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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

FEDERAL TRADE COMMISSION, Plaintiff, v. IFC CREDIT CORPORATION, Defendant.	**CIV. NO.** 07C 3155 **FTC'S MEMORANDUM IN SUPPORT OF MOTION FOR PRELIMINARY INJUNCTION** JUDGE [illegible] MAGISTRATE JUDGE COLE

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I. SUMMARY

Plaintiff Federal Trade Commission ("FTC" or "Commission") seeks a preliminary injunction to stop IFC Credit Corporation ("IFC") from continuing to force nonprofits, churches, small businesses, and their principals to pay tens of thousands of dollars for nothing. IFC bought bogus "equipment rental agreements" that were part and parcel of a fraud perpetrated by a now-defunct telecom provider, NorVergence, Inc. IFC continues to aggressively collect on the agreements, badgering and threatening the victims of that fraud by telling them they have no defenses, and then, if that fails, suing them for amounts ranging from $3,000 to $130,000 (purportedly for rental of equipment actually worth $272 to $1,500). IFC files these suits in a forum far from where the consumers live and run their businesses or organizations, and where they lack the means to defend themselves. IFC's unfair and deceptive practices violate the FTC Act. IFC's collection efforts must be stopped.

NorVergence's salespeople promised significantly discounted rates on telecommunications services that were supposedly guaranteed for five years. Customers paid nothing up front – only a fixed monthly price during the life of the contract – but had to sign multiple, confusing forms and other documents to qualify for the deal. Key to receiving the promised rates was a simple connection box called the Matrix. Although consumers were signing up to receive telecom *services*, the package of documents they signed allocated 75-80% of the monthly payment to a five year "Rental Agreement" for the Matrix box alone.

Allocating most of the service payments to the Rental Agreements benefitted NorVergence and IFC at the expense of their customers. NorVergence was able to reap immediate profits by selling the contracts to leasing companies like IFC. IFC wanted to purchase equipment leases because they are much easier to enforce than service contracts. IFC knew the Rental Agreements were primarily to finance services, not equipment, but as long as they looked like equipment leases, IFC was happy to buy them.

NorVergence ultimately failed to provide the promised telecom services and was forced into bankruptcy. At this point, consumers should have been off the hook. Consideration had failed. But IFC launched a series of ruthless collection efforts that continue to this day, suing more than 500 consumers for payment in full on the bogus equipment leases.

The victims of this fraud are paying IFC for services they can never receive, spending time and money litigating against IFC, and suffering harm to their credit ratings. To prevent

substantial, ongoing harm to IFC's victims, the FTC seeks a preliminary injunction to stop IFC from continuing to collect on these Rental Agreements. The proposed order is limited to the contracts IFC bought from NorVergence.[1] Absent action by this court, IFC will continue collecting on the worthless Rental Agreements during the pendency of this action, causing further consumer injury that will never be remedied. IFC appears to be in financial difficulty, so the need to preserve the status quo is compelling. If the FTC prevails on the merits, as is likely, IFC is unlikely to be able to pay restitution for the monies it has already collected, let alone additional monies collected while the case is pending.

IFC has engaged in and is likely to engage in acts or practices that violate Section 5 of the FTC Act, 15 U.S.C. § 45, and the FTC seeks equitable relief to address those acts or practices. This Court is authorized to grant the requested relief by Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), and Rule 65(a) of the Federal Rules of Civil Procedure.

II. PARTIES

A. Plaintiff

Plaintiff Federal Trade Commission is an independent agency of the United States Government created by statute. 15 U.S.C. §§ 41-58. The FTC enforces Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), which prohibits unfair or deceptive acts or practices in or affecting commerce. The FTC may initiate federal district court proceedings by its own attorneys to enjoin violations of the FTC Act and secure other appropriate equitable relief, including restitution for injured consumers. 15 U.S.C. § 53(b).

B. Defendant

Defendant IFC Credit Corporation ("IFC") is an Illinois corporation with its principal place of business located at 8700 Waukegan Rd., Morton Grove, IL 60053. IFC is a closely held corporation, with its founder, Chief Executive Officer, and President, Rudolph Trebels, as principal shareholder.[2] IFC's principal business has been business equipment leasing.

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[1] The FTC already has a judgment against NorVergence. Here, it seeks a permanent injunction and other equitable relief against IFC, including rescission of contracts and restitution for injured consumers.

[2] Declaration of Amy Brannon-Quale ("Brannon-Quale Dec., PX 39"), Att. B, pp. 11-12.

III. STATEMENT OF FACTS

Between November 2003 and June 2004, IFC purchased approximately 800 rental agreements from NorVergence with a total face value of more than $20 million.[3] The consumers who had signed these agreements were mostly small businesses, religious organizations, and nonprofits.[4] There were personal guaranties on 74% of these contracts.[5] The amount of injury caused by IFC's collection efforts on these contracts varies from around $4,400 to $160,000 for each consumer,[6] plus substantial other costs such as legal expenses.[7]

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[3] Declaration of Gil A. Bosque ("Bosque Dec., PX 38"), ¶ 10. IFC claims it paid NorVergence $13,255,076 for these contracts. Supplemental Affidavit in Support of Application for Relief from Automatic Stay (John Estok, IFC Executive VP and Chief Operating Officer), *In Re NorVergence, Inc.,* No. 04-32079 (Bankr. D.N.J.) (filed Aug. 5, 2004) ("Estok V, PX 44"), ¶ 5.

[4] Declaration of Winnifred A. Bonslett ("Bonslett Dec., PX 1"), ¶ 2 (small, family-owned business); Declaration of Charles Carmen ("Carmen Dec., PX 2"), ¶ 2 (nonprofit); Declaration of John Crane ("Crane Dec., PX 3"), ¶ 2 (family business); Declaration of Bret E. Fields ("Fields Dec., PX 4"), ¶ 2 (small business); Declaration of Stuart Perlitsh ("Perlitsh Dec., PX 6"), ¶ 2 (25-employee credit union); Declaration of Ronald Seidman ("Seidman Dec., PX 7"), ¶¶ 1-2 (preschool); Declaration of Randall Spicher ("Spicher Dec., PX 8"), ¶ 2 (small business); Affidavit of Bonnie Ferguson ("Ferguson Aff., PX 15"), ¶ 3 (small business); Affidavit of Randall Hodges ("Hodges Aff., PX 16"), ¶ 3 (family owned day care center); Affidavit of Linda Joy Shoup ("Shoup Aff., PX 19"), ¶ 3 (small business); Affidavit of Henry Hastava ("Hastava Aff., PX 21"), ¶ 1 (small business); Affidavit of Kimberly Karl ("Karl Aff., PX 22"), pp. 1-3 (non-profit Girl Scouts Council); Affidavit of David Slaughter ("Slaughter Aff., PX 26"), ¶¶ 1, 21 (church); Affidavit of Aaron LaLonde ("LaLonde Aff., PX 27"), ¶ 2; Complaint to Avoid and Recover Fraudulent Transfers and Setoffs, *Trustee of the Estate of NorVergence, Inc., v. Salzano*, No. 04-32079 (D.N.J. July 14, 2006) ("NorVergence Trustee Complaint, PX 41"), p. 13, ¶ 48 (target customer was unsophisticated, with no telecom or information technology staff and no in-house attorney); *see also* Declaration of David O. Rodriguez ("Rodriguez Dec., PX 29"), ¶¶ 2, 17.

[5] Bosque Dec., PX 38, ¶ 9; *see also, e.g.,* Bonslett Dec., PX 1, ¶¶ 4, 12; Crane Dec., PX 3, ¶ 6; Fields Dec., PX 4, ¶ 16; Perlitsh Dec., PX 6, ¶ 6; Spicher Dec., PX 8, ¶ 5; Affidavit of Michael Aliano, Jr., ("Aliano Affid., PX 12"), ¶ 8; Affidavit of James E. Barlow, Jr. ("Barlow Aff., PX 13"), ¶ 9; Affidavit of Mark Christo ("Christo Aff., PX 14"), ¶ 7; Ferguson Aff., PX 15, ¶ 8; Hodges Aff., PX 16, ¶ 7; Affidavit of Luvimino Lim ("Lim Aff., PX 17"), ¶ 9; Affidavit of Wesley H. Smith ("Smith Aff., PX 20"), ¶ 8; Hastava Dec., PX 21, ¶ 20; Karl Dec., PX 22, p. 4.

[6] Bosque Dec., PX 38, ¶ 10.

[7] *See, e.g.,* Bonslett Dec., PX 1, ¶ 12 ($6,731); Carmen Dec., PX 2, ¶ 10 ($4,000); Crane Dec., PX 3, ¶ 13 ($3,386); Declaration of William S. Moore ("Moore Dec., PX 5"), ¶ 9 ($4,000); Perlitsh Dec., PX 6, ¶ 14 ($2,500); Seidman Dec., PX 7, ¶ 8 ($3,000); Spicher Dec., PX 8, ¶ 11 ($3,600); Declaration of Alecia Wengert ("Wengert Dec., PX 10"), ¶ 11 ($2,537).

A. The NorVergence Scam: Savings on Services

1. False Promises

NorVergence engaged in a massive fraud that involved selling long-term packages of telecommunications services.[8] Reciting scripts they had memorized, NorVergence salespersons pitched their "savings solution"[9] and promised unlimited long distance calling (and sometimes telephones), free cell phones and cellular minutes, unlimited Internet service, and guaranteed prices and services for five years even if telephone usage increased.[10] Typically, the salesperson reviewed the consumer's recent bills for landlines, cell phones, and Internet, then created a price-before, price-after, worksheet called the "Proposal of Enhanced Telecommunications Benefits." The worksheet broke down some of the cost elements, but emphasized the one monthly total cost for the whole package.[11] The "after" price was calculated based on a discount of 20 or 30% from the "before" price. Consumers viewed the offer as a package of services with one bottom line monthly price.[12]

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[8] Findings regarding NorVergence's fraudulent practices are contained in a Default Judgment and Order for Permanent Injunction and Monetary Relief, *FTC v. NorVergence, Inc.*, No. CV-04-5414-DRD, 2005 U.S. District LEXIS 40669, at *1 (D.N.J., June 29, 2005) ("Default Judgment, PX 47"), Findings 13-17. The practices are further described in the NorVergence Trustee Complaint, PX 41.

[9] LaLonde Aff., PX 27, ¶¶ 2-5; Affidavit of Lonnie DelaCruz (DelaCruz Aff., PX 28"), ¶¶ 2-5; Rodriguez Dec., PX 29, ¶¶ 4, 19, 36, Att. B, p. 12. *See also* NorVergence Trustee Complaint, PX 41, pp. 13-17, ¶¶ 50-52, 60, 62-65; Declaration of Maxine Stansell ("Stansell Dec., PX 40"), Att. A, pp. 33-34, 49, 51 ["NorVergence Business Plan," attachment to email from Robert Fine (NorVergence) to John Estok (IFC COO)].

[10] Deposition of John Estok, *Florida v. Commerce Commercial Leasing, LLC*, No. 2004 CA 002515 (F. Leon County Cir. Ct. 2nd Jud. Cir. Jan. 5, 2005), Transcript ("Estok II, PX 34"), pp. 48-51; LaLonde Aff., PX 27, ¶¶ 3-5; DelaCruz Aff., PX 28, ¶¶ 3-5; Rodriguez Dec., PX 29, ¶ 19; Crane Dec., PX 3, ¶¶ 3-6; Fields Dec., PX 4, ¶ 5; Moore Dec., PX 5, ¶ 3; Perlitsh Dec., PX 6, ¶¶ 4-6; Seidman Dec., PX 7, ¶ 3; Declaration of Larry Watren ("Watren Dec., PX 9"), ¶ 5; Wengert Dec., PX 10, ¶ 3; Aliano Aff., PX 12, ¶ 6; Hastava Aff., PX 21, ¶¶ 3-8; *see also* Brannon-Quale Dec., PX 39, Att. D, pp. 20-21, 30, 36-37 ["Solutions" Brochure, "NorVergence Solutions Overview," and SOHO Brochure]; Stansell Dec., PX 40, Att. A, p. 79 [Jennifer Klepper, "IFC Vertical Markets"].

[11] Rodriguez Dec., PX 29, ¶¶ 21-22.

[12] Bonslett Dec., PX 1, ¶ 4; Carmen Dec., PX 2, ¶¶ 3-5; Crane Dec., PX 3, ¶ 6; Fields Dec., PX 4, ¶ 5; Moore Dec., PX 5, ¶ 3; Perlitsh Dec., PX 6, ¶¶ 5-6; Siedman Dec., PX 7, ¶ 4; Spicher Dec., PX 8, ¶ 4; Watren Dec., PX 9, ¶¶ 3, 5; Hastava Aff., PX 21, ¶¶ 5, 7; Karl Aff., PX 22, pp. 3-4, Ex. D; *see also* LaLonde Aff., PX 27, ¶¶ 4-5; DelaCruz Aff., PX 28, ¶¶ 4-5; Rodriguez Dec., PX 29, ¶¶ 15, 19, 21, 22; Brannon-Quale Dec., PX 39, Att. N, pp. 182-84, 194, 199, 200, 211, 219; NorVergence Trustee Complaint, PX 41, pp. 16-17, ¶¶ 63, 67, Ex. B, pp. 60-62.

The salespersons claimed that NorVergence could produce the promised savings through a variety of means, including installation of a "black box" it called the Matrix or Matrix Soho.[13] The name "Matrix" stood for "Merged Access Transport Intelligent Xchange," a common, off-the-shelf device typically sold (or provided free with phone services) under less exotic names.[14] The Matrix was simply a device to connect phones and data lines to incoming lines from service providers like Qwest and Sprint, not a miracle money saver.[15]

Consumers were required to sign 10-15 documents to sign up with NorVergence, among them the Rental Agreement.[16] The number and format of these documents reduced the likelihood that consumers would recognize the unique significance of the Rental Agreement. Salespersons were trained to stop the meeting and walk away if consumers tried to read the documents or

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[13] LaLonde Aff., PX 27, ¶¶ 3, 5; DelaCruz Aff., PX 28, ¶¶ 3, 5; Rodriguez Dec., PX 29, ¶ 22; Fields Dec., PX 4, ¶ 5; Perlitsh Dec., PX 6, ¶ 6; Seidman Dec., PX 7, ¶ 4; Spicher Dec., PX 8, ¶¶ 4-5; Hastava Aff., PX 21, ¶¶ 6-7; *see also* Stansell Dec., PX 40, Att. A, p. 34 (NorVergence Business Plan) ("30% to 60% off former expenses"; "Price guaranteed for 5 years"), p. 79 ("IFC Vertical Markets: The IFC/NorVergence, Inc Partnership") (same); Estok II, PX 34, pp. 49-50 ("total solution" sold to the customer on the basis that the overall cost of the telephone service would be less); Brannon-Quale Dec., PX 39, Att. D, pp. 19-23, 28-30, 36-38 [documents produced by IFC: Norvergence "Solutions" brochure, "NorVergence Solutions Overview," "Matrix SOHO Complete Communication Solution," and "NORVERGENCE Business Plan Presentation].

[14] Rodriguez Dec., PX 29, ¶ 22; Brannon-Quale Dec., Att. D. p. 32.

[15] The Matrix 850 is a standard line splitter or converter commonly used to connect analog telephone equipment to a telecom provider's T-1 (high bandwidth data line) or similar data line. Rodriguez Dec., PX 29, ¶ 23; *see also* NorVergence Trustee Complaint, PX 41, p. 15, ¶¶ 55, 57. The Matrix Soho is a standard firewall and router that connects to a DSL or cable modem typically used to access Internet services, not phone services. Brannon-Quale Dec., PX 39, Att. M, pp. 177, 180-81.

[16] Rodriguez Dec., PX 29, ¶¶ 27, 36 & Att. K, pp. 156-89. *See also* Bonslett Dec., PX 1, ¶ 5; Crane Dec., PX 3, ¶ 7 ("several documents"); Fields Dec., PX 4, ¶ 6 (a "thick stack"); Perlitsh Dec., PX 6, ¶ 7; Watren Dec., PX 9, ¶ 4; Wengert Dec., PX 10, ¶ 4; Hastava Aff., PX 21, ¶ 9 ("stack of documents"). The long list of documents appeared on a checklist, *e.g.*, Brannon-Quale Dec., PX 39, Att. N, pp. 188, 203, and included, in addition to the two-page "Equipment Rental Agreement," a "Credit Application," "Hardware Application," "Services Application," "Matrix T1 Number Portability Form," "Responsible Organization Change Authorization," "A Proposal of Enhanced Technology Benefits," a "National Conversion Assistance Program" request, "Appointment of NorVergence as Cellular Agent," "Location Assessment Form," "Facilities Information Form," and an "Accurate Business Assessment Form and Proposal Request." *Id.* at pp. 189-97, 201-18. All were represented to be "non-binding." Rodriguez Dec., PX 29, ¶ 28.

asked too many questions.[17] They assured consumers that they were merely applying for the privilege of receiving services, not signing a binding contract.[18] Accordingly, some documents proclaimed they were "non-binding" in bold print capital letters at the top of the document.[19]

Unlike those forms, however, the Rental Agreement contained a non-cancellability clause and various waivers of defenses on its back page, in small print.[20] In addition, most of the consumer's monthly payment – often 75-80% or more – was allocated to the Rental Agreement, with only a small amount allocated to a "service payment" that was completely unrelated to the true cost of the services.[21] Salespersons were instructed to assure consumers that if anything happened to NorVergence, the services would continue without any problem.[22]

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[17] Rodriguez Dec., PX 29, ¶ 9; *see also* LaLonde Aff., PX 27, ¶ 8 (applying "three strikes and you're out" rule, customer got one strike for asking too many questions); DelaCruz Aff., PX 28, ¶ 8 (same).

[18] Rodriguez Dec., PX 29, ¶¶ 9, 28, Att. C, p. 97 ("Do's" and "Don'ts" instructing sales agents to say "Application," not "Contract"); LaLonde Aff., PX 27, ¶ 6; DelaCruz Aff., PX 28, ¶ 6; Ferguson Aff., PX 15, ¶ 7; Hastava Aff., PX 21, ¶¶ 8-10.

[19] Rodriguez Dec., PX 29, Att. K, p. 158 ("Non-Binding" Hardware Application), ¶ 36; Wengert Dec., PX 10, Att. C, p. 13 ("Non-Binding" Services Application); Barlow Aff., PX 13, Ex. A, pp. 5-6 (both). Former NorVergence salespersons have testified that the Equipment Rental Agreement was presented for signature after a series of "non-binding" documents and was signed with "little or no attention being drawn to it." LaLonde Aff., PX 27, ¶ 6; DelaCruz Aff., PX 28, ¶ 6.

[20] Brannon-Quale Dec., PX 39, Att. D, pp. 55-56; Rodriguez Dec., PX 29, Att. K, pp. 160-61; *see also* Bonslett Dec., PX 1, Att. A, pp. 4-5; Crane Dec., PX 3, Att. B, pp. 7-8; Perlitsh Dec., PX 6, Att. B, pp. 7-8; Spicher Dec., PX 8, Att. B, pp. 6-7.

[21] NorVergence Trustee Complaint, PX 41, p. 17, ¶¶ 66-68 (typically at least 80%). *See also* Illustrative consumer "proposal" forms: Perlitsh Dec., PX 6, p. 6 (monthly payment of 1187.32 is 85.2% of 1393.32 total monthly costs); Karl Aff., PX 22, Att. D (80.4%); Brannon-Quale Dec., PX 39, Att. N, p. 194 (82.5%), p. 211 (80.5%). Former NorVergence employees agree that the Matrix payment was based on services. LaLonde Aff., PX 27, ¶ 5 ("price of the Matrix box listed on the equipment rental agreement depended on the amount of services a company was currently utilizing"); DelaCruz Aff., PX 28, ¶ 5 (telecom service costs "roll[ed] into Matrix lease after salesperson applied 20-30% discount); Rodriguez Dec., PX 29, ¶ 15 (NorVergence salespersons "put most of the customer's monthly cost into the equipment rental"); Affidavit of Ron Zirkin, *Exquisite Caterers LLC v. Popular Leasing USA, Inc.*, No. 04-4467-SRC (D.N.J. filed Dec. 27, 2004) ("PX 31"), ¶ 6 ("price of the Matrix box for customers increased as the cost of services for the customer increased"); Affidavit of Ronald Zirkin, *Custom Data Solutions v. Preferred Capital, Inc.*, No. 04-3376-CK (Mich. Macomb County Cir. Ct.) (filed Dec. 7, 2005) ("PX 32"), ¶ 9 ("leasing companies should have known the book value of what they were financing was essentially services, not the actual value of the MATRIX boxes").

[22] LaLonde Aff., PX 27, ¶4; DelaCruz Aff., PX 28, ¶ 4; Rodriguez Dec., PX 29, ¶ 13; NorVergence Trustee Complaint, PX 41, pp. 13-14, ¶¶ 50, 52.

Reality was quite different from the promises. Some of the early customers did receive a few months of services after a long installation delay, but not because of any special deals with suppliers or magical technology.[23] Rather, NorVergence was providing telecommunication services at a fraction of the price it was paying telecom providers, and subsidizing these services with the up-front payments from finance companies that purchased Rental Agreements.[24]

By March 2004, this scheme was falling apart, and NorVergence was completing few installations.[25] NorVergence was forced into bankruptcy in June 2004. To the extent any NorVergence customers ever had service, it was turned off on or about July 15, 2004.[26] The FTC sued NorVergence in November 2004 and ultimately obtained a default judgment for $181 million.[27] Each victim ended up with a gigantic debt to IFC and a useless "black box" that IFC legally owns but won't take back because it knows the box is worthless.[28]

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[23] Many consumers never received any services at all. *E.g.*, Carmen Dec., PX 2, ¶ 8; Crane Dec., PX 3, ¶ 15; Moore Dec., PX 5, ¶ 6; Perlitsh Dec., PX 6, ¶¶ 9, 15; Seidman Dec., PX 7, ¶ 5; Spicher Dec., PX 8, ¶ 7; Watren Dec., PX 9, ¶ 7; Wengert Dec., PX 10, ¶¶ 7-8; Aliano Aff., PX 12, ¶¶ 9-10; Lim Aff., PX 17, ¶¶ 12, 16; Shoup Aff., PX 19, ¶ 9; Smith Aff., PX 20, ¶¶ 9, 11; Hastava Aff., PX 21, ¶ 17; *see also* Bonslett Dec., PX 1, ¶ 9 (no phone or long distance service); Fields Dec., PX 4, ¶ 7 (wrong service); Christo Aff., PX 14, ¶ 8 (no service at two locations, intermittent service at one location for a week); Ferguson Aff., PX 15, ¶ 11 (service for one week); Affidavit of David Postier ("Postier Aff., PX 18"), ¶ 8 (intermittent phone service for four weeks).

[24] Regardless of what NorVergence charged consumers, it still had to pay the providers' tariffs for local and long distance calling. NorVergence Trustee Complaint, PX 41, p. 15, ¶ 57, p. 21, ¶ 84; *see also* Rodriguez Dec., PX 29, ¶ 24 (tariffs based on services, not equipment). Thus, the NorVergence bankruptcy trustee called NorVergence a combination Ponzi scheme (cash to serve old customers, generated by adding larger and larger numbers of new customers) and "bustout" (where orders are placed on credit without intent to pay suppliers) that was "doomed to fail." NorVergence Trustee Complaint, PX 41, pp. 4-5, ¶¶ 1-3, p. 20-21, ¶¶ 80-81, 84, p. 29, ¶ 114.

[25] IFC's knowledge of this situation is discussed below in Section III.B.2.c, beginning at page 14.

[26] NorVergence Trustee Complaint, PX 41, p. 7, ¶¶ 1-3, pp. 21- 22, ¶ 85; *see also e.g.,* Barlow Aff., PX 13, ¶ 13; Ferguson Aff., PX 15, ¶ 11.

[27] *See* Default Judgment, PX 47, p. 10, Section III.

[28] The programmed Matrix boxes alone have no value, the reason IFC prefers not to take them back from consumers. Deposition of John Estok, *Morey Lumber and Hardware Co. v. IFC Credit Corp.,* No. 348 20819604 (Tex. Tarrant County Dist. Ct. 348th Jud. Dist.) (Feb. 7, 2006) ("Estok III, PX 35"), p. 73. In fact, service providers typically give the Matrix to end-users free with a service agreement, rather than leasing or selling it to them. NorVergence Trustee Complaint, PX 41, p. 23, ¶ 95. Matrix boxes are not compatible with other telecommunications service providers without reprogramming. Estok III, PX 35, pp. 46-48.

2. How the Deal's Structure Made the Fraud Possible

Although the NorVergence fraud provides the backdrop for the FTC's allegations against IFC, this case is about IFC's unfair and deceptive practices in purchasing, collecting on, and attempting to enforce the so-called "Rental Agreements." These Rental Agreements falsely described the consideration at issue. As illustrated by the table below, the Rental Agreements typically described the consideration as equipment only, whereas in fact the Rental Agreements served as a means of financing the entire package of services and equipment for which consumers were contracting:[29]

How a typical NorVergence Rental Agreement listed the items:	We agree to rent you ... the Equipment listed below[:] 1 MATRIX™.[30]
What a truthful contract listing would look like:	We agree to finance for you ... the services and equipment listed below: Five years of landline, Internet, and cell phone services plus incidental hardware.

The false description enabled NorVergence to sell the Rental Agreements to finance companies like IFC. The nature of the consideration was critical to enforcing the Rental Agreements. If the Rental Agreement truthfully described what was being financed – services – it would be harder to enforce. The failure to provide services would mean consideration had obviously failed. With the language looking like a rental, however, it would appear as if NorVergence had fulfilled its obligation simply by delivering the equipment. Thus, IFC took advantage of the provisions in the Rental Agreement waiving all defenses (which NorVergence referred to as "hell or high water" provisions) and purporting to require only delivery of a Matrix box, not even installation or operation.[31] As discussed below, IFC has used these provisions to

[29] Estok II, PX 34, pp. 49-50 (IFC understood NorVergence to be offering a "total solution" for telecommunications); LaLonde Aff., PX 27, ¶ 5; DelaCruz Aff., PX 28, ¶ 5 (phone service costs rolled into Matrix lease after salesperson applied 20%-30% discount); Rodriguez Dec., PX 29, ¶ 15 (rental cost completely unrelated to value of equipment, based only on services).

[30] *E.g.*, Bonslett Dec., PX 1, Att. A, p. 4; Crane Dec., PX 3, Att. B, p. 7; Perlitsh Dec., PX 6, Att. B, p. 7; Spicher Dec., PX 8, Att. B, p. 6.

[31] *See, e.g.,* Perlitsh Dec., PX 6, Att. B, p. 8 ("Other Conditions" provision). These clauses were a selling point when IFC was considering purchasing the NorVergence Rental Agreements. Stansell Dec.,

facilitate enforcement of the contracts, even when NorVergence failed to deliver the promised services.

B. Evidence Is Overwhelming That IFC Knew Services Were the Predominant Purpose of the NorVergence Transaction With Consumers

IFC knew from the beginning that the predominant purpose of the NorVergence transaction was to provide telecommunication services to consumers, and this knowledge only grew over time.

1. Even Before It Purchased Rental Agreements, IFC Knew NorVergence Was Primarily Selling Services

In 2003 – well before IFC purchased any Rental Agreements from NorVergence – IFC's "Credit Committee" (mid-level and senior officials) conducted a detailed review of the NorVergence program.[32] This review led IFC officials to view the NorVergence Rental Agreements as an opportunity to reap big profits and expand IFC.[33] This in turn led to the creation of what IFC officials called the "IFC Credit/NorVergence Partnership,"[34] which was ultimately formalized in a Master Program Agreement ("MPA") of October 2003.[35] It was plain from the outset that services were the core of the Norvergence transaction with consumers.

PX 40, Att. A, pp. 4, 6 (NorVergence touting to IFC fact that "[e]ach customer enters into a 60 month 'hell or high water' rental agreement").

[32] Deposition of John Estok (Oct. 3, 2005), *IFC Credit Corp. v. United Business and Industrial Federal Credit Union*, 474 F.Supp. 2d 956 (N.D.Ill. 2006), Transcript ("Estok I, PX 33"), pp. 10-14; Testimony of John Estok, Mandatory Arbitration, *IFC Credit Corp.v. Mathew I Jones, Inc.,* No. 04- M2-002570 (Cook Cty., Ill. Dist. Ct.) (Mar. 20, 2006) ("Estok VII, PX 51"), pp. 27-28 (4-5 weeks due diligence); Stansell Dec., PX 40, Att. A, pp. 4-19, 20-22, 26-68 (including "Norvergence Credit Committee Questions" and "NorVergence Business Plan").

[33] Investigational Hearing, *In the matter of NorVergence Assignees, unnamed*, No. 052 3010 (F.T.C.) (June 22, 2006) ("Herndon Tr., PX 30"), pp. 16-18, 30-31 (IFC officials expected NorVergence to double IFC's volume).

[34] Stansell Dec., PX 40, Att. A, pp. 76-77, 81-82. NorVergence became, by far, IFC's largest single vendor in terms of volume. Herndon Tr., PX 30, pp. 24-25. NorVergence accounted for 18.9% of IFC's total business as of 2004. Brannon-Quale Dec., PX 39, Att. A, p. 8, Att. B, p. 13 (Response to Item 6).

[35] Affidavit in Support of Application for Relief from Automatic Stay, *In Re NorVergence, Inc.,* No. 04-32079 (Bankr. D.N.J. filed July 20, 2004) ("Estok IV, PX 43"), ¶ 5, Exh. A, pp. 9-17.

a. IFC's Initial Review Revealed that Telecom Services Were Integral to the Rental Agreements

NorVergence's business plan, which it sent to IFC for the initial review, demonstrated the before and after "cost savings strategy" NorVergence would use to attract customers – that is, comparing the consumer's current monthly expenditures with the lower, fixed monthly payment offered by NorVergence. The plan touted: "Savings is Presented to Customer as difference between OLD and NEW. When Cost Savings are established, the deal is signed 60.33% of the time!"[36] The overall cost of the service was clearly the key selling point, not any piece of hardware. As IFC's Chief Operating Officer ("COO") John Estok testified in one court proceeding:

> Our understanding was that [NorVergence] provided customers with . . . a total solution to the customer. . . . And the total solution was sold to the customer on the basis that the overall cost of this service, you know, including what was free and what was charged, was less than the customer's previous history based on their prior three-or-four-month telephone bills.[37]

Indeed, in entering into the MPA, IFC specifically relied on services being integral to the Rental Agreement as an enforcement mechanism for payment. The NorVergence Business Plan presented to IFC stated that if consumers didn't pay for the "rental," NorVergence would cut off telephone services.[38] IFC's COO Estok insisted that the Master Program Agreement be amended to include this point, and it was.[39]

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[36] Stansell Dec., PX 40, Att. A, pp. 26-27, 33. The business plan, as well as consumer sales material NorVergence provided to IFC, claimed consumers would save 30-60% off former telecommunications expenses. *Id.* at p. 34; Brannon-Quale Dec., PX 39, Att. D, pp. 19-20 (touting "solution [that] addresses all of your telecommunications needs and bundles them into an easily managed package"), 28-29 (30-60% savings), 36-37 (touting phone system that "Slashes Your Line Costs!").

[37] Estok II, PX 34, pp. 49-50.

[38] "Risk of non-payment minimized when customer <u>cannot make</u> ANY PHONE CALLS – box and circuit can be turned off!" Stansell Dec., PX 40, Att. A, pp. 27, 55 (emphasis in original). Or, as put by IFC's VP for Credit,"The schpiel is that we are replacing other costs [for long distance and Internet services] with a less expensive alternative . . . and if they don't pay we can turn off their phone and internet service." *Id.* at p 73.

[39] Stansell Dec., PX 40, Att. A, pp. 69-72 (email attaching draft MPA Amendment Agreement); Estok IV, PX 43, ¶ 5, Ex. A, p. 18 (March Amendment).

b. IFC's "Confirmation Script" and Changes in IFC's Standard Practices Further Demonstrate that IFC Knew that the Rental Agreements Were Not Standard Equipment Leases

IFC used a "Confirmation Script" or "Verbal Audit" to call consumers before it paid NorVergence for their Rental Agreements. This script further reveals that IFC knew the true nature of the transaction. IFC employees told consumers that the amount of the Matrix rental's "flat monthly cost [was] protected for a 60-month term, producing the Norvergence savings you were promised."[40] The promised 5-year savings could be produced only if NorVergence provided the promised telecommunications services. IFC officials have admitted they knew from the start that a five-year service agreement was the key component of the offer to consumers.[41]

The NorVergence script was different from IFC's standard confirmation script, which asks consumers whether they have entered into any agreements, other than the lease, in connection with the equipment at issue.[42] Use of IFC's standard script might well have confirmed the existence of the consumers' expectations regarding services. Also, IFC normally verifies that the customer understands the contract is being bought by IFC by asking if the customer authorizes IFC to pay the vendor for it.[43] However, IFC's NorVergence script did not ask these questions or any others that might have prompted consumers to inform IFC that they had other agreements with NorVergence and that they expected to receive services.[44]

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[40] Stansell Dec., PX 40, Att. A, pp. 23-24 [email attaching script]; IFC Credit Corporation's First Amended Counterclaim, *Plans By Design, Inc. v. IFC Credit Corp.*, No. CC-05-10687-E (Tex. Dallas County Ct. at Law No. 5 Oct. 20, 2005) ("PX 48"), Ex. B, p. 19; Herndon Tr., PX 30, pp. 98-99, Ex. 13.

[41] Estok III, PX 35, p. 56 (IFC was aware, when it started the transactions with NorVergence, that the service component was required for the equipment to be of value); Herndon Tr., PX 30, pp. 18-19 ("going in," IFC knew NorVergence consumers expected future services).

[42] *Compare* Herndon Tr., PX 30, Ex. 12 ("Verbal Audit Report") *with* Ex. 13 ("NorVergence Verbal Audit"). IFC appears to use these scripts to establish that the customer understands and agrees to the basic financing terms before IFC pays the vendor for a lease. Herndon Tr., PX 30, pp. 97-101. IFC and NorVergence were jointly responsible for creating the NorVergence script that IFC used. *Id.* at 101-02; Estok III, PX 35, pp. 29-30, Ex. 14.

[43] Herndon Tr., PX 30, pp. 97-98, Ex. 12; Brannon-Quale Dec., PX 39, Att. K, p. 173.

[44] Herndon Tr., PX 30, Ex. 13. IFC's former VP for Collections, Lee Herndon, has acknowledged that in "any other arm's length vendor transaction, IFC wanted to make absolutely sure that the customer clearly authorized payment." As early as December 2003, he took a number of objections to the NorVergence deal to IFC's COO, but he was "beat up." Herndon Tr., PX 30, pp.103-05, 108-09.

Similarly, IFC changed its usual practice by agreeing that it would "not conduct a Customer interview during the credit approval process."[45] Such an interview normally would have happened during the credit approval process (prior to the confirmation call) and would likely have revealed what IFC did not want to document – that consumers expected to receive services pursuant to the Rental Agreement.

Finally, IFC's standard form for lessees to certify acceptance of equipment "certifies that the Lessor has fully and satisfactorily performed all covenants and conditions to be performed by it under the Lease."[46] By contrast, the acceptance form IFC used only for NorVergence does not contain this or any similar language.[47] It seems likely that IFC would have preferred this language because it knew that the original lessor, NorVergence, was obliged to provide services – not just equipment – and thus could not have fully performed by the time the consumer signed the form.

2. Ongoing Dealings Between NorVergence and IFC Also Showed IFC That NorVergence Was Primarily Selling Services

Even after IFC began purchasing and collecting on the Rental Agreements, evidence continued to mount that the Rental Agreements were primarily financing services.

a. Inexplicable, Extreme Price Variations Were a Red Flag

Rental prices for the same equipment varied dramatically. Just over half of the 782 Rental Agreements were for identical equipment – a Matrix box with one card and no phones – but the total rent payments for this package ranged from $4,439 to $64,625, a difference of more than 1,300%.[48] This variation should have been a red flag that something was drastically wrong with the NorVergence deals. COO John Estok has admitted the significance of this disparity, acknowledging that "usually equipment sells for about the same price from one customer to another" and that IFC "notice[d] right away that there were different prices for the Matrix box being charged." He also admitted that "prudence" prompted IFC to ask for an explanation – but the only explanation he has acknowledged receiving was that the number of "cards" (accessory

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[45] Estok IV, PX 43, Exh. A, p. 9, ¶ 1. Failing to do so was "contrary to IFC's standard credit policy." *Id.*

[46] Brannon-Quale Dec., PX 39, Att. K, p. 171.

[47] Brannon-Quale Dec., PX 39, Att. D, p. 59.

[48] Bosque Dec., PX 38, ¶ 11, Att. A, Att. B.

circuit boards) per box varied.[49]

This explanation was obviously bogus. Not only was the price of the cards nominal,[50] but IFC's own records show that the price variations were clearly unrelated to the number of cards. Huge price variations existed for every configuration. The 35 Matrix boxes with no cards and no phones were, on average, more expensive than rental agreements with one card, with rental prices ranging from $7,956 to $68,102.[51] Rental payments for the 58 boxes with two cards and no phones ranged from $31,722 to $76,184, and the two contracts including four cards and no phones called for payments of $83,650 and $160,672.[52] The price disparities appear just as strongly where phones were included in the package. For example, the total of payments for the 23 Rental Agreements including four phone sets and one card ranged from $7,956 to $31,318.[53]

b. IFC Knew that Collateral on the Rental Agreements Had Virtually No Value

The Matrix box was IFC's collateral under the Rental Agreements.[54] IFC's VP of Credit, Steve Csar, has testified that had he known of a gross disparity between actual equipment cost and rental payments, "Common sense would have had me sounding alarms." He would have had a duty to notify his superiors that purchasing the NorVergence contracts would have been "an

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[49] Estok II, PX 34, pp. 59-60.

[50] These cards (plug-in circuit boards that allow connections to additional phone lines) cost NorVergence $77 and the Matrix boxes had a base price of $1,278. Brannon-Quale Dec., PX 39, Att. M, pp. 175-76, 179 [Adtran Response to CID].

[51] Bosque Dec., PX 38, ¶ 11, Att. A, Att. B. Similarly, the rental payments disparity for the 21 Rental Agreements that included Matrix SOHO boxes was from $7,217 to $34,631. *Id.* This variation occurred in the first 10 days that IFC purchased NorVergence contracts. *Id.* ¶ 14. There was no card variation for the SOHO because it took no cards. *See id.* at ¶ 8; Brannon-Quale Dec., PX 39, Att. M, pp. 177, 180-81 [Adtran Response to CID].

[52] Bosque Dec., PX 38, ¶ 11, Att. A, Att. B. Only 19 Matrix boxes had more than two cards and the maximum number of cards for the "active" Rental Agreements was 5. *Id.* at ¶ 13.

[53] Bosque Dec., PX 38, ¶ 12, Att. C. Only 264 of the Rental Agreements included any telephone sets. *Id.* at ¶ 10, Att. A. Disparities in the amount IFC paid NorVergence for the contracts tracked the rental payment disparities. For example, the equipment cost (*i.e.*, IFC's purchase price) for the 392 Rental Agreements with one card and no phones ranged from $3,872 to $48,958. *Id.*, at ¶ 11, Att. A.

[54] Deposition of Rudolph Trebels, *Rosenblum's World of Judaica, Inc., v. IFC*, No. 04-CH-18187 (Ill. Cook County Cir. Ct. Chancery Div.) (Jan. 26, 2007) ("Trebels Tr., PX 36"), pp. 34-35.

unsound financial decision."[55] However, IFC did nothing to determine the value of the Matrix box, and the value of the Matrix was not part of IFC's decision to take assignment of the contracts.[56]

As discussed above, IFC has known from the start that the Matrix box is useless without the promised services.[57] Accordingly, IFC does not repossess NorVergence equipment, and does not even provide a place for consumers to return it.[58] As IFC COO John Estok has explained:

> [T]here's no way to remarket the matrix box today. It's of no value to us. If it had value, we would be out there taking it back.[59]

As early as December 2003, IFC VP for Collections Lee Herndon knew that, in the event of default, IFC would not get its money out of the hardware.[60]

c. Consumer Complaints and Defaults Were Another Red Flag

IFC received additional evidence of the true nature of NorVergence's transaction with consumers in January 2004, when payments on first Rental Agreements purchased by IFC started to come due. Many consumers did not make payments because NorVergence was not delivering the promised services or even installing the equipment, and IFC knew this was the reason they were defaulting.[61] By February, IFC was seeing first-payment defaults on NorVergence Rental Agreements on a "wholesale" scale.[62]

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[55] Deposition of Steve Csar, *Rosenblum's World of Judaica, Inc., v. IFC*, No. 04-CH-18187 (Ill. Cook County Cir. Ct. Chancery Div.) (Jan. 26, 2007) ("Csar Tr., PX 37"), pp. 103-04.

[56] *Id.* at pp. 24, 58-59.

[57] *See supra* at p. 11 and note 41. In addition, IFC acknowledged in the NorVergence bankruptcy proceeding that as collateral, the rental agreements "may have no value without telephone service." Estok IV, PX 43, ¶ 15.

[58] Estok III , PX 35, p. 73.

[59] *Id.*

[60] Herndon Tr., PX 30, p. 76-80, Ex. 9. Similarly, IFC President Rudolph Trebels testified that he had never even thought about repossessing the Matrix if consumers defaulted. Trebels Tr., PX 36, p. 36.

[61] Herndon Tr., PX 30, pp. 105-06; Stansell Dec., PX 40, Att. A, p. 74 (IFC email characterizing what NorVergence consumers got as "packages" including cell phone service and "networking pc's for fax, email, etc."). Both failure to connect the Matrix box and failure to provide cell service caused consumers to refuse to pay. Brannon-Quale Dec., PX 39, Att. C, pp.14-17 (IFC notes from collection calls).

[62] Herndon Tr., PX 30, p. 1061-07.

In fact, the early default rate was even higher than IFC management first realized, because NorVergence was secretly giving some consumers the money to make their first payment.[63] They did this in order to avoid IFC's enforcement of its recourse agreement under the MPA, which allowed IFC to demand that NorVergence buy back contracts for which the consumer was 30 days past due on the first payment.[64] It did not take long for IFC officials to learn of the secret payments,[65] and although they were angry at first,[66] they nonetheless purchased 468 more NorVergence Rental Agreements – with a total rental value of almost $13.3 million – after February.[67] Indeed, when massive first payment defaults began occurring, IFC's sales department resisted enforcing the recourse agreement because NorVergence, as "IFC's premier customer," was "providing [IFC] with substantial growth and revenue."[68] An IFC sales official concluded that requiring NorVergence to buy back contracts would not be "in the best interest of the partnership."[69]

On March 10, IFC's customer service manager notified COO John Estok and two VPs, Ronald Smith and Patrick Witowski, that IFC was "getting an alarming amount of complaints

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[63] Brannon-Quale Dec., PX 39, Att. C, pp. 14-16 (consumers told IFC customer service that NorVergence had sent them first month payment "due to set-up problems"); *see also* Crane Dec., PX 3, ¶ 9 (NorVergence promised to reimburse for first month's bill from IFC but never did); Perlitsh Dec., PX 6, ¶ 11 (received reimbursement for only one of four months); Hastava Aff., PX 21, ¶ 19, Att. 1, p. 7 (never received promised reimbursement).

[64] Estok IV, PX 43, Exh. A, pp. 9-10, ¶ 2. When NorVergence made a first payment for a customer who otherwise would have withheld payment, it transferred risk from NorVergence (under its obligation to repurchase accounts with first payment defaults) to IFC. Herndon Tr., PX 30, pp. 129-30, Ex. 21.

[65] Herndon Tr., PX 30, pp. 133-35, Ex. 22.

[66] COO Estok termed it "completely unacceptable." Herndon Tr., PX 30, pp. 133-35, Ex. 22 [email, Estok to Klepper, *et al.,* 2/26/04]. In fact, VP Herndon testified that this practice by NorVergence is viewed as fraud in the industry, "would never be condoned by the lessor," and "would be a reason not to deal with that vendor." *Id.* at p. 131.

[67] Bosque Dec., PX 38, ¶ 15, Att. D, Att. E.

[68] Stansell Dec., PX 40, Att. A, p. 97 [email Smith to Estok]. When Collections VP Herndon forwarded consumer complaints to other company officials, the Sales VP ridiculed him as a "wimp." *Id.* at pp. 89-90 [email, Smith to Klepper].

[69] Stansell Dec., PX 40, Att. A, p. 93. On later occasions, closer to NorVergence's bankruptcy, IFC did occasionally invoke the recourse agreement. *See* Herndon Tr., PX 30, pp. 36-37.

from Norvergence customers."[70] The next week, Herndon warned Estok that he was "hearing more complaints that NorVergence is un-responsive to the customers."[71] IFC responded by purchasing more NorVergence contracts than ever.[72]

The number of complaints continued to escalate. In early April 2004, NorVergence asked IFC to forward complaints only weekly because the daily volume had grown so large.[73] Herndon warned in mid-April 2004 that "too many customers" had told him they were paying IFC only because NorVergence was giving them money for the payments: "I've never spoken to a group of more remorseful customers than the NorVergence customers who can't get installation, service or a satisfactory response from NorVergence."[74] Herndon recognized that "the majority of the NorVergence accounts don't have service when [the] first payment is due."[75]

And still the pattern continued. On May 11, Vice-President for Legal Affairs John Zinke told Herndon about a NorVergence customer whose equipment was delivered but "not yet operational" and who was "losing money due to not hav[ing] phone service."[76] Herndon responded that "[m]ost of the NorVergence accounts have the same complaint."[77] Zinke also expressed concern that some consumers had "not received any consideration in the form of working equipment."[78] The equipment was not working because it was not connected or NorVergence was not providing any services.[79] As stated by Herndon on May 12, "The number

[70] Stansell Dec., PX 40, Att. A, p. 87.

[71] Herndon Tr., PX 30, p. 39, Ex. 5.

[72] Bosque Dec., PX 38, ¶ 15, Att. D, Att. E. *See also* Herndon Tr., PX 30, p. 39, Ex. 5 ("We went from a few hundred thousand per month to several million dollars in monthly volume in less than four months.").

[73] Herndon Tr., PX 30, 126-27, Ex 19. IFC was sending NorVergence "literally" hundreds of complaints by email each day. Stansell Dec., PX 40, Att. A, pp. 91-92.

[74] Herndon Tr., PX 30, p. 129, Ex. 21.

[75] Stansell Dec., PX 40, Att. A, p. 96.

[76] *Id.* at p.100-101.

[77] *Id.*

[78] *Id.*

[79] *Id. See also* Brannon-Quale Dec., PX 39, Att. C, pp. 14-17; Stansell Dec., PX 40, Att. A, pp. 75, 89-90, 94; Herndon Tr., PX 30, 127-28, Ex. 20.

of unhappy, unsatisfied customers who refuse to pay is growing exponentially." He and VP Smith recognized that the problem was NorVergence's delay in installation and, therefore, failure to provide service.[80] On May 14, IFC determined that 35% of its NorVergence accounts with payments due before March were in default.[81] Yet IFC continued to purchase Rental Agreements for another six weeks,[82] then sought to obtain hundreds more even after NorVergence was in bankruptcy.[83]

IFC's knowledge of the high risk of consumer defaults resulting from NorVergence's failure to provide services is underscored by its negotiation of higher "holdback" amounts – the percentage of the Rental Agreement purchase price deducted by IFC as a protection against potential losses on the contract. Rather than ceasing to do new business with NorVergence, IFC merely increased the holdback amount. As NorVergence declined, the "holdback" went as high as 50%, a rate that VP Herndon called "radical."[84] This meant that IFC was paying as little as one-third the face value of the Rental Agreements, due to problems with NorVergence.[85]

3. IFC Has Continued Collecting on Worthless Rental Agreements, Filing Nearly 500 Suits in Distant Forums

IFC has pursued aggressive debt collection practices even though services have ceased.[86] It has filed more than 500 collection suits, all but one after NorVergence was forced into

[80] Stansell Dec., PX 40, Att. A, pp. 102-04.

[81] Herndon Tr., PX 30, pp. 138-39, Ex 25.

[82] Bosque Dec., PX 38, ¶ 15 (90 more Rental Agreements between May 17 and June 30, 2004).

[83] *See* discussion at pp. 18-19 *infra*.

[84] Herndon Tr., PX 30, pp. 124-26.

[85] For example, Specialty Optical, a small Texas company, had a total of $32,620 in payments due on its Rental Agreement. Brannon-Quale Dec., PX 39, Att. N, p. 185 ($543.67 monthly Matrix payment for 60-month rental term). On paper, the purchase price to NorVergence was $24,723. However, all IFC actually paid NorVergence was $11,744, or about one-third of the face value of the Rental Agreement. Testimony of John Estok, *Specialty Optical v. IFC Credit Corp.*, No. CC-04-04187-C (Tex. Dallas County Ct. at Law No. 3) (Feb. 9, 2006) ("Estok VI, PX 49"), pp. 45-51.

[86] The script IFC used for collecting NorVergence accounts admitted that NorVergence "will not likely be able to provide the service portion of the program." Brannon-Quale Dec., PX 39, Att. E, pp. 63-64.

bankruptcy.[87] Nearly 500 were filed in Illinois – a forum distant from where nearly all the businesses or organizations were located.[88] IFC has also executed default judgments in distant forums. In one case, it got a default judgment in Illinois and then executed in Florida, even though the small business was in California.[89] The costs of defending these distant forum suits, even if just to file objections to Illinois jurisdiction, have been substantial.[90]

Perhaps most egregiously, on July 21, 2004, just after NorVergence was placed into bankruptcy, IFC sought relief from the automatic stay in the bankruptcy court to take possession of 300 more Rental Agreements so it could begin collections.[91] Just two weeks earlier, IFC and NorVergence had entered into agreements that gave IFC $10.2 million in security based on these 300 Rental Agreements which NorVergence had not yet assigned to any finance company.[92] IFC paid nothing for this additional security.[93] IFC did all this even though it had become obvious that no consumers who were party to these contracts would ever receive any of the promised

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[87] Bosque Dec., PX 38, ¶ 16. IFC began suing NorVergence customers en masse in August 2004. *Id.*, Att. F; *see also, e.g.*, Carmen Dec., PX 2, ¶ 10 (Sept. 2004); Spicher Dec., PX 8, ¶ 11 (same); Wengert Dec., PX 10, ¶ 10 (Dec. 2004).

[88] Bosque Dec., PX 38, ¶ 16, Att. F (494 suits listed as Cook County). *See also, e.g.,* Carmen Dec., PX 2, ¶¶ 1,10 (FL); Crane Dec., PX 3, ¶¶ 2,12 (IL); Fields Dec., PX 4, ¶¶ 2,16 (VA); Moore Dec., PX 5, ¶¶ 2, 8 (TX); Perlitsh Dec., PX 6, ¶¶ 2, 14 (CA); Seidman Dec., PX7, ¶¶ 1, 7 (PA); Spicher Dec., PX 8, ¶¶ 2, 11 (TX); Wengert Dec., PX 10, ¶¶ 2, 10 (PA); Aliano Aff., PX 12, ¶¶ 3,5 (NJ); Barlow Aff., PX 13 (GA); Christo Aff., PX 14 (CT); Ferguson Aff., PX 15 (NC); Hodges Aff., PX 16 (TX); Lim Aff., PX 17 (CA); Shoup Aff., PX 19 (FL); Smith Aff., PX 20 (FL/GA); Hastava Aff., PX 21, ¶¶ 1, 20 (NY); Karl Aff., PX 22 (TX); Affidavit of James Mohan ("Mohan Aff., PX 23") (PA); Affidavit of Samuel Aylestock ("Aylestock Aff., PX 25"), ¶¶ 15, 16 (PA); Slaughter Aff., PX 26 (PA).

[89] This was apparently possible because the small business had an account with a national bank that also had branches in Florida. Declaration of Ward H. White ("White Dec., PX 11"), ¶ 13. IFC sued this company despite having been told that an unauthorized, temporary employee had mistakenly signed the NorVergence rental agreement and the Matrix box had never even been received. *Id.* at ¶¶ 7-10; Brannon-Quale Dec., PX 39, Att. C, pp. 17A-B (IFC notes on calls from White).

[90] *See* note 7 above. Some consumers also have incurred the expense of suing to prevent IFC's distant collection efforts. *See* Brannon-Quale Dec., Att. F, pp. 66-136 (declaratory judgment complaints).

[91] Stay Relief App., PX 42. IFC acknowledged that NorVergence would "soon cease its operations." *Id.* at ¶ 8.

[92] Estok IV, PX 43, ¶¶ 9-12, 15.

[93] Estok IV, PX 43, ¶¶ 9-11 and pp. 25-26, 40-41 (Security Agreements).

services. IFC withdrew its application for relief from stay only after the FTC filed objections.[94] The subsequent default judgment and order obtained by the FTC against NorVergence stated that those unassigned rental agreements were void and unenforceable.[95]

C. IFC Falsely Claims That Victims Lack Defenses or Have Defrauded IFC

As early as late January 2004, IFC collectors were telling consumers that their payments were due, regardless of whether the NorVergence equipment was working.[96] IFC instructed collectors to tell consumers that NorVergence contracts were "non-cancelable, whether the equipment has been connected or not,"[97] and VP for Collections Herndon took the same position. In May 2004, Herndon told a consumer attorney:

> It is our position that we purchased a valid non-cancelable contract from NorVergence in which your client . . . agreed to pay 60 rentals of $900.80, plus tax for a Matrix Box. The contract is only for the Matrix Box, with no representations or warranties that the box is capable of performing any specific function.[98]

IFC also sent its NorVergence accounts a letter in August 2004, after NorVergence was in bankruptcy, proclaiming that the customer's duty to make rental payments was unconditional,

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[94] Objection of Federal Trade Commission to IFC's Motion for Relief From the Automatic Stay, *In the Matter of Norvergence, Inc.,* No. 04-32079 (Bankr. D.N.J.) (filed Nov. 5, 2004) ("PX 45"); Letter from E. Salan to Hon. Rosemary Gambardella, dated Nov. 8, 2004, withdrawing IFC's motion for relief from automatic stay ("PX 46").

[95] Default Judgment, PX 47, p. 9, ¶ II.

[96] *E.g.*, Brannon-Quale Dec., PX 39, Att. C, p. 15 (1/29/04 entry). *See also id.* at pp. 16-17 (consumers advised in February that payment was due even though equipment not installed or system not working); Stansell Dec., PX 40, Att. A, p. 75 (same); Bonslett Dec., PX 1, ¶ 10; Crane Dec., PX 3, ¶ 10; Fields Dec., PX 4, ¶ 15; Perlitsh Dec., PX 6, ¶ 12; Seidman Dec., PX 7, ¶ 6; Spicher Dec., PX 8, ¶ 9; Wengert Dec., PX 10, ¶ 8, Att. F; Hastava Aff., PX 21, ¶ 19 and p. 8 (Herndon letter); Ferguson Aff., PX 15, ¶ 12 and Att. C, p. 18.

[97] Herndon, Tr., PX 30, pp. 153-54, Ex. 32.

[98] Stansell Dec., PX 40, Att. A, p. 105; *see also* Herndon Tr., PX 30, pp. 152-53, Ex. 31. IFC took this position even though its VP for Legal Affairs recognized that it could have instead enforced its "recourse agreement . . . with NorVergence that would require them to take the deal back *so we can get out of this mess and give a Release to this Customer.*" Stansell Dec., PX 40, Att. A, p. 101 (emphasis added). Telling consumers that they had no defenses even if they did not have services was the company line. Herndon Tr., 152-53.

and that the customer could not assert against IFC any claims or defenses it had against NorVergence.[99]

IFC's claims are false. In fact, the Rental Agreements are always subject to defenses of fraud that render them void *ab initio*[100] or otherwise unenforceable.[101] For example, in the only reported appellate decision on the merits, the Michigan Court of Appeals upheld a trial court decision that

> the agreement for a total communications package, and the accompanying rental agreements were the result of a fraudulent scheme by Norvergence to finance the services that Norvergence was promising . . . [and this] establishes fraudulent inducement and invalidates the entire contract . . . .[102]

The Michigan appeals court also upheld findings that the Rental Agreements were "part and parcel of the agreement for a total communications package" and that, as NorVergence's assignee, the finance company "stood in the shoes of Norvergence vis a vis the [NorVergence Rental Agreements]." It concluded: "Thus, the [assigned Rental Agreements], which are not agreements separate from the total telecommunications package, are voidable . . . . "[103]

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[99] *See, e.g.,* Spicher Dec., PX 8, p.11; Wengert Dec., PX 10, Ex. F, p. 21. IFC sent a similar letter sent to every Norvergence account. Herndon Tr., PX 30, pp. 154-55, Ex. 33. The letter points to the "hell or high water" clauses in the Rental Agreements, which purport to waive all defenses, saying the customer has to pay no matter what, even if NorVergence or its assignee has breached the contract. *Id.*; Brannon-Quale Dec., PX 39, Att. H, pp. 147, 152, 162-A3, 162-A12 (IFC Complaints filed in Cook County, IL, against consumers), ¶¶ 11-13 (all quoting Rental Agreement). Technically, this type of clause might be enforceable if the contract were a "finance lease" as defined by Article 2A of the Uniform Commercial Code. However, the NorVergence Rental Agreements are clearly not "finance leases" because, among other reasons, § 2A-103(1)(g) requires that "the lessor [rentor] does not select, manufacture, or supply the goods." Here, the original "rentor," NorVergence, selected and supplied the Matrix box, as well as the telecom services. *See also* Amicus Brief of New Jersey Attorney General, *Diversified Aerospace Services, Inc. v. IFC Credit Corp.* (In re Norvergence), No. 04-32079/RG (Bankr. D.N.J. Dec. 3, 2004) ("PX 50"), p. 11.

[100] *E.g.*, *People v. NorVergence, Inc.*, No. 2004-CH-655, slip op. at 3, ¶ 16 (Ill. Sangamon County Cir. Ct. 7th Jud. Cir. May 6, 2005) ("PX 56"); *Texas v. NorVergence, Inc.*, No. 2004-65357, slip op. at 3, ¶ 11 (Tex. Harris County Dist. Ct. 270th Jud. Dist. filed Apr. 29, 2005) ("PX 57");

[101] *E.g.*, *Custom Data Solutions, Inc. v. Preferred Capital, Inc.,* No. 270752, 2006 Mich.App. LEXIS 3858, at *6 (Dec. 19, 2006).

[102] *Id.*

[103] *Id.*

As a finance company and equipment lessor, IFC was well positioned to know that failure of consideration (*i.e.,* lack of services) could render the contracts unenforceable by IFC. Indeed, IFC's General Counsel acknowledged to VP Herndon in early May 2004 that "to the extent that the Customer has not received any consideration in the form of working equipment in exchange for rental payments due under the contract, we may be hard pressed to show that we have a valid and enforceable contract."[104] The next month, Herndon told others at IFC that:

> [T]he idea that we can enforce these contracts when service has not fully been installed is ludicrous. . . . Just because the matrix box has been fastened to the wall does not mean that our non-cancelable contracts are enforceable. . . . We have millions of dollars invested in uninstalled, and probably unenforceable contracts.[105]

IFC also invented a false claim that consumers themselves had defrauded IFC. An IFC executive vice president sent a threatening "Notice of Legal Action" letter to NorVergence customers who were refusing to pay on the worthless contracts.[106] The letter claimed that consumers had, by taking various actions, intentionally deceived IFC into thinking the Matrix box was performing satisfactorily and then paying NorVergence for the assignment.[107] The letter further stated that IFC had only paid NorVergence because of the consumer's deception, and that:

> Therefore, in order to enforce compliance and collection of the amounts due to us, we will now be filing the serious additional claims of ***"Fraud in the Inducement"*** and ***"Misrepresentation"*** against you . . .[108]

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[104] Stansell Dec., PX 40, Att. A, pp. 100-101.

[105] Herndon Tr., PX 30, pp. 163-64, Ex. 35.

[106] *Id.* at pp. 156-57, Ex. 34.

[107] *Id.* at Ex. 34 and pp. 156-61. The letter claimed that the deception was caused by consumers signing the Rental Agreement, signing a "Delivery and Acceptance Certificate," and confirming to IFC by telephone that the equipment had been received and accepted. Tellingly, the "Delivery and Acceptance" form that IFC used for NorVergence customers differed from IFC's standard form in that it did not certify that the lessor (*i.e.*, NorVergence) had fully performed on the lease. *Compare* Brannon-Quale Dec., PX 39, Att. K, p. 171 (IFC's standard form) *with* Wengert Dec., PX 10, p. 34; Aliano Aff., PX 12, p. 28; Ferguson Aff., PX 15, p. 16 (the form IFC used with NorVergence customers).

[108] Herndon Tr., PX 30, pp. Ex. 34 and pp. 156-57 (emphasis in original); Wengert Dec., PX 10, p. 24; Hastava Aff., PX 21, Att. 3, p. 9.

IFC knew or should have known these claims were false or baseless.[109] Nonetheless, IFC made these claims consistently – in debt collection actions as well as in counterclaims in suits filed by consumers to stop IFC's collections.[110] IFC even sought punitive damages from some victims.[111]

IV. LEGAL ARGUMENT FOR PRELIMINARY RELIEF

The FTC seeks a preliminary injunction to halt further collections on the worthless NorVergence Rental Agreements and prevent ongoing harm to consumers. The FTC's complaint alleges that IFC has engaged in unfair practices, violating Section 5 of the FTC Act, by accepting and collecting on the NorVergence Rental Agreements (Count II) and by filing collections and execution actions on NorVergence Rental Agreements in distant forums (Count III). Further, the complaint alleges that IFC has engaged in deceptive practices by representing that consumers have no defenses to payment on the NorVergence Rental Agreements, or are precluded from raising any defenses or counterclaims, and that consumers are obligated to pay IFC under other theories of liability, including fraud in the inducement and misrepresentation (Count I).

A. Section 5 of the FTC Act

1. Unfairness

Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), prohibits unfair or deceptive acts or practices in or affecting commerce. An act or practice is "unfair" if it causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. 15 U.S.C. § 45(n); FTC Unfairness Statement (1980) (appended to *International Harvester Co.*, 104 F.T.C. 949, 1070 (1984), 1984 FTC Lexis 2, *305). Injury is sufficiently substantial under the first prong of this standard if it causes a small harm to a large class of people, *FTC v. Windward Marketing,*

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[109] Collections VP Herndon did not believe consumers were intentionally trying to defraud IFC. He told other IFC officials, including COO Estok and General Counsel Zinke, that he did not agree with sending this letter. Herndon Tr., PX 30, pp. 156-61, Ex 34.

[110] *E.g.,* Complaint, *IFC Credit Corporation v. P.B.O. Corp.,* No. 06M201679, (Ill. Cook County Cir. Ct. Mun. Dep't 2nd Dist. filed June 29, 2006) ("PX 52"), pp. 4-6, ¶¶ 25-41. IFC Credit Corporation's First Amended Counterclaim, *Plans By Design, Inc. v. IFC Credit Corp.,* No. CC-05-10687-E (Tex. Dallas County Ct. at Law No. 5 filed Oct. 20, 2005) ("PX 48"), pp. 8, 11, ¶¶ 42-47, 66-71.

[111] *IFC v. P.B.O. Corp.,* PX 52, p. 8, ¶ E; Perlitsh Dec., PX 6, Att. 6, pp. 32-35.

Ltd., No. 1:96-CV-615-FMH, 1997 U.S. Dist. LEXIS 17114 at *31-32 (N.D. Ga. Sept. 30, 1997), or a severe harm to a limited number of people, *International Harvester*, 104 F.T.C. at 1064, 1984 FTC Lexis 2, *255. The second prong focuses on whether the consumers had a free and informed choice that would have enabled them to avoid the unfair practice. *FTC v. J.K. Publications, Inc.*, 99 F. Supp. 2d 1176, 1201 (C.D. Cal. 2000). Finally, the third prong is satisfied when the adverse consequences for consumers are not outweighed by an increase in services or benefits to consumers or competition. *Windward Marketing, Ltd.,* 1997 U.S. Dist. LEXIS 17114 at *32 (citing *Orkin Exterminating Co., Inc. v. FTC,* 849 F.2d 1354, 1365 (11th Cir. 1988)).

2. Deception

An act or practice is "deceptive" under Section 5 if there is a representation, omission, or practice that is likely to mislead consumers acting reasonably under the circumstances and if that representation, omission, or practice is material to the consumer's payment decision. *FTC v. Bay Area Bus. Council, Inc.*, 423 F.3d 627, 634-35 (7th Cir. 2005)*; Kraft, Inc. v. FTC,* 970 F.2d 311, 314 (7th Cir. 1992); *FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1029 (7th Cir. 1988). Reasonable consumers are not required to doubt the veracity of express representations, and the Court may presume express claims to be material. *Kraft*, 970 F.2d at 322; *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1095 (9th Cir. 1994). Furthermore, consumers' reliance on express claims is presumptively reasonable. *FTC v. World Media Brokers, Inc.*, No. 02 C 6985, 2004 U.S. District LEXIS 3227, at *24-25 (N.D. Ill. March 2, 2004). Implied claims are presumptively material where there is evidence that the seller intended to make the claim, *Kraft*, 970 F.2d at 322, or the claims go to the heart of the solicitation or the characteristics of the product or service offered. *Southwest Sunsites, Inc.*, 105 F.T.C. 7, 149, 1980 FTC Lexis 86, *328 (1985), *aff'd*, 785 F.2d 1431 (9th Cir. 1986).

B. Standards for Injunctive Relief in the Public Interest

Pursuant to Section 13(b) of the FTC Act, this Court has authority to enjoin violations of the FTC Act. *See* 15 U.S.C. § 53(b); *FTC v. Febre*, 128 F.3d 530, 534 (7th Cir. 1997); *World Travel,* 861 F.2d at 1028. Incident to its authority to issue permanent injunctive relief, this Court has the inherent equitable power to grant "any ancillary equitable relief necessary" to effectuate ultimate relief. *FTC v. Amy Travel Services, Inc.*, 875 F.2d 564, 572 (7th Cir. 1989). This

ancillary relief includes, *inter alia*, restitution and rescission of contracts. *See, e.g., Febre*, 128 F.3d at 534 (redress as restitution or rescission); *Pantron I*, 33 F.3d at 1102-03 (restitution and disgorgement); *Windward Marketing,* 1997 U.S. Dist. LEXIS 17114 at *42 (restitution and disgorgement). Courts appropriately invoke Section 13(b) in fraud cases, *World Travel,* 861 F.2d at 1024-28; *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1111 (9th Cir. 1982), and courts in this district have regularly gone far beyond the relief sought here, in issuing preliminary relief.[112]

To obtain preliminary relief, the FTC must demonstrate only: (1) a likelihood of success on the merits, and (2) that the balance of the equities tips in its favor. *World Travel*, 861 F.2d at 1029. The FTC need not prove "irreparable injury" to obtain a preliminary injunction. *Kinney v. Int'l Union of Operating Eng'rs*, 994 F.2d 1271, 1277 (7th Cir. 1993). The public interest "must receive far greater weight" than any private concerns. *World Travel*, 861 F.2d at 1029. In the Seventh Circuit, to show a likelihood of success, the plaintiff must merely show a better than negligible chance of success on the merits. *See Cooper v. Salazaar*, 196 F.3d 809, 813 (7th Cir. 1999); *FTC v. Windermere Big Win Int'l, Inc.,* No. 98 C 8066, 1999 U.S. Dist. LEXIS 12259, at *17 (N.D. Ill. Aug. 5, 1999).

C. The Evidence Demonstrates a Likelihood of Ultimate Success on the Merits

1. Unfair Acceptance of and Collection on Rental Agreements (Complaint Count II)

IFC's practice of acquiring and collecting on the NorVergence Rental Agreements has caused substantial injury to consumers. Consumers have spent thousands of dollars in payments to IFC on the bogus Rental Agreements and attorneys fees fighting IFC's relentless collection efforts. Consumers also have spent countless hours dealing with and defending against IFC. All of this injury would have been minimized if IFC's collection efforts had stopped when NorVergence went into bankruptcy in June 2004 or when services stopped soon thereafter. Stated most simply, IFC financed fraud when it purchased the bogus Rental Agreements. The Rental Agreements on their face purported to finance only a Matrix box, but IFC understood that NorVergence was truly selling services, not the Matrix, and the predominant purpose of the

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[112] *E.g.*, *FTC v. 120194 Canada, Ltd.,* 04 C 7204 (N.D. Ill. Nov. 8, 2004) (issuing *ex parte* temporary restraining order with asset freeze); *FTC v. Xtel Marketing, Inc.*, No. 04 C 7238 (N.D. Ill. Nov. 9, 2004) (same); *FTC v. Datatech Communications Inc., et al.,* 03 C 6249 (N.D. Ill. Sept. 8, 2003) (same).

Rental Agreements was to finance those services. For IFC to purchase the Rental Agreements under these circumstances and then collect on them when they are worthless is unfair.

The injury was not reasonably avoidable by consumers themselves. When they entered into the deal with NorVergence, consumers were presented with 10-15 documents to evaluate and sign. They were told that they would realize significant savings over the five-year period, and they were entitled to rely on the express representations of salespersons without being experts themselves. *World Media Brokers,* 2004 U.S. District LEXIS 3227, at *24; *World Travel*, 861 F.2d at 1029. Under these circumstances, consumers had no reason to expect IFC would enforce the Rental Agreements when services were not being provided, and had no reasonable way to prevent it.

No legitimate countervailing benefit to consumers or competition outweighed the injury to consumers here. Providing *legitimate* equipment lease financing benefits small businesses and non-profit organizations. However, there is no benefit to either consumers or competition when the leases are grounded in fraud and falsely describe their purpose. Allowing IFC to collect on bogus leases only benefits IFC. It causes substantial harm to consumers and disadvantages competitors who play by the rules. IFC acceptance of and collection on the Rental Agreements thus constitutes an unfair practice under the FTC Act. 15 U.S.C. § 45(n).

2. Unfair Use of Distant Forum Lawsuits (Complaint Count III)

IFC unfairly filed hundreds of legal actions against consumers in distant forums to collect on NorVergence contracts. This tactic has caused substantial harm. For those consumers who defend the suits, their distance from the court greatly increases their costs. Neither they nor any of the potential witnesses to the original transaction are in the court's jurisdiction.[113] Notably, at least 48 IFC consumers have already suffered large default judgments, almost all in a distant forum.[114] Compounding this harm, every consumer in this case has viable defenses and good reason to refuse payment on the Rental Agreements. Worse still, all but one of the collection

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[113] *See* note 88, *supra*.

[114] Bosque Dec., PX 38, ¶ 19 (Cook County defaults against 46 defendants located outside Illinois).

suits were filed by IFC *after* the NorVergence bankruptcy, when no one could deny that NorVergence had been a scam.[115]

Consumers could not reasonably have avoided the harm here. NorVergence assigned the Rental Agreements to IFC without any advance notice to the consumer. Similarly, IFC's decision to sue in Illinois was beyond the consumer's control or ability to negotiate, other than hiring a lawyer in Illinois (after the fact) to seek a change of forum. Consumers could do nothing to prevent IFC from invoking this provision. Indeed, most consumers had no idea the provision even existed, buried as it was in a single one of many documents they signed, and which they were discouraged from reading.[116]

Finally, the substantial injury to consumers caused by IFC's practice cannot possibly be outweighed by benefits to consumers or competition. Clearly there is no benefit to consumers, who are substantially harmed by the practice. Finance companies such as IFC may save some costs by centralizing their litigation in a single forum, but this benefit is marginal in comparison to the consumer harm, particularly where consumers with valid defenses may be effectively precluded from raising them. In sum, IFC's practice of filing distant forum collection suits in this case – when it was abundantly clear that the Rental Agreements had been procured through fraud – satisfies all three elements of unfairness under the FTC Act.

The unfairness of distant forum collection suits under the FTC Act is in fact well-established. The Commission brought numerous actions challenging this practice in the 1970s. In the only litigated case, *FTC v. Spiegel, Inc.*, the Seventh Circuit unambiguously upheld the FTC's authority under Section 5 of the FTC Act to prohibit use of distant forums.[117] 540 F.2d 287 (7th Cir. 1976). The underlying Commission decision applied the principle both to suits

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[115] IFC filed all but one of its collection suits against NorVergence victims on or after August 13, 2004. *Id.* at ¶ 16.

[116] *See* pp. 5-6 and notes 16-17, *supra*, and accompanying text. The forum selection clause was not mentioned by NorVergence salespersons, let alone negotiated. Carmen Dec., PX 2 ¶ 11; Aliano Aff., PX 12, ¶ 8; Barlow Aff., PX 13, ¶ 10; Christo Aff., PX 14, ¶ 7; Ferguson Aff., PX 15, ¶¶ 7, 10; Hodges Aff., PX 16, ¶ 7; Lim Aff., PX 17, ¶¶ 8, 10; Shoup Aff., PX 19, ¶ 8; Smith Aff., PX 20, ¶ 8; Hastava Aff., PX 21, ¶¶ 10, 12; Karl Aff., PX 22, p. 3; Aylestock Aff., PX 25, ¶¶ 8-9; Slaughter Aff., PX 26, ¶¶ 7-8; Rodriguez Dec., PX 29, ¶ 9.

[117] The Commission's rationale included the costs of defending in a distant forum. 540 F.2d at 293.

against individual consumers and suits against small businesses.[118] Although the standard for an unfairness violation was codified after *Spiegel,* 15 U.S.C. § 45(n) (1994), the current standard is clearly met here.

Indeed, the instant case presents a far stronger consumer injury case than *Spiegel* and other, settled distant forum cases.[119] In none of those cases did the FTC did allege, as it does here, that consumers had defenses to the suits. Many consumers in those cases simply could not afford to pay and might have defaulted wherever the suit was filed. Here, by contrast, *every* IFC consumer has defenses and few would likely default if given a local forum.[120]

IFC has based its distant forum suits on a "floating venue" provision found in fine print in the NorVergence rental agreement, which states that any suit to enforce the contract may be brought in the state of any future assignee, and the contract interpreted under the laws of that state, if the assignee so chooses.[121] This is an unusually vague method to select a forum. It has been held unenforceable in several Illinois state cases,[122] and, recently, all IFC's collection suits in Illinois state courts were stayed pending a decision on appeal on this issue of personal

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[118] As stated in the Initial Decision adopted by the full Commission, "A customer of a mail-order house, be it an individual *or a small company* engaged in a one-state operation, is also more likely to be unprepared to defend itself in a foreign forum than is a company which transacts a substantial amount of interstate business." *Spiegel, Inc.,* 86 F.T.C. 425, 439, 1975 FTC Lexis 107, *14-15 (1975) (citation omitted) (emphasis added); *aff'd with minor changes not related to the quoted text*, *FTC v. Spiegel, Inc.*, 540 F.2d at 287.

[119] *E.g., West Coast Credit Corp.*, 84 FTC 1328, 1329, 1974 FTC Lexis 29, *3 (1974) (requiring borrowers to waive statutory venue provisions "effectively deprives them of rights otherwise available to move for a change of forum," so use of those provisions is unfair); *J.C. Penney Co.*, No. 852 3029, 109 F.T.C. 54 (1987), 1986 WL 722090 ("PX 59").

[120] A recent case did allege fraud in selling business opportunities and investment schemes under the guise of equipment leases and, in a stipulated order, prohibited distant forum suits based on a contract provision specifying venue in Massachusetts. *See FTC v. Leasecomm Corp.*, No. 03-cv-11034 (D. Mass.) (filed May 29, 2003), Complaint for Injunctive and Other Equitable Relief ("PX 60") and Stipulated Final Judgment and Order ("PX 61").

[121] The venue provision stated that all legal actions relating to the "lease" were to "be venued exclusively in a state or federal court" in the State in which the principal offices of NorVergence or its assignee are located. *See, e.g.,* Brannon-Quale Dec., PX 39, Att. D, p. 56 ("Applicable Law" provision); Spicher Dec., PX 8, p. 7 (same).

[122] *E.g.*, *IFC Credit Corp. v. Main St. Mortgage of Cent. Fla., Inc.,* No. 04 M3 2649 (Ill. Cook County Cir. Ct. 3rd Mun. Dist. Mar. 30, 2005) ("PX 53"); *IFC Credit Corp v. South Coast Dental Lab., Inc.*, No. 04 M3 2646 (Ill. Cook County Cir. Ct. 3rd Mun. Dist. June 21, 2005) ("PX 54").

jurisdiction.[123] Regardless of the form of any venue provision, it is IFC's choice to sue NorVergence victims in a distant forum – not the mere existence of the provision – that is unfair under the FTC Act.

The recent decision in *IFC v. Aliano Bros.* is not to the contrary. In *Aliano*, the Seventh Circuit held the floating venue provision in the NorVergence Rental Agreement was valid to confer personal jurisdiction unless Aliano could demonstrate it was "procured by fraud" or otherwise invalid. *IFC Credit Corp. v. Aliano Bros. Gen. Contractors, Inc.*, 437 F.3d 606, 613 (7th Cir. 2006). Here, the FTC has clearly alleged and presented ample evidence of fraud by NorVergence.[124] More important, the *Aliano* court was not deciding an FTC Act unfairness claim. Notably, the Seventh Circuit has specifically recognized that, even if a floating venue provision *were* enforceable in a private action, it could still be unfair under the FTC Act: "[T]he Commission may find [the distant forum] practice to be unfair within the meaning of Section 5 even though the same practice has repeatedly withstood attack in the courts."[125] *Spiegel,* 540 F.2d at 294-95 (footnote omitted). Thus, the *Aliano* decision does not preclude a finding of unfairness in this case.

3. Misrepresenting Consumers' Obligations (Complaint Count I)

IFC also has made deceptive statements to consumers in violation of Section 5 of the FTC Act. In order to coerce payments from its victims and discourage them from mounting defenses to collection actions, IFC has misrepresented that consumers have no defenses to payment on the worthless Rental Agreements and no counterclaims they can raise. (See Complaint Count I.A.) These claims are false. Consumers have numerous defenses and counterclaims, arising both from the NorVergence fraud and from IFC's own misdeeds. These express claims are presumed material, *Pantron I*, 33 F.3d at 1095, and consumers who have paid

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[123] Order, *IFC Credit Corp. v. Parc Solutions, Inc.,* No. 06 M2 01327, slip op. at 2 (Ill. Cook County Cir. Ct. 2nd Mun. Dist. Apr. 17, 2007) ("PX 55").

[124] *See also Custom Data Solutions, Inc.,* cited and discussed *supra* notes 101-103 and corresponding text (finding NorVergence fraudulently induced consumers into signing Rental Agreements); *Specialty Optical v. IFC Credit Corp.*, Cause No. 04-04187-C (Tex. Dallas County Ct. at Law No. 3 heard on Feb. 9, 2006), Findings of Fact and Conclusions of Law, ¶ 39 (June 5, 2006) ("PX 58") (same); Default Judgment, PX 47, pp. 5-8, Findings 13-17.

[125] *See also West Coast Credit*, 84 FTC at 1329, 1974 FTC Lexis 29, *3.

anything to IFC have been injured by the entire amount paid.[126] Deception about the lack of defenses is particularly injurious when used in conjunction with distant forum suits, because consumers are already at a disadvantage even in appearing and mounting a defense.

Similarly, in an effort to coerce payment, IFC has falsely claimed that the consumers defrauded IFC into paying NorVergence for the Rental Agreements.[127] (See Complaint Count I.B.). This express claim is presumed material to consumers' decisions regarding payment.

D. The Balance of the Equities Requires the Preliminary Relief Requested

The balance of the equities weighs decidedly in favor of preliminary relief. As a matter of law, the public interest – in stopping the significant ongoing harm caused by IFC's practices and in effective enforcement of the law – receives far greater weight than any private concerns. *World Travel*, 861 F.2d at 1029. By contrast, the private equities in this case are not compelling. Requiring IFC to refrain from engaging in unfair practices and making false representations in collecting on worthless contracts is not an unreasonable burden. *See FTC v. World Wide Factors, Ltd.*, 882 F.2d 344, 347 (9th Cir. 1989).

Yet IFC wants to keep collecting. It wants to pay off its own debts (the loans it took out to buy the Rental Agreements) and realize the profits it anticipated. However, this is not a private equity that merits protection. Continued collections on worthless contracts means the victims will pay twice for telecommunications services: once for their real services, and a second time for the NorVergence services they did not get. This is a tremendous hardship for these small businesses and organizations. Many have refused to pay and are trying to fight IFC. This, too, adds to their expense. At the same time, their credit is being undermined by the pending collection actions. Absent action by this court, IFC will continue compounding consumer injury.

Accordingly, the FTC seeks an order preliminarily enjoining IFC: (1) from making material misrepresentations about the Rental Agreements and potential defenses; (2) from continuing any collection activities related to the Rental Agreements; (3) from contesting any effort by a consumer to transfer venue of an IFC lawsuit filed against the consumer in a distant forum; and (4) from failing to take remedial steps to limit ongoing harm to consumers' credit

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[126] As noted in Section III.A.1 above, a small percentage of customers may have received services for a very limited period. Their injury is accordingly reduced. *See* p. 7 and notes 23-28.

[127] See pp. 21-22 and notes 106-11 above.

ratings. Although IFC's collection matters in Cook County Circuit Court have been stayed pending resolution of IFC's appeal, injunctive relief is still necessary here to prevent IFC from resuming its collections litigation in Illinois or initiating hundreds of new actions in other jurisdictions, depending on the appellate court's ruling.

V. CONCLUSION

IFC has caused and continues to cause injury to consumers through its unfair and deceptive practices in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a). To prevent ongoing consumer harm during the pendency of litigation, plaintiff moves this Court to issue the requested Preliminary Injunction.

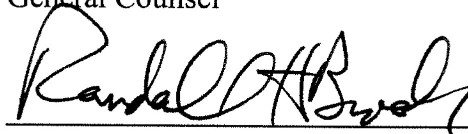
Respectfully submitted,

Dated: June 6, 2007

Local Counsel:

Theresa M. McGrew
Federal Trade Commission
55 West Monroe Street, Suite 1825
Chicago, IL 60603
(312) 960-5634 (telephone)
(312) 960-5600 (fax)

WILLIAM BLUMENTHAL
General Counsel



RANDALL H. BROOK
MAXINE R. STANSELL
DAVID M. HORN
Federal Trade Commission
915 2nd Avenue, Ste. 2896
Seattle, WA 98174
(206) 220-6350 (telephone)
(206) 220-6366 (fax)

Attorneys for Plaintiff
FEDERAL TRADE COMMISSION