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UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

FEDERAL TRADE COMMISSION, Plaintiff, v. NORVERGENCE, INC., Defendant.	**CIV. NO. 04-CV-05414-DRD-SDW** **Hearing date: July 18, 2005** **PLAINTIFF FTC'S NOTICE OF MOTION FOR DEFAULT JUDGMENT, MOTION FOR DEFAULT JUDGMENT AND ORDER FOR PERMANENT INJUNCTION, RESCISSION, AND MONETARY RELIEF, AND MEMORANDUM IN SUPPORT**

NOTICE OF MOTION TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

Please take notice that plaintiff Federal Trade Commission will move this Court to enter a default judgment and order for permanent injunction, rescission, and monetary relief against defendant NorVergence, Inc., ("NorVergence") pursuant to Rule 55(b)(2) of the Federal Rules of Civil Procedure, on July 18, 2005.

MOTION AND MEMORANDUM

On November 4, 2003, the Commission filed its complaint against defendant NorVergence alleging violations of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. NorVergence is a debtor in a liquidation case under Chapter 7 of the Bankruptcy Code pending in this district (Docket 04-32079-RG). Charles Forman is the duly appointed Chapter 7 trustee for NorVergence. The Commission's action against NorVergence, including the enforcement of a judgment obtained in this action other than a money judgment against NorVergence, is not stayed by 11 U.S.C. § 362(a)(1), (2), (3), or (6) because it is an exercise of the Commission's police or regulatory power as a governmental unit pursuant to 11 U.S.C. § 362(b)(4) and, thus, falls within an exemption from the automatic stay.

On May 20, 2005, the Clerk entered a Certificate for Entry of Default as to

defendant NorVergence. The FTC moves for entry of a default judgment and has included a calculation of consumer injury for restitution. Enforcement of the monetary judgment would be through the NorVergence bankruptcy proceeding, although the debtor's estate is unlikely to HAVE any money to satisfy the judgment.

Summary of Complaint Allegations

The FTC's complaint sought injunctive and other equitable relief, including restitution and rescission of contracts. It alleged that NorVergence violated Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), in connection with the sale and financing of telecommunications services and related products.

NorVergence's principal business was the resale of telecommunications services that it purchased from common carriers or others. NorVergence resold these services to consumers who were primarily small businesses, non-profit organizations, churches, and municipalities. NorVergence marketed its services as integrated, long-term packages, including landline (wired) and cellular telephone service and Internet access.

NorVergence financed the sale of its services by apportioning most of the consumers' payments to "rental agreements" for a "Matrix" box (actually a standard router to combine voice and data) whose base cost was $1,550. For larger customers, circuit board cards might be added to the box, increasing the cost

slightly. For smaller customers, NorVergence supplied a "Matrix Soho" box that cost from $200 to $400. The rental agreements for the Matrix ranged from $7,000 to $340,000. The cost of the Matrix box, and the fact that the Matrix box was only a small and incidental cost within the package of services and products provided by NorVergence, did not appear anywhere on the rental agreement. NorVergence did not sell or rent the Matrix boxes separately from the service package.

NorVergence typically sold its services to consumers as a five-year package. It did not tell consumers that it had no long-term commitment from any service provider for the long-term services it was promising to provide. It also did not tell them that the Matrix box would be of little or no value to the consumer if NorVergence failed to provide the promised telecommunications services.

Prior to the bankruptcy, NorVergence had converted most of those rental agreements to cash by selling or assigning them to finance companies. As noted in the Declaration of Amount Due (attached as Exh. D to this Motion) ("Amount Dec."), the best summary records currently available show that NorVergence had 9,404 rental agreements. (Since some purchasers had multiple rental agreements, the total number of customers was less than 9,404.) Approximately 1,600 of the rental agreements were not assigned to finance companies and are still held by NorVergence.

NorVergence Post-Bankruptcy

On June 30, 2004, an involuntary Chapter 11 bankruptcy petition was filed against NorVergence in the United States Bankruptcy Court for the District of New Jersey (Case No. 04-32079-RG). On July 14, 2004, an order for relief was entered against NorVergence and the Chapter 11 case was converted to Chapter 7. On that same date, the Bankruptcy Court entered orders granting certain of NorVergence's telecommunication carriers relief from the automatic stay provisions of 11 U.S.C. §362 to allow them to discontinue the services that they had been providing for NorVergence's customers. Shortly thereafter, the bankruptcy trustee notified those consumers in writing that their service would likely be disconnected without notice. *See* Trustee's Letter attached as Exh. A to this Motion.

Despite the cutoff in services, the finance companies have continued to demand payment from consumers and have, in many cases, sued for payment in full on the worthless NorVergence rental agreements. In doing so, they have relied on provisions in the rental agreements that the complaint in this action has challenged as providing the means and instrumentalities to the finance companies to commit unfair or deceptive acts in violation of the FTC Act.

As to the 1,600 rental agreements not assigned to finance companies, the trustee never attempted to provide services nor to collect payments from the

consumers. The trustee treated the rental agreements as executory contracts under 11 U.S.C. § 365 and chose not to assume them. By action of 11 U.S.C. § 365(d)(1), the rental agreements are deemed rejected by the trustee.

In filings made in the bankruptcy proceedings, the trustee has stated that the estate is administratively insolvent. At the same time, general unsecured claims exceed $320 million, not including the FTC claim that was filed in the amount of $200 million. *See* Trustee's Spreadsheet of Claims dated April 7, 2005, which is attached as Exh. B to this Motion. Thus, the FTC does not expect any payout from NorVergence, regardless of the amount of monetary judgment ordered by this Court.

State Default Judgments Against NorVergence

The Attorneys General of Texas, Illinois, Massachusetts, and Pennsylvania have filed separate actions in state courts against NorVergence under their own consumer protection statutes. Like the FTC's action, the state actions are exempt from stay pursuant to 11 U.S.C. § 362(b)(4). The Texas action has resulted in a default judgment being entered; the others have had orders of default entered by the court clerks.

The judgment in Texas declared that the NorVergence rental agreements are void *ab initio* under state law and included monetary judgments for penalties. *See* Texas Judgment attached as Exh. C to this Motion. The states are seeking civil

penalties, while relying on the FTC to seek nationwide restitution before this Court. Thus, none of the state actions will result in monetary restitution judgments that could reduce the amount sought by the FTC here.

Legal Basis for Broad Equitable Relief

As stated in the FTC's complaint, this case was brought under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), to secure permanent injunctive relief, including rescission of contracts, cessation of collections, and other equitable relief for defendant's unfair and deceptive acts or practices in violation of the FTC Act. Every United States Court of Appeals that has considered the question has held that the relief available under this provision includes the full range of equitable remedies, including monetary equitable relief for consumer injury.[1] These decisions are well grounded in the law governing the scope of relief available where Congress has provided that the government may invoke courts' equitable powers, and recognizes Congress' purpose in providing these remedies to

[1] *See, e.g., FTC v. H.N. Singer*, 668 F.2d 1107 (9th Cir. 1982); *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1033 (9th Cir.1994) (disgorgement of unjust enrichment proper relief under Section 13(b)); *FTC v. Figgie International, Inc.*, 994 F.2d 595, 606 (9th Cir. 1993), *cert. denied*, 510 U.S. 1110 (1994) (monetary equivalent of rescission a proper form of relief under Section 13(b)); *FTC v. Southwest Sunsites, Inc.*, 665 F.2d 711 (5th Cir. 1982) (reversing district court's denial of ancillary relief under first section of Section 13(b), including escrow and consumer notification)*; FTC v. Amy Travel Serv., Inc.*, 875 F.2d 564, 571 (7th Cir.), *cert. denied*, 493 U.S. 954 (1989) (court's equitable powers under Section 13(b) include power to order restitution); *FTC v. Security Rare Coin & Bullion Corp.*, 931 F.2d 1312 (8th Cir. 1990) (authority to grant Section 13(b) relief includes power to grant rescission or its monetary equivalent); *FTC v. U.S. Oil & Gas Corp.*, 748 F.2d 1431 (11th Cir. 1984) (affirming grant of ancillary relief under Section 13(b), including freezing assets and appointing receiver).

effectuate the FTC Act's consumer protection goals.

The federal courts are empowered to craft flexible, case-specific equitable relief where Congress has given the government the right to proceed under equitable principles:

> Statutory provisions for injunctive relief should be construed generously and flexibly pursuant to principles of equity. . . . [W]hen Congress endows the federal courts with equitable jurisdiction, Congress acts aware of this longstanding tradition of flexibility.[2]

Moreover, where "the public interest is involved," as here, a court's "equitable powers assume an even broader and more flexible character than when only a private controversy is at stake . . . . The court may go beyond the matters immediately underlying its equitable jurisdiction . . . and give whatever other relief may be necessary under the circumstances."[3] It is these principles that govern the relief available under Section 13(b) of the FTC Act.

In calculating the amount of a monetary remedy, the courts have regularly

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[2] *California v. American Stores Co.*, 495 U.S. 271, 294 (1990). *See, also, Mitchell v. Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 291-92 (1960) ("When Congress entrusts to an equity court the enforcement of prohibitions contained in a regulatory enactment, it must be taken to have acted cognizant of the historic power of equity to provide complete relief in light of the statutory purposes"); *Porter v. Warner*, 328 U.S. 395, 398 (1946) ("Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied.").

[3] *Porter*, 328 U.S. at 399; *see, also, Virginian R. Co. v. Railway Employees*, 300 U.S. 515, 552 (1967) ("Courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved").

applied a restitution standard that would make consumers whole, regardless of the amount of unjust enrichment to the defendant.[4] The fact that consumers may have received some value does not detract from a standard calculation based on gross sales less refunds.[5] Nonetheless, the FTC has allowed in its damage calculation generously for possible value received and not attempted to calculate the substantial direct and indirect costs to business consumers of changing their phone services twice in a short period. *See* Amount Dec. ¶¶ 15-18. Finally, the FTC does not need to prove actual reliance on false and misleading statements for each consumer.[6]

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[4] *See*, *e.g., Figgie International, Inc.*, 994 F.2d 595 at 606 (upholding district court's grant of the monetary equivalent of rescission under Section 13(b); *Security Rare Coin*, 931 F.2d 1312 (court's authority under Section 13(b) includes power to grant rescission or its monetary equivalent; "The innocent customers' losses exceed Security Coin's gains, it may be true, but we conclude that restoration of the victims of Security Coin's con game to the status quo ante was not an abuse of the district court's discretion"); *Kitco of Nevada, Inc.*, 612 F. Supp.1282,1295 (D. Minn. 1985) ("defendants may be liable for the full amount of the monetary equivalent of rescission, even though it may exceed the amount of a defendant's unjust enrichment").

[5] *McGregor v. Chierico*, 206 F.3d 1378, 1389 (11th Cir. 2000) (“While it may be true that the defrauded businesses received a useful product, and though less likely, they may have even received the product at a competitive price, the central issue here is whether the seller's misrepresentations tainted the customer's purchasing decisions” [footnote omitted]).

[6] *E.g.*, *Security Rare Coin*, 931 F.2d at 1316 (citing *F.T.C. v. Amy Travel Service, Inc.*, 875 F.2d 564, 573 (7th Cir.1989); *F.T.C. v. Kitco of Nevada, Inc.*, 612 F.Supp. at 1293.

Motion for Default Judgment

Plaintiff requests entry of a default judgment and submits with this motion: (1) the Declaration of Amount Due describing how the FTC calculated the consumer injury amounts sought in plaintiff's proposed Default Judgment and Order; and (2) plaintiff's proposed Default Judgment and Order for Permanent Injunction, Rescission, and Monetary Relief, which includes the liquidation of a specific dollar amount of consumer injury for restitution. As calculated by the FTC after subtracting from the total consumer injury the cancellation of indebtedness for rental agreements that will be cancelled by this case, the judgment amount is $181,721,914. *See* Amount Dec. ¶ 18. In the unlikely event that the FTC did receive any payout, it would attempt to return that money to injured consumers, if feasible.

The FTC also notes that various state attorneys general have reached settlements in the form of Assurances of Voluntary Compliance ("AVCs") with some of the finance companies and are continuing discussions with others. These AVCs typically require the finance companies to offer consumers a debt forgiveness of 85% of the total of rental payments due after the bankruptcy filing. In exchange, consumers must give up any claims and defenses they may have against the finance companies, including the defense that they should not have to pay for any period during which they received no services. Participation by

consumers in the terms of the AVCs is voluntary and still requires a 15% payment for post-bankruptcy services that they will never receive.

At this time there is no way to predict how much of the total consumer injury caused by NorVergence may be shifted to the finance companies through these settlements. For this reason, the FTC seeks entry of judgment in the full amount of injury, subtracting only the value of contracts voided by the proposed order. Should there be an actual distribution possible from the NorVergence bankruptcy, the FTC will adjust its claim to account for any further mitigation based on finance company settlements with NorVergence consumers.

Dated: June 8, 2005.

Respectfully submitted,

s/ Randall H. Brook
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