

FEB 26 2007

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CASE MANAGEMENT CONFERENCE SET

JUL 27 2007 - 9<sup>00</sup> AM

DEPARTMENT 212

8 Attorneys for the People of the State of California  
9

10 SUPERIOR COURT OF CALIFORNIA

11 CITY AND COUNTY OF SAN FRANCISCO

12 **THE PEOPLE OF THE STATE OF CALIFORNIA,**

13 Plaintiff,

14 v.

15 **JTH TAX, INC. (D/B/A LIBERTY TAX SERVICE),**  
16 **EMPLOYEESPLUS, INC., and DOES 1 THROUGH**  
17 **150, INCLUSIVE,**

18 Defendants.

Case No. **CGC-07-460778**

**COMPLAINT FOR  
INJUNCTION, CIVIL  
PENALTIES AND OTHER  
RELIEF**

19  
20 The People of the State of California, by Edmund G. Brown Jr., Attorney General for  
21 the State of California, are informed and believe and on such information and belief, allege as  
22 follows:

23 **DEFENDANTS**

24 1. Defendant JTH Tax, Inc. is a privately held Delaware corporation which  
25 franchises and operates a network of offices in the United States that engage in the preparation  
26 of personal income tax returns. This network currently comprises more than 100 offices located  
27 in California, and more than 2,000 offices nationwide, all of which do business under the name  
28 Liberty Tax Service.

1           2. Defendant EmployeesPlus, Inc. is a Virginia corporation and a wholly owned  
2 subsidiary of JTH Tax, Inc. Defendant EmployeesPlus, Inc. operates tax preparation stores  
3 owned by JTH Tax, Inc. and/or its subsidiaries.

4           3. JTH Tax, Inc. and EmployeesPlus, Inc. are engaged, through their officers, agents,  
5 representatives and employees, in the business of tax preparation, the marketing and facilitation  
6 of tax “refund anticipation loans” and related products and services.

7           4. The true names and capacities, whether individual, corporate, or otherwise, of  
8 defendants named as Does 1 through 150 are unknown to Plaintiff who therefore sues these  
9 defendants by these fictitious names. Plaintiff will amend this complaint to show the true names  
10 of these defendants when their names and capacities have been ascertained.

11           5. All the defendants described in paragraphs 1 through 4 may collectively be  
12 referred to as “Defendants” or “Liberty” in this complaint.

13           6. At all relevant times, Defendants have transacted business in the City and County  
14 of San Francisco and elsewhere in California. The violations of law herein alleged have been  
15 carried out in the City and County of San Francisco and elsewhere in the State of California.

16           7. At all relevant times, each of Doe defendants 1 through 150 has acted as an agent,  
17 representative, or employee of the other defendants, and has acted within the course and scope  
18 of that agency, representation or employment; and has participated in, has conspired with, and/or  
19 has aided and abetted others, including the other defendants in committing the violations alleged  
20 in this complaint.

21           8. Whenever reference in this complaint is made to any act of Defendant(s), that  
22 allegation shall be deemed to mean the act of each defendant acting individually and jointly.

23           9. Whenever reference in this complaint is made to any act or transaction of any  
24 corporation, partnership, business or other organization, that allegation shall be deemed to mean  
25 that the corporation, partnership, business or other organization did or authorized the acts alleged  
26 in this complaint through its principals, officers, directors, employees, members, agents and  
27 representatives while they were acting within the actual or ostensible scope of their authority.

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1 loans itself. Consequently, the loans are technically provided by lenders with which Liberty  
2 contracts. It is primarily Liberty, however, not the lenders, that has advertised and promoted the  
3 loans. It is also Liberty that in the course of providing its tax preparation service has offered the  
4 loans to its clients, provided its clients the multi-page loan applications, filled out the  
5 applications, and obtained the signed loan applications. Liberty also has delivered the loan  
6 applications to the lender, and subsequently distributed the loan proceeds to most of its taxpayer  
7 clients. All loan fees and any tax preparation fees that the client has not already paid have been  
8 deducted from the loan amount before the remainder of the loan proceeds are made available,  
9 generally at the Liberty office in the form of a paper check printed by Liberty that the client must  
10 pick up.

11 15. Liberty has received substantial revenue from the loans, the extent of which has  
12 not been disclosed with any specificity to Liberty's clients.

13 16. Since 2002, Liberty customers in California have entered into tens of thousands  
14 of RALs and Electronic Refund Checks ("ERCs"), generating significant income for Liberty.

15 17. The loan application which Liberty personnel have had their clients sign  
16 authorizes the lender to set up a temporary "account" in the client's name for the sole purpose  
17 of receiving the taxpayer's refund directly from the IRS. The client may not deposit to or  
18 withdraw any amount from the collection account. When the client's tax return is sent to the  
19 IRS, Liberty designates the collection account as the destination to which the refund should be  
20 directed. Once the IRS is notified, the destination for the tax refund cannot be changed. When  
21 the refund arrives from the IRS, the lender repays itself out of the refund and forwards to Liberty  
22 the amount of any tax preparation or other fees owed Liberty.

23 18. Liberty has represented that a customer will receive a RAL within one to two  
24 days.

25 19. When a client's tax return is filed electronically, as Liberty does for the vast  
26 majority of its clients, the IRS provides the refund within approximately 8-15 days by direct  
27 deposit to a taxpayer's own bank account or in about 21-28 days if sent by U.S. mail.

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1           20. Because Liberty clients with bank accounts may receive their RAL proceeds no  
2 more than a week before they would have received their refund from the IRS, RALs are very  
3 short-term, very expensive loans. Since the lender is repaid by the receipt of the borrower's tax  
4 refund from the IRS in an average of about 10 days, Liberty's RAL clients have typically paid  
5 interest, depending on the size of the loan, at an Annual Percentage Rate (APR) of from 40% to  
6 well over 100% APR. If all administrative and application fees required to be paid to receive  
7 the loan were included, the rate could be in excess of 500%.

8           **B. Liberty's RAL Program Has Targeted the Working Poor**

9           21. The Earned Income Tax Credit (EITC) is a tax credit paid by the federal  
10 government to low-income taxpayers. Although EITC recipients make up less than twenty  
11 percent of all taxpayers, they constitute a significant percentage of all customers for Liberty's  
12 RALs and related products. Because the EITC is a tax credit rather than a deduction, receipt of  
13 the EITC, which averages several thousand dollars, often sharply increases or provides the  
14 entirety of a taxpayer's refund.

15           22. Persons eligible for the credit can elect to have much of their EITC distributed  
16 in their paychecks throughout the year rather than having to wait for a lump sum refund at tax  
17 time (a program known as the "Advance EITC"). Similarly, even those who are not eligible for  
18 an EITC may keep more of their income during the year, rather than having to wait for it after  
19 filing their year-end tax returns, simply by adjusting their W-4 withholding amounts. Liberty  
20 has not effectively provided information about adjusted withholding or the Advance EITC to  
21 those who – because of the size of their refunds and as recipients of RALs – are eligible for them.

22           23. The consequences of entering into a RAL may be severe. Submitting the  
23 application documents transfers clients' entitlement to their tax refund to the lender and  
24 Defendants. If for any reason a client's refund is not deposited into the temporary "account" or  
25 is less than expected because other debts have been deducted from the refund amount, the  
26 consumer is still held liable for the full amount of the RAL.

27           24. If a Liberty client's application for a RAL is denied for any reason, the client  
28 receives no money until the IRS sends the client's refund to the temporary "account."

1 Nevertheless, certain fees are still charged. In other words, such clients receive no loan, and  
2 obtain the remaining portion of their refund (less additional fees) no faster than they would have  
3 had they simply elected to receive their refund by direct deposit from the IRS.

4 **C. Defendants Have Offered Deferral of Tax Preparation Fees Through**  
5 **Purportedly Rapid “Electronic Refund Checks.”**

6 25. Generally, the fees for Liberty’s tax preparation and related services are due at  
7 the time a client’s taxes are prepared. Defendants offer their clients the option of deferring  
8 payment of those fees until after their tax refund has been received from the IRS – but only if the  
9 clients agree to pay a fee to get a RAL or another refund-based product that Defendants call an  
10 “Electronic Refund Check” or “ERC.”

11 26. In offering an ERC to its clients, Liberty – as it does with a RAL – obtains its  
12 clients’ signatures on a multi-page application form which transfers the clients’ rights to receive  
13 their tax refunds to Liberty’s chosen bank. The bank sets up a temporary collection account to  
14 secure the deferred tax preparation fees due Liberty as well as the fees charged to get an ERC,  
15 and the IRS is directed to send the client’s tax refund directly to the bank. Unlike a RAL, where  
16 customers get the money while in the Liberty office or a day or two later, with an ERC customers  
17 do not receive any money until after the IRS has delivered their refund to the collection account  
18 at the bank. When the tax refund arrives, the bank deducts both the fees charged for allowing  
19 the deferral through the “account,” and all tax preparation fees and other charges owed to  
20 Liberty, before forwarding whatever remains for the client. Liberty clients receive this remaining  
21 amount of their refund, either in the form of a paper check they must pick up at the Liberty office  
22 (if, for example, they do not have a bank account of their own), or by direct deposit into the  
23 clients’ own bank account, approximately 8-15 days after Liberty electronically files their returns  
24 – or in precisely the same amount of time that the clients would have received their refunds  
25 (without cost) straight from the IRS by direct deposit.

1           **D. Defendants' RALs and ERCs Have Bound Clients to Automatic Debt**  
2           **Collection**

3           27. Defendants have participated in a mutual debt-collection scheme through a debt-  
4 pool participation agreement with their partner lenders, other commercial tax preparers, and the  
5 partner lenders of those tax preparers. RAL-related charges can become delinquent debts if, for  
6 any reason, the IRS does not send all or part of the anticipated refund securing the RAL. The  
7 applications which Defendants have had their clients sign (for a RAL or ERC) purport also to  
8 bind the clients to the automatic collection of any debt from a prior year's RAL- or ERC-type  
9 products that any debt-pool participant believes the client may owe. Only through a RAL or an  
10 ERC – and the accompanying “agreement” to have alleged past debts to Defendants and other  
11 entities collected – can clients defer paying their tax preparation fees at the time that their taxes  
12 are prepared, which may be a financial necessity.

13           28. The RAL or ERC forms have not specified that the partner bank *is* a debt  
14 collector, but rather have stated that the partner bank *may* be acting as a debt collector. Neither  
15 the application forms Defendants have provided for a RAL or ERC nor any other document or  
16 information they have provided before the client was committed to purchasing the RAL or ERC,  
17 however, has given notice to the client of any specific debt or any specific creditor to whom a  
18 debt is owed. Nor have Defendants given their clients an opportunity to dispute the existence  
19 and amount of any alleged debt.

20           29. Defendants have known that an application for a RAL would be denied if it was  
21 made by a Liberty client who was considered by Liberty, or Liberty's partner lender, or by  
22 *another* participating tax preparer or RAL lender, to owe a RAL-related debt to a bank from a  
23 previous year. Defendants have nevertheless continued to offer such loans to their clients.  
24 Defendants have also known that once the RAL or RAC application is signed and the tax return  
25 sent, the refund would be sent to the partner bank/debt collector, not the client. Consequently,  
26 Defendants have also known that their client would not receive written notice of the amount of  
27 the alleged debt, or of the identity of the creditor, or of their right to dispute the validity of a  
28 purported specific debt, until after the client had already lost control over the anticipated refund.

1 Moreover, although the client is entitled by law to 30 days from notice to contest the validity of  
2 the specified debt, the debt collector bank has had control over the refund from the date the client  
3 signs and submits the loan application, and has generally transferred the purported debt owed to  
4 the purported creditor even before the thirty-day period ends.

5 30. The RAL application documents have provided that a client who signs up for  
6 a RAL, and is denied the loan, will automatically be switched to an ERC instead. Therefore, in  
7 any case where a Liberty client who has owed an alleged prior debt to any debt pool participant  
8 has applied for an ERC, the client has been within a day or so denied a RAL (money within 1-2  
9 days), given an ERC (money in 8-15 days, no faster than direct deposit from the IRS), and  
10 assessed a fee for the ERC. If the amount of the alleged debt and the current year's fees has been  
11 greater than the amount of the client's tax refund, then the client has received nothing from the  
12 refund sent by the IRS.

13 31. Therefore, Liberty clients who are claimed to owe a debt from a prior year have  
14 been led to expect a loan of the amount the IRS is to refund, but instead find themselves in a  
15 collection proceeding.

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17 **E. Defendants Have Made Misleading and Deceptive Statements to Consumers**

18 32. To market and sell their tax preparation services, as well as RALs and other  
19 products, Defendants have used a variety of media and in-store statements that offer to get money  
20 back fast for customers. Defendants' advertising and other statements to consumers have blurred  
21 the distinctions between a "refund" and a "loan" in an effort to steer consumers toward bank  
22 products rather than getting their refunds directly from the IRS.

23 33. Defendants have made misleading statements to lure customers, including but not  
24 limited to portraying RALs provided by Liberty as "refund money" rather than as a loan, and  
25 characterizing loan proceeds as "America's fastest refunds." Defendants have minimized or  
26 omitted words and phrases that would have indicated to clients and potential clients that a RAL  
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1 is in fact a loan that must be repaid with interest and fees rather than a faster way of getting a tax  
2 refund.

3 34. Defendants have attempted to steer their clients to costly RALs or ERCs by  
4 misstating or omitting to state, in communications with their clients and potential clients, the  
5 amount of time it takes to receive a refund directly from the IRS, as compared with the time to  
6 receive money through a RAL or ERC.

7 35. In advertisements and other statements regarding RALs/ERCs, Defendants have  
8 failed to disclose or to disclose adequately that the ERC (1) is an expensive product that includes  
9 substantial fees that may be avoided by paying for one's tax preparation services up front and (2)  
10 does not arrive any faster than would a refund directly deposited from the IRS into the client's  
11 own bank account.

12 36. The debt collection program included in RALs and ERCs has not been disclosed  
13 or adequately disclosed in Defendants' promotion of those products.

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15 **F. Defendants Have Shared Taxpayer Information, Without Consent, For**  
16 **Purposes Not Related To Tax Preparation**

17 37. The law strictly limits tax preparers' use of information derived from individuals'  
18 tax returns. Defendants have not obtained their clients' consent to share such information in the  
19 manner required by law.

20 38. Defendants have disclosed their clients' tax return information to their partner  
21 RAL-lenders and banks, for purposes of providing RALs and ERCs, without first obtaining the  
22 clients' separate written consent.

23 39. Defendants have used and disclosed their clients' tax return information for  
24 marketing RALs and other items, without first obtaining a separate written consent for each of  
25 those uses and disclosures.

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1 Defendants offer, have made, disseminated or caused to be made or disseminated, before the  
2 public in the city and county of San Francisco, and elsewhere in the State of California, untrue  
3 or misleading statements, which they knew or reasonably should have known were untrue or  
4 misleading at the time the statements were made.

5 46. These untrue, misleading or deceptive statements include, but are not limited to,  
6 the following:

- 7 a. Defendants have portrayed their RAL product as the client's tax refund or as  
8 "refund money" rather than as a loan. They have minimized or omitted words  
9 and phrases that would have indicated that a RAL is a loan. They have run  
10 advertisements that misidentify loans as refunds and blur the distinction between  
11 the two. These statements are untrue or misleading because a RAL is not the  
12 taxpayer's refund or the taxpayer's money but, instead, a high-cost, short-term  
13 loan.
- 14 b. Defendants have stated, directly or by implication, that their (high-cost) RALs  
15 and ERCs are a faster way to receive money at tax time than waiting to receive  
16 a refund directly from the IRS. These statements are untrue or misleading  
17 because taxpayers can receive a direct deposit refund from the IRS on a return  
18 filed electronically as fast as they can receive a direct-deposited ERC or a ERC  
19 check, and the difference between the time to receive a costly RAL or ERC and  
20 the time needed for delivery of an IRS check by mail is less than that represented.
- 21 c. In advertisements and other statements Defendants have misleadingly described  
22 RALs and ERCs as ways of receiving money faster at tax time or avoiding up-  
23 front payment of tax preparation fees. These statements are untrue or  
24 misleading because they fail to disclose that, by applying for these products,  
25 Defendants' clients also purportedly authorize automatic collection of unspecified  
26 debts in unspecified amounts from prior years which may be claimed to be owed  
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to any of a number of RAL-lenders who are participants in a debt-pooling arrangement.

**SECOND CAUSE OF ACTION**

**VIOLATION OF CALIFORNIA BUSINESS AND PROFESSIONS CODE SECTION 17200 (UNFAIR COMPETITION)**

47. The People incorporate by reference paragraphs 1 through 43 and 45 through 46 of this Complaint as though they were set forth fully in this cause of action.

48. Defendants, and each of them, have engaged in and remain engaged in unfair competition, as defined in California Business and Professions Code section 17200. These acts of unfair competition include, but are not limited to, the following:

- a. Defendants have violated Business and Professions Code section 17500 as alleged in the First Cause of Action.
- b. Defendants have participated with, aided and abetted, acted as agents of, or conspired with persons acting as debt collectors in the following violations of fair debt collection principles governing third-party debt-collectors:
  - (1) Failing promptly to give alleged debtors information, including the amount of the purported debt and the creditor to whom it is owed as well as the debtors' right to dispute the debt, without overshadowing or contradicting this notice;
  - (2) Engaging in debt-collection activities that are misleading or deceptive;
  - (3) Engaging in debt-collection activities that are unfair or unconscionable.
- c. Defendants have participated with, aided and abetted, acted as agents of, or conspired with persons acting as debt collectors in the following violations of the California Rosenthal Fair Debt Collection Practices Act (governing both creditors and third-party debt-collectors):
  - (1) Engaging in debt-collection activities that are misleading or deceptive, in violation of Civil Code section 1788.17;

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- (2) Engaging in debt-collection activities that are unfair or unconscionable, in violation of Civil Code section 1788.17;
- (3) Engaging in the practice of falsely representing the true nature of the business or services being rendered by a debt collector, in violation of Civil Code section 1788.13(i).
- d. In connection with RALs and related products, Defendants have engaged in the following violations of the Consumer Legal Remedies Act:
  - (1) Advertising goods or services with intent not to sell them as advertised, in violation of Civil Code section 1770(a)(9);
  - (2) Representing that a transaction confers or involves rights, remedies, or obligations which it does not have or involve, or which are prohibited by law, in violation of Civil Code section 1770(a)(14).
- e. Defendants have used or disclosed information from their clients' tax returns for purposes other than preparing the return, without first obtaining a separate written consent for each such use or disclosure, in the following ways:
  - (1) Disclosing their clients' tax return information to their partner RAL-lenders and banks, for purposes of providing RALs and ERCs, without first obtaining the clients' separate written consent;
  - (2) Using and disclosing their clients' tax return information for marketing RALs and other items, without first obtaining a separate written consent for each of these uses and disclosures;
  - (3) Using and disclosing their clients' tax return information for purposes of collecting debts, without first obtaining a separate written consent for each of these uses and disclosures.
- f. Defendants have disclosed information obtained in the business of preparing federal or state income tax returns without obtaining the taxpayer's consent in a

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separate written document that states to whom the disclosure will be made and how the information will be used, in the following ways:

- (1) Disclosing their clients' tax return information to their partner RAL-lenders and banks, for purposes of selling RALs and ERCs, without first obtaining the clients' consent in a separate document, in violation of Business and Professions Code sections 17530.5 and 22253;
- (2) Disclosing their clients' tax return information to their partner lenders and banks and other RAL lenders for purposes of collecting debts or allowing others to collect debts, without first obtaining the clients' consent in a separate document, in violation of Business and Professions Code sections 17530.5 and 22253.

g. Defendants hold themselves out to their clients and to the public as experts on tax preparation. They have sought to gain and have gained the confidence of their clients, and have purported to act or advise their clients with the clients' interests in mind. Despite this confidential relationship, however, Defendants have acted in their own financial interest rather than their clients' in the following ways:

- (1) They have served simultaneously as the agent of their clients and of their partner lenders and banks, aggressively marketing and steering their clients to purchase RALs and ERCs that profit the lenders and banks and Defendants whether or not these products are in the clients' financial best interest;
- (2) They have failed to disclose clearly and accurately to their clients the expense of each refund option by, including but not limited to, failing to disclose as interest the cost associated with deferring payment of Defendants' tax preparation fees;
- (3) They have failed to clearly and accurately disclose the amount of time it takes to receive money under each refund option;

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- (4) They have failed to disclose to their clients the extent of their own financial interests in RALs and ERCs;
  - (5) They have failed disclose to their RAL and ERC clients the option of saving RAL- and ERC-related fees and getting more money for ongoing living expenses by adjusting their withholding of taxes so that they receive more of their income each month during the year rather than having to wait until the end of the year to receive it in a refund or high-cost RAL or ERC;
  - (6) They have failed to disclose to their RAL and ERC clients who receive the EITC the option of saving RAL- and ERC-related fees and getting more money for ongoing living expenses by adjusting their withholding or receiving part of their EITC in their paychecks every month during the year as part of the “Advance EITC” program, rather than having to wait until the end of the year to receive it in a refund or high-cost RAL or RAC/ERC; and
  - (7) They have, in “bait-and-switch fashion,” held out the promise of a RAL even to those clients whom Defendants or other debt-collection pool participants believe owe delinquent debt, and who will as a result have a RAL application denied and instead find themselves placed into an ERC and in the midst of a debt collection proceeding.
- h. In offering ERCs to their clients, Defendants have misrepresented the cost of Defendants’ extension of credit (deferral of payment of tax preparation fees) as a service fee instead of interest on the extension of credit.
  - i. By obtaining refund anticipation loans for its clients, and/or assisting or advising its clients about obtaining refund anticipation loans, Defendants have performed the services of a “credit services organization” within the meaning of the Credit Services Act of 1984. (Civil Code, § 1789.10 et seq.) Defendants, however, have violated the Credit Services Act by:

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- (1) failing to register with the Department of Justice, in violation of Civil Code section 1789.25(a);
- (2) failing to post a surety bond, in violation of Civil Code section 1789.18;
- (3) making or using untrue or misleading representations in the offer or sale of refund anticipation loans provided by third-party lenders, in violation of Civil Code section 1789.13(b);
- (4) engaging, directly or indirectly, in any act, practice, or course of business which operates as a fraud or deception upon consumers in connection with the offer or sale of refund anticipation loans provided by third-party lenders, in violation of Civil Code section 1789.13(h);
- (5) advertising, or causing to be advertised, refund anticipation loans provided by third-party lenders without first being registered as a credit services organization with the Department of Justice, in violation of Civil Code section 1789.13(i);
- (6) failing, prior to executing contracts for refund anticipation loans provided by third-party lenders, to provide consumers a written statement containing all of the information contained in Civil Code section 1789.15, in violation of Civil Code section 1789.14; and
- (7) failing to provide consumers written contracts that conspicuously disclose the buyer's right to cancel the transaction within five business days, in violation of Civil Code section 1789.16;

WHEREFORE, plaintiff prays for judgment as follows:

- 1. Pursuant to Business and Professions Codes sections 17535 and 17203, that Defendants, their successors, agents, representatives, employees, and any and all other persons who act in concert or participation with Defendants be permanently restrained and enjoined from:

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- a. Doing any of the acts alleged in this complaint to be a violation of law, or any other act or practice in violation of Business and Professions Code section 17200 *et seq.*;
  - b. Making or disseminating any of the untrue or misleading statements alleged in this complaint or any other statement in violation of Business and Professions Code section 17500 *et seq.*;
2. Pursuant to Business and Professions Code section 17536, that Defendants be assessed a civil penalty of \$2500.00 for each violation of Business and Professions Code section 17500 as proven at trial, in a total amount not less than \$1.5 million;
  3. Pursuant to Business and Professions Code section 17206, that defendants be assessed a civil penalty of \$2500.00 for each violation of Business and Professions Code section 17200 as proven at trial, in a total amount not less than \$1.5 million;
  4. Pursuant to Business and Professions Code sections 17203 and 17535, that Defendants be ordered to make full restitution of any money or other property that may have been acquired by Defendants' violations of Business and Professions Code sections 17200 and 17500, as proven at trial;
  5. That Plaintiff recover its costs of suit;
  6. That the Court order such other relief as the nature of the case may require and the court may deem appropriate and just.

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Dated: February 26, 2007

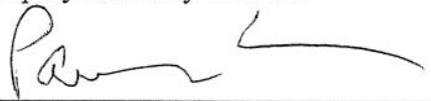
Respectfully submitted,

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Supervising Deputy Attorney General

SETH E. MERMIN  
Deputy Attorney General



PAUL STEIN  
Deputy Attorney General

Attorneys for the People of the State of California

**THIS COMPLAINT IS SUBJECT TO C.C.P. § 446(a)  
GOVERNING VERIFICATION OF PLEADINGS**