25 on the CD-ROM. At the very least, the defendants contend that
26 Goldfarb's actions suggest that he created additional data in an
27 effort to cooperate with the FTC and "cover up his own complicity
28 in any alleged misconduct." (Vol. III at 138-39.) The
defendants' contention is based on pure speculation.

The Court observes that the defendants did not call the one
witness who might have supported their theory, assuming that it
was supportable -- Tim Rider.

²⁰ Of course, neither side recalled Goldfarb to ask him
why it took him about a month to respond to the Receiver's
request for additional data.

1 after all, was the defendants' agent for the collection of
2 charges from the defendants' customers. Indeed, on February 2,
3 February 8 and February 22, 1999, Goldfarb submitted declarations
4 in support of the defendants' (1) motion for order modifying the
5 temporary restraining order and (2) response to the Court's order
6 to show cause why preliminary injunction should not issue. Given
7 that Goldfarb was cooperating with the defense for a good part of
8 February 1999 (and presumably January 1999), the Court is not
9 surprised that ATS only produced a copy of the Historical
10 Database CD-ROM after it produced a copy of the same CD-ROM to
11 former defense counsel Saferstein, despite the Receiver's
12 requests for more data about a month earlier. The delay in
13 producing the CD-ROM to the Receiver could have been the result
14 of Goldfarb's efforts to cooperate with the defendants. In sum,
15 the Court finds no evidence that supports the defendants'
16 contention that the one month delay in producing the CD-ROM to
17 the Receiver indicates that Goldfarb was manipulating the data to
18 cooperate with the FTC or cover up his complicity.

19 108. Neither Kane nor others from the Receiver's office ever
20 returned to ATS's office to verify independently that the CD-ROM
21 ATS produced accurately reflects the transactions that ATS had
22 processed for Taves' companies. (Kane, Vol. III at 78.)

23 109. No one on behalf of the defendants has ever requested
24 Goldfarb to extract, burn and produce another CD-ROM with the
25 same query to see if the results would be different. (Goldfarb
26 at 124.)

27 110. No one on behalf of the defendants has ever asked
28 Goldfarb to extract, burn and produce a CD-ROM that contains the

1 historical transactions of all of ATS's clients for the same time
2 period (for comparison purposes). (Goldfarb at 124.)

3 111. Based on Goldfarb's and Kane's testimony concerning
4 their production and chain of custody, the Court finds the
5 Historical Database CD-ROM, and the records contained therein,
6 reliable evidence of the credit and debit card transactions the
7 defendants caused to be processed through ATS.

8 **G. The Records from the Historical Database CD-ROM**

9 112. Kane testified that the data on the Historical Database
10 CD-ROM was saved in ASCII format.²¹ He imported the data from
11 the CD-ROM into his computer hard drive using Microsoft Access²²
12 to sort and analyze the data. (Kane at 154-55.)

13 113. The Historical Database CD-ROM contains records of
14 2,584,919 transactions (not card numbers) processed by ATS for
15 the corporate defendants. (Order at 32.)²³

17 ²¹ ASCII is the acronym for American Standard Code
18 Information Interchange. Webster's II New Riverside University
19 Dictionary 129 (1994). Data in ASCII format is written in a
20 standard code that allows "information [to be] exchange[d]
21 between equipment produced by different manufacturers." Id.

22 ²² According to Microsoft's web site, the Microsoft Access
23 is a "Database Management System." See <http://www.microsoft.com/office/access>.

24 ²³ The Court notes that in the Order, the Court used
25 "purportedly" to describe the number of records in the ATS
26 database because the Court had concerns about Goldfarb's
27 credibility and, hence, the reliability of the ATS database
28 produced under Goldfarb's instructions. (See Order at 32.) The
2,584,919 figure was calculated by Card Alert Services, FTC's
expert, whose report was submitted in support of the FTC's motion
for summary judgment. At trial, neither side challenged this
calculation. Instead, the parties focused on whether all of the
transactions recorded in the ATS database should be attributed to
the defendants, not whether the FTC's expert incorrectly totaled
the number of transactions or amount of dollars actually
identified in the database.

1 114. The records on the CD-ROM do not include pre-1998
2 transactions. Historical records for earlier time periods were
3 not available because they had been purged. (Goldfarb at 61,
4 106-07.)

5 115. Goldfarb testified that the purging of old records in
6 the ATS historical database occurred in connection with a series
7 of upgrades that ATS's computer system underwent from 1995-1998.
8 Goldfarb could not recall when the pre-1998 records were purged.
9 (Goldfarb at 61, 106-07.)

10 116. The defendants offered no evidence to either contradict
11 this testimony or refresh Goldfarb's recollection.

12 117. The Historical Database CD-Rom did not identify any
13 merchant names; it only identified merchant IDs. Those merchant
14 IDs matched all of the merchant IDs on the floppy disks produced
15 by ATS. Using the merchant names and associated merchant IDs
16 from the floppy disks, Kane matched the merchant names to the
17 entries identified in the historical records. (Kane at 171.)

18 118. Based on his review and knowledge of the records in
19 this case, Kane testified that he would never find more than one
20 person, company or other entity sharing a merchant ID, but one
21 person, company or entity might have multiple merchant IDs.
22 (Kane at 171-72.)

23 119. Exhibit 3 is a hard copy of a table prepared by Kane
24 and others from the Receiver's office. (Kane at 157-58.)

25 120. Exhibit 3 summarizes and sorts the financial data
26 contained in the CD-ROM. The table has 17 principal columns with
27 the following headings: ID, Mer Name, Mer_Id, 199801, 199802,
28 199803, 199804, 199805, 199806, 199807, 199808, 199809, 199810,

1 199811, 199812, 199901, and MERID TOTALS. The table has 156
2 principal rows, each of which is associated with a separate
3 Mer_Id. (Ex. 3.)

4 121. Among other things, Exhibit 3 identifies the total
5 dollar amount processed each month for each merchant ID, in
6 addition to the total dollar amount processed each month for all
7 of the merchant IDs combined. (Ex. 3.)

8 122. The records from the Historical Database CD-ROM show a
9 total of \$47,512,530 in credit and debit card transactions were
10 processed through the defendants' merchant accounts from January
11 1998 to January 1999. (Ex. 3; Kane at 179.)²⁴

12
13 ²⁴ The defendants argue that this \$47.5 million figure
14 does not "jibe" with Goldfarb's testimony that ATS received 10
15 percent of the defendants' "net". (Vol. III at 137.) The
16 defendants' argument, while not fully articulated, appears to be
17 the following: ATS received approximately \$2.6 million in 1998.
18 (Id.) Because Goldfarb testified that the "net" was based on
19 total number of dollars processed less chargebacks and credits,
20 the "net" for 1998, based on the total sales identified in the
21 ATS Historical CD-ROM, should be far more than what ATS earned.
22 Because the defendants did not do the calculation for the Court,
23 the Court assumes the defendants have in mind the following
24 sample calculation: \$47,512,530 less \$5,619,942 (total
25 chargebacks and credits registered through December 1998 (Ex. 4))
26 = \$41,892,587. Ten percent of that amount would be approximately
27 \$4.1 million.

28 The defendants' argument -- which is really all they have --
does not persuade the Court to change its finding concerning the
credibility of Goldfarb and reliability of the records contained
in the Historical Database CD-ROM. Goldfarb testified that he
could not recall all of the details of the formula used to
calculate the "net." (Fact No. 38.) Goldfarb also testified
that he always accepted Taves' oral representation concerning the
monthly chargebacks [and credits]. (Fact No. 39.) Thus,
Goldfarb's undisputed trial testimony shows (1) the "net" formula
could have required additional amounts to be deducted from the
total sales; and (2) leaves open the possibility that Taves
misrepresented the chargeback figures in order to pay less fees.
(After all, he certainly had a financial incentive for doing
that.) This discussion simply shows that the defendants'
contention is based on speculation. The Court cannot find that
the \$47.5 million necessarily does not "jibe" with Goldfarb's
testimony.

1 123. \$3,357,442 of the \$47,512,530 processed was linked to
2 web sites hosted by the defendants' San Diego server. This
3 represents 7.07 percent of the total. (Kane at 179-80.)

4 124. \$1,026,407 of the \$47,512,530 processed was linked to
5 45 known third party web sites (on behalf of which the defendants
6 had submitted charge requests). This represents 2.16 percent of
7 the total. (Kane at 177-79.)

8 125. In other words, \$4,383,849 (\$3,357,442 plus \$1,026,407)
9 was derived from legitimate business activities.

10 126. \$43,128,681 of the \$47,512,530 processed was associated
11 with merchant IDs and merchant names for which there are
12 "absolutely no business records." This represents 90.77 percent
13 (hereinafter "90.8 percent") of the total. (Kane at 181-82.)

14 127. Kane attempted to verify independently the data he
15 obtained from the CD-ROM. (Kane, Vol. III at 7.)

16 128. Kane compared the complaint letters that identified
17 credit card numbers with credit card numbers identified in the
18 Historical Database CD-ROM. (Kane, Vol. III at 7-9.)

19 //

20
21 _____
22 The Court also observes that Goldfarb's deposition
23 testimony, the transcript of which was submitted as an exhibit in
24 support of the FTC's summary judgment motion, indicates that the
25 "net" was calculated in the following manner: "Gross revenue,
26 minus bank discount rate, minus bank transaction fees, minus
27 reserves, minus credits, minus chargebacks." (FTC's S.J. Ex. 7
28 at 528.) This testimony, taken on June 24, 1999 when Goldfarb's
memory was obviously better, is consistent with Goldfarb's trial
testimony that there could be more to the fee calculation.
Because neither side introduced Goldfarb's deposition testimony
at trial to refresh Goldfarb's recollection, the Court does not
rely on Goldfarb's deposition testimony to reach its conclusion
here. The Court simply notes that the record in this case
supports the Court's credibility finding and emphasizes the lack
of support for the defendants' argument.

1 129. Out of a total of 1815 such complaint letters, 1676 (or
2 92 percent) contained credit card numbers that matched those
3 identified in the CD-ROM. (Kane, Vol. III at 9.)

4 **H. The Receiver's Calculation of Damages**

5 130. The Receiver, Robb Evans & Associates, is composed of
6 largely former bankers and C.P.A.s who manage receiverships.
7 Kane, a member of Robb Evans & Associates, has over 20 years of
8 bank operational and financial experience. He referred to
9 himself as a "banker by trade." (Kane at 146 & Vol. III at 36,
10 46.)

11 131. In connection with this case, Kane reviewed, among
12 other things, the business records the Receiver's staff found in
13 the defendants' Malibu offices, accounting records turned over by
14 the defendants' outside bookkeeper, and the data in the
15 Historical Database CD-ROM. (Kane at 147.)

16 132. Kane has also been involved with the tracing of the
17 defendants' off-shore funds for recovery into the receivership
18 estate. (Kane at 147.)

19 133. Based on Kane's analysis of the defendants' Charter
20 Pacific and Heartland bank statements, Kane determined that
21 \$49,417,142.94 (hereinafter "\$49,417.143") was processed and
22 deposited into the defendants' merchant accounts in 1998. (Kane,
23 Vol. III at 10-11; Ex. 4.)

24 134. Of this amount, \$7,300,000 in chargebacks and credits
25 has been processed through February 2000. (Kane, Vol. III at 24-
26 25; Ex. 7.)

27 135. Kane and his staff attempted to match the total monthly
28 dollar amount reflected in the Historical Database CD-ROM with

1 the total monthly deposits reflected in the defendants' bank
2 statements. They could not find an exact match. (Kane, Vol. III
3 at 94.)

4 136. There is a difference of \$1,906,693 between the
5 \$49,417,143 total bank deposits and the \$47,512,530 total
6 processed by ATS. (Kane at 11.)

7 137. Goldfarb testified that he learned in 1998 that some
8 transactions which resulted in chargebacks registered in the
9 defendants' Charter Pacific account were not processed by ATS.
10 (Goldfarb at 136-37.)²⁵

11 138. If the defendants used another processor, then the
12 \$1,906,693 difference may simply be the amount processed by that
13 mysterious processor.

14 139. The \$1,906,693 difference does not cause Kane to
15 question the accuracy of his calculations. He and others at the
16 Receiver's office "checked and rechecked the bank deposits."
17 (Kane, Vol. III at 12-13.)

18 140. Although neither side brought this to the Court's
19 attention, the Court observes that the January 1999 historical
20 records reflected in the Historical Database CD-ROM must refer to
21 transactions ATS processed for TAL. (See Ex. 3.)²⁶ Thus, the

22
23 ²⁵ In response to Charter's inquiry about those
24 transactions, ATS searched its computer system but found no
25 record of those transactions. ATS learned that "JC" was the
26 terminal identifier associated with those transactions. At the
time, ATS's terminal identifier with the authorizing network was
"EA". Thus, Goldfarb concluded that those transactions did not
originate from ATS. (Goldfarb at 137.)

27 ²⁶ ATS stopped processing for JKP and MJD in 1998. (Fact
28 Nos. 4 & 68.) It makes sense that the same merchant IDs were
involved because MJD transferred its existing book of business to
TAL around the time that it stopped processing with ATS. (See

1 \$47,512,530 total "sales" identified in the CD-ROM includes
2 \$35,805 processed (in January 1999) for TAL. However, according
3 to Exhibit 4, the \$49,417,143 total bank deposits only concern
4 1998 deposits in JKP and MJD's merchant accounts at Charter
5 Pacific and Heartland. (Ex. 4.)²⁷ Based on the evidence
6 introduced at trial, the inclusion of TAL's "sales" from the CD-
7 ROM and exclusion of TAL's "sales" deposits is another reason the
8 two records' total "sales" figure do not match.

9 141. According to the court docket, the FTC obtained a
10 clerk's entry of default against TAL on July 29, 1999. However,
11 it appears that the FTC has never obtained a default judgment
12 against TAL. Although the FTC probably could have demonstrated
13 that TAL should be jointly and severally liable with Herbal Care,
14 JKP and MJD, the FTC chose to prosecute TAL separately. As a
15 result, the issue of TAL's liability has not been addressed by
16 this Court. Under the circumstances, the Court does not consider
17 the \$35,805 processed for TAL when considering the total "sales"
18 identified in the CD-ROM.²⁸ Subtracting \$35,805 from the CD-
19 ROM's figures, the total becomes \$47,476,725. Then, the
20 difference between 1998 "sales" activities reflected in the total
21 bank deposits and the 1998 "sales" activities reflected in the

22 //

23 //

24 _____
25 Order at 25.)

26 ²⁷ TAL had its own merchant account with Charter Pacific.
(Order at 24-25.)

27 ²⁸ The Court is aware that TAL simply received the portion
28 of MJD's "book of business" that was processed through MJD's
Charter Pacific account in December 1998. (Order at 25.)

1 CD-ROM increases by \$35,805, i.e., \$1,942,498 rather than
2 \$1,906,693.²⁹

3 142. Because the Receiver has found no business records to
4 support 92 percent of the transactions processed by ATS, Kane
5 testified that he and the Receiver have consistently maintained
6 that 92 percent of the "sales" generated by the defendants were
7 the fruit of unauthorized transactions. (Kane, Vol. III at 84-
8 86.)

9 143. However, Card Alert Services, the independent expert
10 retained by the FTC (or the Receiver), opined that 90.8 percent
11 of the transactions identified in the Historical Database CD-ROM
12 represents unauthorized transactions. (Kane, Vol. III at 84.)

13 144. To give the defendants the benefit of the doubt, for
14 purposes of this trial, the Receiver submits that 90.8 percent of
15 the defendants' "sales" activity for 1998 was the result of
16 unauthorized credit and debit transactions. (Kane, Vol. III at
17 84-85.)

18 145. Using this 90.8 percent as the benchmark, the Receiver
19 opines that the total restitution required to remedy the
20 defendants' 1998 fraudulent practices is \$37,525,200. (Ex. 17.)

21 146. This \$37,525,200 figure is derived from the following:
22 \$43,100,000 (90.8 percent of \$47,512,530 (ATS)) plus \$1,725,200
23 (90.8 percent of \$1,900,000³⁰ additional "sales" deposits per
24 //

25
26 ²⁹ Ultimately, as the Court demonstrates below, this does
27 not change the total restitution amount under the Receiver's
28 formula.

³⁰ The Receiver rounded off the \$1,906,693 difference that
it calculated.

1 bank statements) minus \$7,300,000 (100% of the chargebacks and
2 credits processed through February 2000). (Ex. 17.)³¹

3 147. 90.8 percent of \$47,512,530 (ATS) is \$43,141,377, not
4 the \$43,100,000 used by the Receiver. It appears that the
5 Receiver rounded off the number to the nearest hundred thousand
6 for purposes of calculating damages. The Court does not find
7 such rounding off appropriate for this calculation. Because this
8 amount is supposed to reflect the amount of consumer loss, and
9 \$41,377 represents a significant amount of consumer loss, the
10 \$41,377 should be considered. Therefore, applying the Receiver's
11 formula to the evidence introduced at trial, the total
12 restitution required to remedy the defendants' 1998 fraudulent
13 practices is \$37,566,577 (\$37,525,200 plus \$41,377).

14 148. The total restitution figure remains the same even if
15 the amount from the Historical Database CD-ROM is reduced by
16 \$35,805 (the TAL transactions): \$43,108,866³² (90.8 percent of
17 \$47,476,725 (ATS)) plus \$1,757,711³³ (90.8 percent of \$1,935,805
18 [\$1,900,000 plus \$35,805] additional "sales" deposits per bank
19 statements) minus \$7,300,000 (total chargebacks and credits)
20 equals \$37,566,577.

21 149. The defendants have no business records for 1997.
22 (Kane, Vol. III at 30.)

23
24 ³¹ The Receiver's formula is basically the equivalent of
25 taking 90.8 percent of the total bank deposits for 1998 minus
26 total chargebacks and credits. This explains why it makes no
27 difference, as shown below, whether or not the Court actually
28 removes the transactions ATS processed for TAL from the
calculation.

³² The actual total is \$43,108,866.30.

³³ The actual total is \$1,757,710.94.

1 150. In the early part of 1997, JKP/Netfill maintained a
2 merchant account at Humboldt Bank. (Kane at 14.)

3 151. From June 1997 through December 1997, JKP/Netfill
4 maintained a merchant account at Charter Pacific. (Ex. 15; see
5 Order at 19-21.)

6 152. Based on his analysis of the defendants' bank
7 statements from Charter Pacific and Humboldt Bank, Kane
8 determined that \$4,977,219 was processed and deposited into the
9 defendants' merchant account in 1997. (Kane, Vol. III at 14.)

10 153. Exhibit 15, prepared by Kane, is a summary of the
11 monthly deposits into the defendants' Charter Pacific and
12 Humboldt Bank accounts for 1997. (Kane, Vol. III at 14; Ex. 15.)

13 154. Of the total deposited into the defendants' merchant
14 accounts in 1997, \$1,760,168 was deposited in November and
15 December. (Ex. 15.)

16 155. Kane testified that the total restitution required to
17 remedy the defendants' 1997 fraudulent practices is \$1,598,233,
18 or 90.8 percent of the \$1,760,168. (Kane, Vol. III at 24; Ex.
19 17.)

20 156. This calculation assumes that some of the chargebacks
21 registered in the early months of 1998 would relate to 1997
22 charge transactions. (Kane, Vol. III at 22-23.)

23 157. The bank statements obtained by the Receiver show that
24 chargebacks were registered in early 1998 -- January through
25 March. (Ex. 4.)

26 158. Because he understands that the typical lag time for
27 chargebacks to register is between 30 to 90 days, Kane concluded
28 that some of the January through March 1998 chargebacks relate to

1 charges processed in November and December 1997. (Kane, Vol. III
2 at 22-23, 30.).

3 159. Although Kane does not expressly articulate his opinion
4 as such, it appears that he believes the existence of those
5 chargebacks shows the transactions processed in November and
6 December 1997 involved unauthorized transactions. (See Kane,
7 Vol. III. 22-23, 30.)

8 160. Accordingly, Kane opines that the 90.8 percent
9 unauthorized charges formula (derived from analysis of post-1997
10 transactions) should be used for 1997. Therefore, at least 90.8
11 percent of the November and December 1997 deposits should be
12 presumed to be the result of unlawful practices. (Kane at 24;
13 Ex. 17.)

14 161. The Court is mindful of the fact that the evidence
15 shows the defendants first obtained access to the Charter Pacific
16 Database in November 1997. (Order at 17.)

17 162. The Court is also mindful of the fact that the evidence
18 shows Taves first began to transmit thousands of charge requests
19 to ATS for processing by e-mail in "late 1997 or early 1998."
20 (Order at 17.)

21 163. However, the Court is troubled by the fact that FTC has
22 offered no additional evidence to corroborate Kane's conclusion
23 when it appears that such evidence may in fact exist.

24 164. Despite stating that they "could quite easily" have
25 verified which of the 1998 chargebacks are actually attributable
26 to the November and December 1997 charges, neither Kane nor any
27 of his staff has attempted such verification. (Kane, Vol. III
28 at 61.)

1 165. In addition, Kane's assumption that 90.8 percent of the
2 charges processed in November and December 1997 is attributed to
3 unauthorized charges just because the evidence shows 90.8 (or 92
4 percent) of the 1998 transactions were unauthorized is too
5 speculative.

6 166. Based on this record, the Court finds that it cannot
7 take the 1997 bank deposits into consideration for the damages
8 determination.

9 167. Alternatively, in the event the Court does not find the
10 Historical Database CD-ROM reliable, the FTC proposes that the
11 total restitution required to remedy the defendants' fraudulent
12 practices equals 100 percent of the total bank deposits less
13 total chargebacks and credits.

14 168. Because the Court finds that the Historical Database
15 CD-ROM and the records contained therein reliable, the Court
16 rejects this alternative calculation.

17 169. Because the Court finds that the Historical Database
18 CD-ROM and the records contained therein are reliable, the Court
19 also rejects the three alternative methods of calculation
20 proposed by the defendants:³⁴

- 21 (a) The defendants proposed that the total consumer
22 loss should equal approximately \$99,750. (See
23 Vol. III at 135.) This calculation uses the
24 maximum of 5,000 written consumer complaints that
25 the Receiver has reviewed. It also assumes that

27 ³⁴ The defendants requested that the Court find Goldfarb
28 and the Historical Database CD-ROM unreliable and, instead,
consider the following methods of calculation.

1 each consumer lost \$19.95. This method, of
2 course, grossly understates the amount of consumer
3 loss. It certainly fails to take into account the
4 Court's prior finding (at summary judgment stage)
5 that the number of consumer complaints of
6 unauthorized charges far exceeds the 5,000 written
7 complaints received by the Receiver. (See Order
8 at 26-30.) It also fails to take into account the
9 Court's finding that there are undoubtedly injured
10 cardholders who will never file a complaint
11 because they did not catch the unauthorized
12 charges on their bank statements. (See Order at
13 30.)

- 14 (b) The defendants proposed that the Court assume that
15 ATS's fees -- approximately \$2.6 million plus
16 \$80,000 (unpaid portion) represent 10 percent of
17 the "net" sales earned by the defendants. (Vol.
18 III at 146-47.) Under this calculation, the
19 damages would be approximately \$26,800,000. If
20 the Court were to reject the FTC's evidence, e.g.,
21 Goldfarb's testimony and the CD-ROM, the Court
22 would not rely on any portion of Goldfarb's
23 testimony, including testimony concerning the
24 "net." Thus, the Court does not find this an
25 acceptable alternative method of calculation.
- 26 (c) The defendants propose that the amount of damages
27 be equivalent to the amount of profits earned by
28 the defendants in 1998. (Vol. III at 147-48.)

1 Using Exhibit 101, the August 4, 1999 report
2 prepared by the Receiver, the gross profit before
3 ordinary business expenses equal \$30,600,000.
4 (Ex. 101.) The defendants have offered no
5 justification for using gross profits as the basis
6 of computing consumer loss in this case. In light
7 of the fact that the FTC has offered competent
8 testimony and reliable evidence of the approximate
9 amount of unauthorized sales for 1998, the Court
10 sees no reason why the amount of consumer redress
11 must be reduced by the millions of dollars in bank
12 charges and fees, etc. (see Ex. 101) that the
13 defendants incurred as part of their cost of doing
14 business.

15 170. The defendants offered no evidence that shows less than
16 90.8 percent of their 1998 "sales" activities was the result of
17 unauthorized transactions.

18 171. The Court finds that the FTC has proven by a
19 preponderance of the evidence that 90.8 percent of the
20 defendants' 1998 credit and debit card transactions was
21 unauthorized.

22 172. The Court finds that the FTC has proven by a
23 preponderance of the evidence that 90.8 percent of the total
24 "sales" amount the defendants caused to be deposited into their
25 merchant accounts was unauthorized.

26 173. The Court finds that the FTC has proven by a
27 preponderance of the evidence that \$37,566,577 reasonably

28 //

1 approximates the amount of consumer loss caused by the
2 defendants' unlawful activities in 1998.

3 174. Any conclusion of law which is deemed a finding of fact
4 is incorporated herein by reference.

5 **CONCLUSIONS OF LAW**

6 1. Defendants Herbal Care, JKP and MJD violated section 5
7 of the FTC Act, 15 U.S.C. § 45(a). (Order at 53.)

8 2. Defendants Ken Taves, Herbal Care, JKP and MJD engaged
9 in the unfair practice of operating a fraudulent scheme by which
10 they debited and charged card numbers without the cardholders'
11 authorization. (Order at 53, 55 n.67.)

12 3. This practice resulted in substantial injury to an
13 untold number of consumers. (See *id.*)

14 4. Defendants Ken Taves, Teresa Taves, Herbal Care, JKP
15 and MJD are jointly and severally liable for the corporate
16 defendants' unfair practices.

17 5. In proper cases, Section 13(b) of the Federal Trade
18 Commission Act provides that the FTC "may seek, and after proper
19 proof, the court may issue, a permanent injunction." 15 U.S.C.
20 § 53 (b).

21 6. The authority granted by section 13(b) "includes the
22 'authority to grant any ancillary relief necessary to accomplish
23 complete justice.'" FTC v. Pantron I Corp., 33 F.3d 1088, 1102
24 (9th Cir. 1994) (quoting FTC v. H.N. Singer, Inc., 668 F.2d 1107,
25 1113 (9th Cir. 1982)). This power includes the power to grant
26 monetary equitable relief, such as restitution. *Id.* (citing FTC
27 v. Amy Travel Serv., Inc., 875 F.2d 564, 571 (7th Cir. 1989)).

28 //

1 7. "The remedy of restitution seeks to correct unjust
2 enrichment, and is therefore particularly suited to remedying
3 economic injuries." Pantron I Corp., 33 F.3d at 1102.

4 8. Where it would be impracticable to reimburse all of the
5 consumers who have been injured by the defendants' unlawful
6 practices, the district court has the discretion to order some
7 remedy which requires the defendants to disgorge their unjust
8 enrichment. Id. at 1102-03 n.34.

9 9. The FTC need not show that its calculation of consumer
10 loss is exactly the amount of consumer loss. Instead, the FTC
11 must show that "its calculation reasonably approximated the
12 amount of customer's net losses[.]" FTC v. Febre, 128 F.3d 530,
13 534 (7th Cir. 1997) (emphasis added). Then, "the burden shifts
14 to the defendants to show that those figures were inaccurate."
15 Id.

16 10. In determining the amount of damages, any "'risk of
17 uncertainty should fall on the wrongdoer whose illegal conduct
18 created the uncertainty.'" Id.

19 11. In this case, the FTC detailed the steps it took to
20 reach 90.8 percent (fraudulent transactions) figure and the
21 \$37,566,577 consumer loss calculation. The FTC relied on the
22 historical records from the Historical Database CD-ROM,³⁵ the
23 bank statements relating to JKP and MJD's merchant accounts,
24 business records found at the defendants' Malibu offices,
25 accounting records produced by the defendants' outside bookkeeper
26 and expert testimony.

27 ³⁵ The Historical Database CD-ROM is admissible as a
28 reliable copy of a business record. See Fed. R. Evid. 803(6).

1 12. The defendants failed to offer any evidence (as opposed
2 to speculation) as to why or how the FTC's calculations do not
3 reasonably approximate the amount of consumer loss.

4 13. To the extent that the FTC's calculations may be
5 somewhat inaccurate, the inaccuracy is the direct result of the
6 defendants' failure to maintain sufficient business records. The
7 risk of uncertainty should fall on the defendants whose conduct
8 created the uncertainty.

9 14. To the extent that the defendants contend that the
10 amount of profits and not consumer loss is the proper measure of
11 damages, the Court rejects this argument. "A major purpose of
12 the Federal Trade Commission Act is to protect consumers from
13 economic injuries. Courts have regularly awarded, as equitable
14 ancillary relief, the full amount lost by the consumer." Febre,
15 128 F.3d at 536. Here, the Court holds that the unauthorized
16 credit and debit card charges that the defendants caused to be
17 deposited into their merchant accounts (without consideration of
18 the defendants' profits) provide the appropriate measure of
19 restitution. See id.

20 15. To the extent that it would be impossible or unfeasible
21 for the FTC to distribute all of the \$37,566,577 to injured
22 consumers, the unpaid funds shall be deposited into the United
23 States Treasury. See FTC v. Gem Merchandising Corp., 87 F.3d
24 466, 469-70 (11th Cir. 1996) (district court had power to order
25 payment of excess award to the U.S. Treasury); Febre, 128 F.3d at
26 537 (same); cf. Pantron I, 33 F.3 at 1102-03 ("If the court
27 reasonably concludes that it would be impossible or impracticable
28 to locate and reimburse all of the consumers who have been

1 injured . . . it may order some other remedy which requires [the
2 defendants] to disgorge its unjust enrichment").

3 16. The Court hereby DISCHARGES its May 4, 1999 and May 5,
4 1999 orders holding Ken Taves in contempt of the Court's
5 temporary restraining order and preliminary injunction order.

6 17. Any finding of fact which is deemed a conclusion of law
7 is incorporated herein by reference.

8 SO ORDERED

9 DATED: August 9, 2000

10 Audrey B Collins
11 AUDREY B. COLLINS
12 UNITED STATES DISTRICT JUDGE
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