

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF MINNESOTA

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FEDERAL TRADE COMMISSION, )  
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 )  
 Plaintiff, )  
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 )  
 v. )  
 )  
 )  
 WEBVALLEY, INC., )  
 a Minnesota Corporation, )  
 )  
 )  
 PROFILE NATIONAL BUSINESS DIRECTORY, INC., ) Civil Action No.  
 a Minnesota Corporation, )  
 )  
 )  
 NATIONAL BUSINESS DIRECTORY, INC., )  
 a Minnesota Corporation, )  
 )  
 )  
 PROTEL ADVANTAGE, INC., )  
 a Minnesota Corporation, )  
 )  
 )  
 U.S. PROTEL, INC., )  
 a Minnesota Corporation, )  
 )  
 )  
 SATYA P. GARG, )  
 individually and as an officer of )  
 WebValley, Inc., Profile National )  
 Business Directory, and National )  
 Business Directory, Inc., )  
 )  
 )  
 BLAINE C. CHRISTOFFERSON, )  
 individually and as an officer of )  
 U.S. Protel, Inc., and )  
 )  
 )  
 SCOTT D. LEE, )  
 individually and as an officer of )  
 Protel Advantage, Inc., )  
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 )  
 Defendants. )  
 )  

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**MEMORANDUM IN SUPPORT OF PLAINTIFF'S MOTION FOR AN  
EX PARTE TEMPORARY RESTRAINING ORDER AND OTHER EQUITABLE RELIEF,  
AND ORDER TO SHOW CAUSE  
WHY A PRELIMINARY INJUNCTION SHOULD NOT BE ISSUED**

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## **I. INTRODUCTION**

This case involves fraud in the "sale" of Internet web pages to small businesses across the United States. Defendants have billed thousands of consumers, on their telephone bills, in excess of \$9 million for services that they never ordered.

The scheme itself is simple. Defendants cold call consumers and offer to design web pages for them to be posted on the Internet. Defendants mention a "no obligation," free, 30-day trial period. They promise to send mock-ups of their web pages in the mail. Significantly, defendants fail to mention cost or billing practices. At most, consumers agree to receive more information. They have no idea, however, that they will automatically be assessed charges on their phone bills.

Defendants then sometimes (but not always) send prototypes of basic web pages that they have designed in India. Accompanying printed materials do not clearly explain what, if anything, consumers need to do, and do not explain how consumers would be expected to pay for this service if they wanted it. Consumers never receive a bill or invoice from defendants.

Consequently, the vast majority of consumers do not know that they must contact the defendants within thirty days to cancel or the defendants will begin charging them \$24.95 per month on their telephone bills. In many cases it is several months before consumers notice the charges and complain.

Defendants themselves estimate that they have "sold" more than 50,000 web pages.

The evidence submitted by the Federal Trade Commission ("Commission" or "FTC"), including the sworn statements of numerous consumers and three former employees, demonstrates that this is a carefully-constructed scam of large proportion. The FTC reviewed more than 900 consumer complaints. We also conducted a random survey of ninety-one businesses and organizations that had web pages hosted on defendants' web site.

An FTC investigator spoke with seventy of these businesses and organizations, the majority from Minnesota. Fifty-two, or 74%, of them had no idea that they had web pages on the Internet. Only twenty of those surveyed recall agreeing to the free 30-day trial period, but a majority of these twenty did not understand that they had to cancel the services in order to avoid being charged on their telephone bills. Of all the businesses and organizations surveyed, only two reported that they were "satisfied" or "pleased" with their web pages.

Likely hoping to capitalize on the popularity of Internet stocks, defendants currently await approval to sell \$34.5 million of stock through an initial public offering ("IPO"). Indeed, just prior to registering their IPO with the Securities and

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<sup>1</sup> The Securities and Exchange Commission ("SEC") is aware of the investigation that led to the filing of this case. Approval of defendants' \$34.5 million stock offering remains pending.

<sup>2</sup> The Minnesota Attorney General's office is concurrently

## II. STATEMENT OF FACTS

### A. The Parties

#### 1. Plaintiff

The Commission is an independent agency of the United States government created by the FTC Act, 15 U.S.C. § 41, et seq. The Commission is charged, inter alia, with enforcement of 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 Commission is authorized by Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), to initiate proceedings in federal district court to enjoin violations of the FTC Act, as well as to obtain consumer redress and to secure necessary equitable relief. 15 U.S.C. §§ 53(b).

#### 2. Defendants

Defendants are a single enterprise organized as three corporations. Three individuals control these organizations, one of whom is the enterprise's dominant figure.

Defendant **WebValley, Inc.**, began its operations as **National Business Directory, Inc.** ("National"), in May 1996.<sup>3</sup> National thereafter changed its name to **Profile National Business**

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<sup>3</sup> Plaintiff's Exhibit (hereinafter "**PX**") 19, p. 444 [Daniels (FTC Investigator) Dec., Appendix ("App.") F] in Declarations and Exhibits in Support of Plaintiff's Ex Parte Temporary Restraining Order and Other Equitable Relief ("Declarations and Exhibits"). The page number reference following "**PX**" in this and other citations refers to the continuously-numbered pages in Volumes I and II of the Declarations and Exhibits.

**Directory, Inc.** ("Profile").<sup>4</sup> Profile subsequently changed its name to WebValley.<sup>5</sup> (Hereinafter, the term "WebValley" refers collectively to Profile, National, and WebValley.) WebValley's headquarters are in Hopkins, Minnesota. Its subsidiary, Software Moguls, Ltd., in New Delhi, India, produces web pages.<sup>6</sup>

**Satya P. Garg** has served as President and/or Chief Executive Officer of National, Profile, and WebValley.<sup>7</sup> Mr. Garg lives in the District of Minnesota.

The headquarters of **Protel Advantage, Inc.** ("Protel"), are in Roseville, Minnesota.<sup>8</sup>

**Scott D. Lee** is Protel's President and Director.<sup>9</sup> He lives in the District of Minnesota.

**U.S. Protel, Inc.** ("U.S. Protel"), has its headquarters in Roseville, Minnesota.<sup>10</sup>

**Blaine C. Christofferson** is U.S. Protel's Chief Executive

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<sup>4</sup> PX 19, pp. 446-48 [Daniels (FTC Investigator) Dec., App. F].

<sup>5</sup> PX 19, p. 451 [Daniels (FTC Investigator) Dec., App. F].

<sup>6</sup> PX 19, pp. 461-62 [Daniels (FTC Investigator) Dec., App. G].

<sup>7</sup> PX 19, pp. 445-47, 451, 455-56, 463-69 [Daniels (FTC Investigator) Dec., Apps. F, G].

<sup>8</sup> PX 19, pp. 473, 497 [Daniels (FTC Investigator) Dec., Apps. G, L].

<sup>9</sup> PX 19, pp. 484, 491 [Daniels (FTC Investigator) Dec., Apps. H, J].

<sup>10</sup> PX 19, p. 473 [Daniels (FTC Investigator) Dec., App. G].

Officer.<sup>11</sup> He lives in the District of Minnesota.

As a merged operation, U.S. Protel and Protel maintain four or five calling centers in Roseville, St. Cloud, and Duluth, Minnesota, as well as in New Richmond and Eau Claire, Wisconsin.<sup>12</sup> Together, the two corporations are known as "the Protel companies."<sup>13</sup> In addition to telemarketing WebValley's Internet services, the "Protel companies" have marketed long distance service from at least two of the calling rooms.<sup>14</sup>

**B. Defendants' Deceptive and Misleading Business Practices**

**1. Defendants' Scheme**

Protel and U.S. Protel make unsolicited telephone calls on behalf of WebValley<sup>15</sup>, targeting small businesses and nonprofit

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<sup>11</sup> **PX** 19, p. 474 [Daniels (FTC Investigator) Dec., App. G].

<sup>12</sup> **PX** 17, pp. 287-88 [Maiterth (Former Employee) Dec., ¶ 9].

<sup>13</sup> **PX** 15, p. 129 [Andrie (Former Employee) Dec., ¶ 4].

<sup>14</sup> Currently, Protel markets long distance telephone service out of its St. Paul office. **PX** 17, pp. 289-90 [Maiterth (Former Employee) Dec., ¶¶ 18-19]. In addition, Protel's offices in Eau Claire, Wisconsin, were raided by the Wisconsin Department of Agriculture, Trade, and Consumer Protection, pursuant to a search warrant, in February 1997. The basis for the search warrant was information that Protel was engaged in slamming - the unauthorized switching of long-distance telephone service. **PX** 14, p. 119 [Krueger (Wisconsin Consumer Protection Investigator) Dec., ¶¶ 2-4].

<sup>15</sup> **PX** 20, p. 498 [McNerney (Consumer) Dec., ¶ 3]; **PX** 5, p. 33 [Haining (Consumer) Dec., ¶ 3]; **PX** 12, p. 86 [Schoen (Consumer) Dec., ¶ 3].

organizations throughout the United States.<sup>16</sup> Speaking quickly throughout the pitch<sup>17</sup>, defendants describe the benefits of advertising on the Internet and propose to design prototype web pages customized for the businesses of every consumer they contact.<sup>18</sup>

To entice interest, defendants promise consumers a free, 30-day trial period.<sup>19</sup> Defendants claim that they will produce web pages during this free period and post them on the Internet. Defendants emphasize that the trial period carries “no obligation” and “no risk” for consumers.<sup>20</sup> In other instances, defendants never mention a free, 30-day trial period and simply

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<sup>16</sup> E.g., **PX** 3, p. 20 [Bieda (Consumer) Dec., ¶1 (WA)]; **PX** 4, p. 30 [Davis (Consumer) Dec., ¶1 (IL)]; **PX** 12, p. 86 [Schoen (Consumer) Dec., ¶ 1 (NY)].

<sup>17</sup> **PX** 24, p. 515 [Benham (Consumer) Dec., ¶ 9]; **PX** 4, p. 30 [Davis (Consumer) Dec., ¶ 4]; **PX** 20, p. 499 [McNerney (Consumer) Dec. ¶ 8]; **PX** 25, p. 518 [L. Oldham (Consumer) Dec., ¶ 9].

<sup>18</sup> **PX** 24, p. 514 [Benham (Consumer) Dec., ¶ 2]; **PX** 3, p. 20 [Bieda (Consumer) Dec., ¶ 3]; **PX** 4, p. 30 [Davis (Consumer) Dec., ¶ 3]; **PX** 6, p. 35 [Hanson (Consumer) Dec., ¶ 3]; **PX** 20, p. 498 [McNerney (Consumer) Dec. ¶ 3]; **PX** 25, p. 517 [L. Oldham (Consumer) Dec., ¶ 2]; **PX** 5, p. 33 [Haining (Consumer) Dec., ¶ 3].

<sup>19</sup> **PX** 2, p. 5 [Athay (Consumer) Dec., ¶ 2]; **PX** 20, pp. 498-99 [McNerney (Consumer) Dec. ¶ 5]; **PX** 12, p. 86 [Schoen (Consumer) Dec., ¶ 3]; **PX** 11, p. 81 [Ruder (Consumer) Dec., ¶ 2].

<sup>20</sup> **PX** 2, pp. 5-6 [Athay (Consumer) Dec., ¶ 4]; **PX** 20, pp. 498-99 [McNerney (Consumer) Dec. ¶ 5]; **PX** 5, p. 33 [Haining (Consumer) Dec., ¶ 3]; **PX** 12, p. 86 [Schoen (Consumer) Dec., ¶ 5]; **PX** 11, p. 81 [Ruder (Consumer) Dec., ¶ 2].

offer to send consumers information.<sup>21</sup> In both scenarios, defendants promise to send packages to consumers within about a week, ostensibly so that consumers can decide whether to use defendants' services. These packages purportedly will contain information about WebValley as well as color models of the customized web pages.<sup>22</sup> In some instances, defendants even tell consumers that they will contact them in a few weeks to see if consumers wish to purchase the web-page service.<sup>23</sup>

Consumers do not believe that they are being asked to buy defendants' services.<sup>24</sup> Defendants do not mention the cost of their services.<sup>25</sup> They do not disclose their billing policies or practices.<sup>26</sup> Defendants never mention a cancellation policy.<sup>27</sup>

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<sup>21</sup> **PX 24**, p. 515 [Benham (Consumer) Dec., ¶ 7]; **PX 4**, p. 31 [Davis (Consumer) Dec., ¶ 8]; **PX 25**, p. 517 [L. Oldham (Consumer) Dec., ¶ 2].

<sup>22</sup> **PX 4**, p. 30 [Davis (Consumer) Dec., ¶ 4]; **PX 20**, pp. 498-99 [McNerney (Consumer) Dec. ¶ 5]; **PX 25**, p. 517 [L. Oldham (Consumer) Dec., ¶ 3]; **PX 5**, p. 33; **PX 5**, p. 33 [Haining (Consumer) Dec., ¶ 3]; **PX 12**, p. 87 [Schoen (Consumer) Dec., ¶ 8].

<sup>23</sup> **PX 2**, p. 7 [Athay (Consumer) Dec., ¶ 12].

<sup>24</sup> **PX 20**, p. 499 [McNerney (Consumer) Dec. ¶ 9]; **PX 25**, p. 517 [L. Oldham (Consumer) Dec., ¶ 8]; **PX 5**, p. 33 [Haining (Consumer) Dec., ¶ 3]; **PX 12**, p. 87 [Schoen (Consumer) Dec., ¶ 7]; **PX 11**, p. 81 [Ruder (Consumer) Dec., ¶ 3].

<sup>25</sup> **PX 24**, p. 514 [Benham (Consumer) Dec., ¶ 5]; **PX 3**, p. 21 [Bieda (Consumer) Dec., ¶ 6]; **PX 4**, p. 31 [Davis (Consumer) Dec., ¶ 8]; **PX 25**, p. 517 [L. Oldham (Consumer) Dec., ¶ 4]; **PX 5**, p. 33 [Haining (Consumer) Dec., ¶ 3].

<sup>26</sup> **PX 2**, p. 6 [Athay (Consumer) Dec., ¶ 6]; **PX 24**, p. 515 [Benham (Consumer) Dec., ¶ 5]; **PX 3**, p. 21 [Bieda (Consumer) Dec., ¶ 6]; **PX**

Defendants instruct their representatives to be intentionally vague and not to give consumers too much information during solicitation calls.<sup>28</sup> If consumers ask questions, the marketers are required to tell them that all of the information they need is included in the introductory packages they will receive shortly.<sup>29</sup> Defendants specifically instruct their sellers not to tell consumers, unless directly asked, that consumers are required to call and cancel defendants' services to avoid being automatically billed after thirty days.<sup>30</sup> Although defendants provide their telemarketers with written scripts, defendants' common practice is to encourage telemarketers to improvise or write their own. In fact, most do.<sup>31</sup> To facilitate sales, telemarketers are free to tell

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4, p. 31 [Davis (Consumer) Dec., ¶ 8]; **PX** 25, p. 517 [L. Oldham (Consumer) Dec., ¶ 4]; **PX** 12, p. 87 [Schoen (Consumer) Dec., ¶ 6 (impression that bill would be sent through mail)].

<sup>27</sup> **PX** 24, p. 514-15 [Benham (Consumer) Dec., ¶ 6]; **PX** 4, p. 31 [Davis (Consumer) Dec., ¶ 9]; **PX** 25, p. 517 [L. Oldham (Consumer) Dec., ¶ 5].

<sup>28</sup> **PX** 13, pp. 104-105 [Cramer (Former Employee) Dec., ¶¶ 22-23]; **PX** 17, pp. 293, 295, 300-01 [Maiterth (Former Employee) Dec., ¶¶ 35, 42, 64-68].

<sup>29</sup> **PX** 13, p. 104 [Cramer (Former Employee) Dec., ¶ 22]; **PX** 17, p. 293, [Maiterth (Former Employee) Dec., ¶ 35].

<sup>30</sup> **PX** 17, pp. 294-95 [Maiterth (Former Employee) Dec., ¶¶ 39-40, 44]; **PX** 13, p. 107 [Cramer (Former Employee) Dec., ¶ 35].

<sup>31</sup> **PX** 17, p. 294 [Maiterth (Former Employee) Dec., ¶ 38]; **PX** 13, pp. 105-106 [Cramer (Former Employee) Dec., ¶¶ 29-32]. Information such as defendants' intention to charge consumers' phone bills and

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how to contact defendants to cancel is omitted from scripts  
defendants used. **PX** 17, p. 317 [Maiterth (Former Employee) Ex B].

<sup>32</sup> **PX** 2, pp. 5-6 [Athay (Consumer) Dec., ¶ 4]; **PX** 20, p. 500  
[McNerney (Consumer) Dec. ¶ 11].

<sup>33</sup> **PX** 24, p. 515 [Benham (Consumer) Dec., ¶ 8]; **PX** 3, pp. 20-1  
[Bieda (Consumer) Dec., ¶ 5]; **PX** 25, p. 518 [L. Oldham (Consumer)  
Dec., ¶ 7]; **PX** 12, p. 87 [Schoen (Consumer) Dec., ¶ 8].

trial period,<sup>37</sup> and when defendants fail to contact consumers as promised.<sup>38</sup>

Defendants attempt to legitimize their practices by “verifying” their calls with consumers. Using either live

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<sup>37</sup> **PX** 6, pp. 35-36 [Hanson (Consumer) Dec., ¶¶ 3, 5]; **PX** 5, p. 33 [Haining (Consumer) Dec., ¶ 5].

<sup>38</sup> E.g., **PX** 19, pp. 386-87 [Daniels (FTC Investigator) Dec., ¶ 89].

<sup>39</sup> **PX** 17, pp. 301-05 [Maiterth (Former Employee) Dec., ¶¶ 69-89].

<sup>40</sup> **PX** 17, p. 318 [Maiterth (Former Employee) Dec., App. C].

<sup>41</sup> **PX** 24, p. 515 [Benham (Consumer) Dec., ¶ 10]; **PX** 3, p. 20-21 [Bieda (Consumer) Dec., ¶ 5]; **PX** 20, p. 500 [McNerney (Consumer) Dec. ¶ 12]; L. Oldham ¶ 10; **PX** 12, p. 87 [Schoen (Consumer) Dec., ¶ 9].

supposed to recite the following:

Remember, set-up and your first 30 days are a trial period. At the end of your trial period you will be billed only \$19.95 a month, charged on your local telephone bill for your convenience. You are under no obligation and may cancel at any time, so if you have any questions or concerns please contact our customer service by calling the toll-free number included in your packet.<sup>42</sup>

The verifiers do not ask consumers whether they understand the terms of the offers or if they accept them. Defendants' verification script, to the extent it is followed, does not verify that consumers agree to be billed after the trial period.

The last minute disclosures about billing are often obfuscated by fast-talking verifiers, verifiers who consistently depart from the scripts, and telemarketers who talk over the disclosures.<sup>43</sup> One former employee reports that even if consumers hung up during the verification process, the sales would still be considered "verified."<sup>44</sup> According to a former employee who monitored the verifications, most consumers do not understand that they will be billed if they take no action.<sup>45</sup> Defendants' verification scripts were clearly not drafted to avoid consumer confusion.

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<sup>42</sup> **PX** 17, p. 318 [Maiterth (Former Employee) Dec., App. C].

<sup>43</sup> **PX** 17, pp. 301-05 [Maiterth (Former Employee) Dec., ¶¶ 69-89].

<sup>44</sup> **PX** 13, p. 110 [Cramer (Former Employee) Dec., ¶ 48].

<sup>45</sup> **PX** 17, p. 305 [Maiterth (Former Employee) Dec., ¶ 89].

The deception initiated in defendants' sales pitches is furthered by the introductory packages sent to some consumers.<sup>46</sup> These materials say nothing about billing practices or the cost of the services.<sup>47</sup> In addition, they do not disclose that consumers will be charged on their telephone bills after the expiration of the free, 30-day trial period unless consumers cancel defendants' service.<sup>48</sup> Of course, when the promised materials never arrive, consumers have no telephone number for contacting defendants. The fact that defendants never send invoices or bills compounds consumers' confusion.

## 2. Third-Party Billing Aggregators and Refunds

Defendants use third-party billing aggregators to place

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<sup>46</sup> Many consumers never even receive the introductory materials that defendants claim will arrive in "5 to 7 business days." **PX** 7, p. 52 [Ellis (Consumer) Dec., ¶ 15]; **PX** 6, p. 39 [Hanson (Consumer) Dec., ¶ 20]; **PX** 25, p. 518 [L. Oldham (Consumer) Dec., ¶ 11]; **PX** 23, p. 512 [M. Oldham (Consumer) Dec., ¶ 13]; **PX** 5, pp. 33-34 [Haining (Consumer) Dec., ¶ 6].

<sup>47</sup> **PX** 2, p. 7 [Athay (Consumer) Dec., ¶ 12]. Nothing in the welcome letter alerts people to defendants' intent to charge. The letter contains only a vague reference to billing and costs that is buried among extraneous information: "It's **inexpensive**. For around a dollar a day, you are connected to the world with total freedom to update at any time. You may be billed through your local telephone company (where available), on your credit card, or by automated bank debit." **PX** 2, p. 12 [Athay (Consumer) Dec., App. B (emphasis in original)]. This description of billing and cost is hardly sufficient. Defendants do not disclose that the service fee is \$24.95 a month, or that they always charge consumers through telephone bills. Moreover, the conditional statement "[y]ou may be billed" implies to a reasonable consumer that billing occurs, if at all, when consumers accept the service and authorize charging.

<sup>48</sup> **PX** 12, pp. 87-88 [Schoen (Consumer) Dec., ¶ 11].

charges on consumers' local telephone bills.<sup>49</sup> Consumers often do not notice the charges because they are too busy tending to their small businesses and organizations, or because they are not aware that third parties can make unauthorized charges to their telephone bills.<sup>50</sup>

Consumers who notice defendants' unauthorized charges and seek refunds are often given the runaround. Because the third-party billing aggregators' names are usually identified on the telephone bills, consumers often call them first.<sup>51</sup> In many instances, the billing aggregators claim that the consumers authorized the charges, and either refuse to give consumers refunds or issue only partial refunds.<sup>52</sup> Most consumers are told to call or write WebValley. WebValley also takes the position

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<sup>49</sup> A billing aggregator collects miscellaneous telephone charges from vendors such as defendants and processes them to local telephone companies. The telephone companies print the charges on consumers' home bills and collect payment.

Consumers' telephone bills usually identify the name of the third-party billing aggregator that placed the charges, and, in some cases, also identify National, Profile, or WebValley. E.g., **PX** 1, p. 1 [Gittelman (Consumer) Dec., ¶ 2]; **PX** 11, pp. 84-85 [Ruder (Consumer) Dec., App. A].

<sup>50</sup> **PX** 2, pp. 8-9 [Athay (Consumer) Dec., ¶ 19]; **PX** 7, pp. 49-50 [Ellis (Consumer) Dec., ¶ 4]; **PX** 6, pp. 36-37 [Hanson (Consumer) Dec., ¶ 10]; **PX** 8, pp. 58-59 [Moilanen (Consumer) Dec., ¶ 11]; **PX** 1, p. 1 [Gittelman (Consumer) Dec., ¶ 2].

<sup>51</sup> E.g., **PX** 21, p. 502-503 [Huttenlock (Consumer) Dec., ¶ 4].

<sup>52</sup> **PX** 9, p. 63 [Ratcliff (Consumer) Dec., ¶ 8]; **PX** 1, pp. 1-2 [Gittelman (Consumer) Dec., ¶ 5].

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<sup>53</sup> **PX** 3, p. 24 [Bieda (Consumer) Dec., ¶ 19]; **PX** 7, p. 50 [Ellis (Consumer) Dec., ¶ 7]; **PX** 23, pp. 510, 512 [M. Oldham (Consumer) Dec., ¶¶ 7, 10]; **PX** 9, p. 64 [Ratcliff (Consumer) Dec., ¶ 11]. In many instances, employees who supposedly ordered defendants' services had no authority to make purchases. Sometimes no one at the entities

Although some consumers eventually receive full credits, the refunds often come from the phone companies, not defendants.<sup>58</sup> Other consumers cancel the services but fail to obtain credits for past charges.<sup>59</sup> Some consumers receive only partial credits.<sup>60</sup> Even after canceling defendants' service, many consumers find that new charges continue to be added to their phone bills.<sup>61</sup> Whatever the outcome, getting through to defendants, their billing aggregators, and the phone companies is difficult, making the process of obtaining refunds laborious.<sup>62</sup>

### 3. Value of Defendants' Web Pages

Defendants' web pages are of questionable value. A web page has utility if it can be found on the Internet or if a business owner can promote the web page itself through other media. Yet, in this instance, the very consumers whose businesses are promoted on defendants' web site frequently do not know that

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<sup>58</sup> **PX 2**, p. 8 [Athay (Consumer) Dec., ¶ 18]; **PX 3**, pp. 24-25 [Bieda (Consumer) Dec., ¶ 21]; **PX 11**, p. 83 [Ruder (Consumer) Dec., ¶ 10].

<sup>59</sup> **PX 3**, p. 24 [Bieda (Consumer) Dec., ¶ 18]; **PX 7**, pp. 50-52 [Ellis (Consumer) Dec., ¶¶ 9, 14].

<sup>60</sup> **PX 9**, p. 67 [Ratcliff (Consumer) Dec., ¶ 21].

<sup>61</sup> **PX 7**, p. 51 [Ellis (Consumer) Dec., ¶ 10]; **PX 6**, pp. 37-38 [Hanson (Consumer) Dec., ¶ 14-15, 17]; **PX 8**, p. 58 [Moilanen (Consumer) Dec., ¶ 9]; **PX 9**, pp. 65 [Ratcliff (Consumer) Dec., ¶ 13]; **PX 12**, p. 89 [Schoen (Consumer) Dec., ¶ 18].

<sup>62</sup> E.g., **PX 9**, p. 67 [Ratcliff (Consumer) Dec., ¶ 21]; **PX 23**, p. 513 [M. Oldham (Consumer) Dec., ¶ 16].

their web pages exist.<sup>63</sup> In fact, 74 percent of the organizations we contacted had no idea that defendants had created web pages for them.

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<sup>63</sup> **PX** 19, p. 9 [Daniels (FTC Investigator) Dec., ¶ 9].

<sup>64</sup> Id.

<sup>65</sup> **PX** 19, p. 350 [Daniels (FTC Investigator) Dec., ¶ 11]. Some consumers try but are unable to locate their web pages. See **PX** 1, p. 3 [Gittelman (Consumer) Dec., ¶ 10].

<sup>66</sup> **PX** 19, pp. 354-55 [Daniels (FTC Investigator) Dec., ¶¶ 23-26].

<sup>67</sup> **PX** 2, p. 12 [Athay (Consumer) Dec., App. B]; **PX** 17, pp. 295-96 [Maiterth (Former Employee) Dec., ¶ 45].

On April 8, 1999, WebValley filed a registration statement with the SEC seeking to sell \$34.5 million of stock in an IPO. In its registration statement, the company asserts its (short-lived) rationale for seeking consumers' permission before billing them:

We understand that many of our clients are intimidated or unsure about establishing a Web site. To alleviate our clients' concerns, we previously offered free trial periods for our services. We recently discontinued this practice as part of our plan to reduce our client attrition rate and we now provide a site design review period and call back confirmation before the first billing cycle. We believe this new process is a low cost, low risk solution for our clients, comparable to the previously offered trial period.<sup>68</sup>

Perhaps to satisfy the SEC and investors, defendants attempted to sell their Internet services honestly in late March and early April.<sup>69</sup> Sales plummeted. In the New Richmond office, for example, sales more than 90 percent.<sup>70</sup>

A few weeks later, in April 1999, defendants decided to tell consumers that they would send them prototype web pages and some informational material to review. "Customer care representatives" would follow up shortly thereafter to see if

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<sup>68</sup> **PX** 19, p. 475 [Daniels (FTC Investigator) Dec., App. G (emphasis added)].

<sup>69</sup> **PX** 17, pp. 308, 310-11 [Maiterth (Former Employee) Dec., ¶¶ 106, 113-18].

<sup>70</sup> **PX** 15, p. 131 [Andrie (Former Employee) Dec., ¶ 10]; **PX** 17, p. 311 [Maiterth (Former Employee) Dec., ¶¶ 119-20].

consumers wanted to purchase the service.<sup>71</sup> Apparently, this offer was put into effect before defendants had an actual "customer care" team set up to handle these calls.<sup>72</sup> Although defendants' sales increased slightly with this change, they apparently were not high enough. After only a few weeks, defendants changed their offer again.<sup>73</sup>

On April 22, 1999, the Illinois Attorney General filed a consumer protection action accusing WebValley of deceptive acts and practices similar to those alleged here by the Commission. At about this same time, defendants began offering consumers a "fifteen-day review period," after which consumers would be billed if they did not call to cancel.<sup>74</sup>

With this latest permutation, defendants essentially returned to the practice of deceiving consumers by billing them without authorization. Defendants once again allowed telemarketers to script their own pitches.<sup>75</sup> Ostensibly, telemarketers were supposed to tell consumers that they had to

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<sup>71</sup> **PX** 17, p. 311-13 [Maiterth (Former Employee) Dec., ¶¶ 121-25]; **PX** 15, p. 132 [Andrie (Former Employee) Dec., ¶ 13].

<sup>72</sup> **PX** 15, pp. 132-33 [Andrie (Former Employee) Dec., ¶ 14].

<sup>73</sup> **PX** 15, p. 133 [Andrie (Former Employee) Dec., ¶¶ 16-17].

<sup>74</sup> **PX** 15, p. 134 [Andrie (Former Employee) Dec., ¶¶ 18-20].

<sup>75</sup> **PX** 15, p. 134 [Andrie (Former Employee) Dec., ¶ 19].

cancel the service within fifteen days to avoid being billed.<sup>76</sup> According to a former employee, however, management is aware that only about half of the telemarketers actually make this disclosure to consumers.<sup>77</sup> The same former employee reports that while verifications were also initially cleaned up in March 1999, the telemarketers quickly resumed coaching consumers' answers and talking over the relevant disclosures.<sup>78</sup>

Viewed together, the multiple and short-lived changes in sales strategies and scripts, the shift back towards deceptive practices, and continued consumer complaints all suggest that defendants' sales tactics remain deceptive. Indeed, consumer Joe Briggs received a call from defendants in May 1999. He was offered a "free trial period" on a web site.<sup>79</sup> Mr. Briggs declined the offer, but to appease a persistent telemarketer agreed to accept an information package. Mr. Briggs specifically told the telemarketer that he did not want to purchase a web site because his company had just invested over \$1,000 in creating its own web site.<sup>80</sup> Costs or billing never entered their discussion.

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<sup>76</sup> Id.

<sup>77</sup> **PX** 15, p. 134 [Andrie (Former Employee) Dec., ¶ 20].

<sup>78</sup> **PX** 15, p. 135 [Andrie (Former Employee) Dec., ¶¶ 23-24].

<sup>79</sup> **PX** 15, p. 137 [Andrie (Former Employee) App. A]; **PX** 21, p. 507 [Briggs (Consumer) Dec., ¶ 4].

<sup>80</sup> **PX** 21, p. 507 [Briggs (Consumer) Dec., ¶¶ 2-4].

While Mr. Briggs never received an information package, his company was billed \$24.95 by defendants.<sup>81</sup>

Despite the aforementioned changes, defendants never stopped making unauthorized charges to the telephone bills of people they previously deceived.<sup>82</sup> Of the consumers we surveyed in May and June 1999, fourteen of them had been billed continuously for a period ranging from 5 to eighteen months.<sup>83</sup>

### **III. THIS COURT HAS AUTHORITY TO GRANT THE REQUESTED RELIEF**

Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), provides that "in proper cases the Commission may seek, and after proper proof the court may issue, a permanent injunction." Section 13(b) authorizes the Commission to seek injunctive relief against violations of "any provision of law enforced by [it]." A case of deceptive practices such as this one, involving misrepresentations of material facts in violation of Section 5, is a "proper case." FTC v. World Travel Vacation Brokers, Inc.,

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<sup>81</sup> **PX** 21, p. 508 [Briggs (Consumer) Dec., ¶¶ 8, 9]; **PX** 21, p. 502 [Huttenlock (Consumer) Dec., ¶ 2].

<sup>82</sup> For example, defendants added more than \$350 in authorized charges to the local telephone bill of the Whidbey Evangelical Free Church. **PX** 9, pp. 62-63 [Ratcliff (Consumer) Dec., ¶ 5]. See also **PX** 2, pp. 3, 4 [Athay (Consumer) Dec., ¶¶ 13, 15, 17]; **PX** 4, pp. 30-31 [Davis (Consumer) Dec., ¶ 6]; **PX** 7, p. 49 [Ellis (Consumer) Dec., ¶ 2]; **PX** 6, p. 36 [Hanson (Consumer) Dec., ¶ 7]; **PX** 3, pp. 23-24 [Bieda (Consumer) Dec., ¶¶ 16-17]; **PX** 8, p. 57 [Moilanen (Consumer) Dec., ¶ 3]; **PX** 23, p. 510 [M. Oldham (Consumer) Dec., ¶ 4]; **PX** 12, p. 88 [Schoen (Consumer) Dec., ¶ 13]; **PX** 1, p. 1 [Gittelman (Consumer) Dec., ¶ 2].

<sup>83</sup> **PX** 19, p. 353 [Daniels (FTC Investigator) Dec., ¶ 21].

861 F.2d 1020, 1028 (7<sup>th</sup> Cir. 1988); FTC v. Kitco of Nevada, Inc., 612 F. Supp. 1282, 1291 (D. Minn. 1985).

Once the Commission invokes the equitable power of the federal courts, the full breadth of this Court's authority is available, including the power to grant ancillary final relief such as rescission of contracts and restitution. See, e.g., FTC v. Security Rare Coin & Bullion Corp., 931 F.2d 1312, 1314-15 (8<sup>th</sup> Cir. 1991); FTC v. Amy Travel, 875 F.2d 564, 571-72 (7<sup>th</sup> Cir.), cert. denied, 493 U.S. 954 (1989). Further, the Court may grant a preliminary injunction, a temporary restraining order, and whatever additional preliminary relief is necessary to preserve the possibility of effective final relief. Security Rare Coin, 931 F.2d at 1314-15; World Travel, 861 F.2d at 1026.

asset freeze, appointment of a receiver, production of financial records, access to business premises, and expedited discovery).

**A. The Commission Meets the Applicable Legal Standard for the Issuance of a Temporary Restraining Order and Preliminary Injunction**

In order to grant preliminary injunctive relief in a case under the FTC Act, the Court must determine the Commission's likelihood of ultimate success, and balance the equities. See World Travel, 861 F.2d at 1029. When considering the public and private equities, the Court should give the public interest much greater weight. Id. Preliminary injunctive relief is therefore proper if the Commission shows that there is a probable chance of success on the merits and that the balance of the equities - with a "far greater" emphasis on the public interest - favors the grant of injunctive relief.<sup>84</sup> Id.

**1. The Evidence of Defendants' Violations of Section 5 of the FTC Act Demonstrates the Commission's Likelihood of Success on the Merits**

The evidence submitted by the Commission establishes a strong likelihood of ultimate success on the merits. The evidence shows that defendants are engaged in a widespread, lucrative scheme to defraud the public by making unauthorized charges to consumers' telephone bills. Misrepresenting material facts to induce the purchase of goods or services is a deceptive

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<sup>84</sup> No security is required of any agency of the United States for issuance of a restraining order. FED.R.CIV.P. 65(c). The Commission therefore need not post bond.

practice that violates Section 5. See, e.g., Kitco, 612 F. Supp. at 1291. Specifically, shipping and billing for unordered merchandise violates Section 5. FTC v. Goldberg, 40 F.T.C. 296, 300-01 (1945).

To establish a violation of Section 5, the Commission must show (a) that there was a misrepresentation or omission of a kind usually relied upon by reasonable and prudent persons; (b) that the misrepresentations or omissions were widely disseminated; and (c) that the injured consumers purchased defendants' products. Security Rare Coin, 931 F.2d at 1316; Kitco, 612 F. Supp. at 1293. If the Commission makes this showing, the burden shifts to defendants to prove that consumers did not rely upon the misrepresentations. Kitco, 612 F. Supp. at 1293. Here, the Commission has made the required showing.

**a. A Reasonable and Prudent Person Would Rely Upon Defendants' Misrepresentations and Omissions**

Given the nature and extent of defendants' misrepresentations and omissions of material fact, reasonable and prudent consumers naturally relied upon defendants' sales pitches and materials.

This Court may examine the sales techniques at issue to reach its own conclusions about a reasonable consumer's interpretation of defendants' representations. See FTC v. U.S. Sales Corp., 785 F. Supp. 737, 745 (N.D. Ill. 1993). Defendants' tactic is to tell consumers that their trial offers of customized

web pages are "risk free" and "without obligation." They suggest that consumers will have the opportunity to review their

system so that consumers cannot hear the disclosures.<sup>85</sup> Most

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<sup>85</sup> **PX** 13, p. 111 [Cramer (Former Employee) Dec., ¶ 52]; **PX** 15, p. 135 [Andrie (Former Employee) Dec., ¶¶ 23-24]; **PX** 17, pp. 303, 304 [Maiterth (Former Employee) Dec., ¶¶ 78, 85].

<sup>86</sup> **PX** 17, p. 305 [Maiterth (Former Employee) Dec., ¶ 89]; **PX** 13, p. 111 [Cramer (Former Employee) Dec., ¶ 53].

<sup>87</sup> Those states are AZ, IA, ID, IL, NY, OH, OR, PA, SD, UT, and WA. In addition, an FTC investigator spoke to more than 50 consumers from Minnesota. **PX** 19, pp. 363-404 [Daniels (FTC Investigator) Dec., ¶¶ 49-119]. The investigator also reviewed in excess of 900 complaints lodged with the FTC and other law enforcement agencies, billing aggregators, and Better Business Bureaus. **PX** 19, pp. 358-62 [Daniels (FTC Investigator) Dec., ¶¶ 35-48].

<sup>88</sup> Defendants' New Richmond call center averages two hundred sales each day. **PX** 17, pp. 291-92 [Maiterth (Former Employee) Dec., ¶ 29 ]; **PX** 15, p. 131 [Andrie (Former Employee) Dec., ¶ 10]. Defendants, however, operate out of five separate call centers, so the average daily sales for the entire operation are probably significantly higher. See **PX** 17, pp. 287-88 [Maiterth (Former Employee) Dec., ¶ 9]; **PX** 19, p. 477 [Daniels (FTC Investigator) Dec., App. G].

themselves claim that they host as many as 54,000 web pages for consumers.<sup>89</sup> They also claim to "have had significant success in attracting a diversified client base across the entire United States."<sup>90</sup>

**c. Injured Consumers Are Charged for Defendants' Services**

The Commission's evidence shows that defendants charged consumers across the country at least \$19.95 without authorization. Many consumers were charged for multiple months, in some cases more than \$400.<sup>91</sup> Defendants admit that their net sales on web pages exceed \$9 million since 1996.<sup>92</sup> Considering that few if any consumers actually agree to purchase defendants' services,<sup>93</sup> thousands of consumers were charged and paid for services that they did not authorize.

**2. The Public Interest Requires the Issuance of Provisional Relief**

Immediate injunctive relief is necessary to protect the public from further financial harm. Defendants have defrauded consumers continuously since at least 1996. The evidence shows

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<sup>89</sup> **PX** 16, p. 139 [Krause (FTC Investigator) Dec., ¶ 4].

<sup>90</sup> **PX** 19, pp. 478-79 [Daniels (FTC Investigator) Dec., App. G].

<sup>91</sup> **PX** 19, p. 353 [Daniels (FTC Investigator) Dec., ¶ 21].

<sup>92</sup> **PX** 19, p. 468(a) [Daniels (FTC Investigator) Dec., App. G].

<sup>93</sup> **PX** 19, pp. 352-53 [Daniels (FTC Investigator) Dec., ¶¶ 18-20].

that they continue to collect unauthorized fees from consumers.<sup>94</sup> The vast majority - **91.4%** - of the consumers interviewed in the Commission's survey apparently were unaware of the automatic consequences of accepting defendants' so-called free, "no obligation" offers.<sup>95</sup> Nearly **58%** of these consumers were already charged by defendants.<sup>96</sup> Of 70 organizations contacted by the FTC, only two indicated satisfaction with defendants' services.<sup>97</sup> Nearly three-quarters of those surveyed had no idea they even had a web site.<sup>98</sup>

The evidence also shows that even though defendants tried to sell their web pages without deception for a few weeks in March 1999, they quickly returned to their misleading practices. (See Section II.B.4, infra.) Enjoining the inconsistent behavior of a defendant requires a showing of "some cognizable danger of recurrent violation, something more than the mere possibility which serves to keep the case alive." United States v. W.T. Grant Co., et al., 345 U.S. 629, 633 (1953). See also FTC v. Security Rare Coin & Bullion Corp., 1989-2 Trade Cas. (CCH)

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<sup>94</sup> **PX** 19, p. 353 [Daniels (FTC Investigator) Dec., ¶ 21].

<sup>95</sup> **PX** 19, pp. 350-51 [Daniels (FTC Investigator) Dec., ¶ 13].

<sup>96</sup> Id.

<sup>97</sup> **PX** 19, p. 349 [Daniels (FTC Investigator) Dec., ¶ 10].

<sup>98</sup> **PX** 19, pp. 349, 350 [Daniels (FTC Investigator) Dec., ¶¶ 9, 11].

¶ 68,807, at 62,219-20 (D. Minn. 1989), aff'd., 931 F.2d 1312 (8<sup>th</sup> Cir. 1991); Kitco, 612 F. Supp. at 1296.

The Commission's evidence suggests more than "some cognizable danger of recurrent violation." The evidence shows continued, egregious violations that are highly likely to recur. As of May 1999, defendants were failing to disclose in about half of all sales calls that consumers will be billed month after month unless they take steps to cancel.<sup>99</sup> Such calls undoubtedly account for most of defendants' sales. Moreover, defendants have returned to their practice of encouraging telemarketers to deviate from their written scripts.<sup>100</sup> Even the Illinois Attorney General's case has not deterred them.

Furthermore, the public's interest in protecting consumers and securing relief for defendants' victims far outweighs any burden imposed on defendants by the proposed Temporary Restraining Order ("Proposed TRO"). The Proposed TRO and preliminary injunction are narrowly tailored to prohibit only unfair and deceptive conduct. Such prohibitions do not work any undue hardship on defendants. See Security Rare Coin & Bullion Corp., 1989-2 CCH ¶ 68,807, at 62,220. Defendants plainly have no right to persist in conduct that violates federal law. FTC v. World Wide Factors, Ltd., 882 F.2d 344, 347 (9<sup>th</sup> Cir. 1989)

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<sup>99</sup> **PX** 15, p. 134 [Andrie (Former Employee) Dec., ¶ 20].

<sup>100</sup> **PX** 15, p. 134 [Andrie (Former Employee) Dec., ¶ 19].

(upholding district court's finding of "no oppressive hardship to the defendants in requiring them to comply with the FTC Act, refrain from fraudulent representation, or preserve their assets from dissipation or concealment.").

**B. Satya P. Garg, Blaine C. Christofferson, and Scott D. Lee are Personally Liable**

Mr. Garg, Mr. Christofferson, and Mr. Lee are key figures in the operations of WebValley, Protel, and U.S. Protel. Because each individual is subject to injunctive provisions, each is also personally liable for violations of the FTC Act. To obtain the monetary equivalent of rescission from an individual defendant, the Commission must prove that the individual had knowledge that a corporation or one or more of its agents engaged in dishonest or fraudulent conduct. Kitco, 612 F. Supp. at 1292. Knowledge is demonstrated by actual knowledge of material misrepresentations, reckless indifference to the truth or falsity of such misrepresentations, or an awareness of a high probability of fraud along with an intentional avoidance of the truth. Id. See also Amy Travel, 875 F.2d at 573.

Additionally, the Commission must show that the defendants directly participated in the acts or had the authority to control the conduct. "Authority to control the company is evidenced by active involvement with business matters and corporate policy including assumption of officer duties." Amy Travel, 875 F.2d at 573; Kitco, 612 F. Supp. at 1292.

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<sup>101</sup> **PX** 17, pp. 288-89, 309-10 [Maiterth (Former Employee) Dec., ¶¶ 12, 14-15, 109-10, 112].

<sup>102</sup> **PX** 19, p. 468(b) [Daniels (FTC Investigator) Dec., App. G].

<sup>103</sup> **PX** 19, pp. 445-47, 451, 455-56 [Daniels (FTC Investigator) Dec., App. F].

<sup>104</sup> **PX** 19, pp. 463-69 [Daniels (FTC Investigator) Dec., App. G].

<sup>105</sup> **PX** 19, pp. 470-71 [Daniels (FTC Investigator) Dec., App. G].

WebValley was Protel's principal client.<sup>107</sup> Along with Mr. Christofferson and Mr. Lee, Mr. Garg is carbon copied on internal memoranda distributed throughout U.S. Protel.<sup>108</sup> Mr. Christofferson, the Chief Executive of U.S. Protel, and Mr. Lee, the President of Protel, are said to "report" to Mr. Garg.<sup>109</sup> At a management meeting in Minnetonka, Minnesota, in early 1999, where employees of WebValley and U.S. Protel gathered, Mr. Garg was introduced as the "main man" and owner and president of "the company" - a reference to a single entity that no one questioned.<sup>110</sup> Mr. Garg has also been called the financial backbone of "the company." Mr. Garg emphasized his role as the head of "the company" by assuring a manager of the Protel companies that she could telephone him directly should she have questions or concerns about corporate policies.<sup>111</sup> Protel and U.S. Protel employees understood that Mr. Garg was their boss.<sup>112</sup>

Besides control over the corporate entities, Mr. Garg has knowledge of their deceptive acts and practices. Many consumers

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<sup>107</sup> **PX** 19, p. 481 [Daniels (FTC Investigator) Dec., App. G]; **PX** 13, p. 101 [Cramer (Former Employee) Dec. ¶ 7].

<sup>108</sup> **PX** 17, p. 316 [Maiterth (Former Employee) Dec., App. A].

<sup>109</sup> **PX** 17, p. 289 [Maiterth (Former Employee) Dec., ¶ 15].

<sup>110</sup> **PX** 17, p. 309 [Maiterth (Former Employee) Dec., ¶ 109].

<sup>111</sup> **PX** 17, pp. 309-10 [Maiterth (Former Employee) Dec., ¶ 112].

<sup>112</sup> **PX** 17, p. 309 [Maiterth (Former Employee) Dec., ¶ 109].

challenging unauthorized charges complain directly to WebValley or to one of its billing aggregators. One such billing aggregator sent WebValley summaries of complaints from consumers on a regular basis. In a two-day period, 43 complaints logged by the billing aggregator were sent via facsimile to WebValley's headquarters.<sup>113</sup> In addition, WebValley sent weekly reports of customer cancellation rates to Protel and U.S. Protel. WebValley knew that sales made by certain telemarketers resulted in cancellation rates as high as 70%.<sup>114</sup>

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<sup>113</sup> **PX** 19, p. 359 [Daniels (FTC Investigator) Dec., ¶ 36].

<sup>114</sup> **PX** 17, p. 301 [Maiterth (Former Employee) Dec., ¶ 67].

<sup>115</sup> **PX** 19, p. 474 [Daniels (FTC Investigator) Dec., App. G]; **PX** 17, p. 289 [Maiterth (Former Employee) Dec., ¶ 14].

<sup>116</sup> **PX** 17, p. 316 [Maiterth (Former Employee) Dec., App. A].

to Mr. Christofferson, and Mr. Christofferson is involved in the day-to-day operations of the Protel Companies.<sup>117</sup> He regularly conducts business at U.S. Protel's telemarketing offices in New Richmond, Wisconsin - one of several corporate sales sites where telemarketers engage in deceptive and misleading sales pitches.<sup>118</sup> Mr. Christofferson is, at a minimum, constructively aware of the company's pattern and practice of deception.

### 3. Scott D. Lee

Mr. Lee is personally liable because he controls Protel and U.S. Protel, and he knows about the corporations' deceptive acts and practices. He is President and Director of Protel.<sup>119</sup> Mr. Lee is also an owner of U.S. Protel.<sup>120</sup> Along with Mr. Garg and Mr. Christofferson, Mr. Lee is copied on U.S. Protel memoranda concerning telemarketing strategy.<sup>121</sup> Like Mr. Christofferson, Mr. Lee is involved in the day-to-day operations of the Protel Companies.<sup>122</sup> He also regularly conducts business at U.S.

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<sup>117</sup> PX 17, p. 289 [Maiterth (Former Employee) Dec., ¶¶ 15-16].

<sup>118</sup> PX 17, p. 289 [Maiterth (Former Employee) Dec., ¶ 15].

<sup>119</sup> PX 19, pp. 484, 491 [Daniels (FTC Investigator) Dec., Apps. H, J].

<sup>120</sup> PX 17, p. 289 [Maiterth (Former Employee) Dec., ¶ 14].

<sup>121</sup> PX 17, p. 316 [Maiterth (Former Employee) Dec., App. A].

<sup>122</sup> PX 17, p. 289 [Maiterth (Former Employee) Dec., ¶¶ 15-16].

Protel's New Richmond office.<sup>123</sup> U.S. Protel's general manager reports to Mr. Lee.<sup>124</sup> Mr. Lee is, at a minimum, constructively aware of the Protel Companies' pattern and practice of deception.

**IV. THE ANCILLARY RELIEF REQUESTED BY THE COMMISSION  
IS NECESSARY AND APPROPRIATE**

**A. An Asset Freeze is Necessary to Preserve the  
Possibility of Redress Pending a Hearing on the Merits**

The Court's authority to enter orders to preserve the defendants' assets is ancillary to its equitable authority to order consumer redress. See Security Rare Coin, 931 F.2d at 1314-15. Freezing a defendant's assets is appropriate when the possibility of dissipation exists. See FSLIC v. Sahni, 868 F.2d 1096, 1097 (9<sup>th</sup> Cir. 1989). That possibility is always present when, as here, defendants' business is permeated by fraud. SEC v. Manor Nursing Ctrs., 458 F.2d 1082, 1106 (2d Cir. 1972).

The Court has the authority, moreover, to freeze both corporate and individual assets. H. N. Singer, 668 F.2d at 1113; see also World Travel Vacation Brokers, 861 F.2d at 1031. In the instant case, such action is necessary to eliminate the risk of dissipation and preserve assets for redress to consumers.<sup>125</sup>

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<sup>123</sup> Id.

<sup>124</sup> **PX** 17, p. 289 [Maiterth (Former Employee) Dec., ¶ 16].

<sup>125</sup> Although an asset freeze may interfere with the defendants' activities, it "is a necessary and . . . unavoidable consequence of the violation." National Soc'y of Professional Eng'rs v. U.S., 435 U.S. 679, 697 (1978).

**B. An Equity Receiver Will Maintain the Status Quo and Preserve the Assets of the Corporate Defendants**

The appointment of a temporary receiver over the corporate defendants, like an asset freeze, is appropriate and necessary. See FTC v. American Nat'l Cellular, 810 F.2d 1511, 1512-14 (9<sup>th</sup> Cir. 1987). Appointment of a temporary receiver will maintain the status quo, thereby preventing the destruction of documents and the secretion of assets while the case is pending. A temporary receiver is particularly appropriate when defendants' pervasive fraud presents the likelihood of continued misconduct. See SEC v. Bowler, 427 F.2d 190, 197-98 (4<sup>th</sup> Cir. 1970) (prima facie showing of fraud and mismanagement, absent insolvency, is sufficient basis for appointment of a receiver); SEC v. Capitol Counselors, Inc., 332 F. Supp. 291, 304 (S.D.N.Y. 1971).

Appointment of a temporary receiver is appropriate because defendants' business practices are fraudulent. These practices continue despite the fact that defendants have been sued by the Illinois Attorney General.<sup>126</sup> If defendants remain in control of their business, there is a substantial risk that they will destroy evidence and misappropriate the fruits of their fraud. A temporary receiver will eliminate those risks without disrupting any legitimate business activities. See SEC v. Keller Corp., 323

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<sup>126</sup> PX 15, pp. 133-36 [Andrie (Former Employee) Dec., ¶¶ 17-25]; PX 21, p. 508 [Briggs (Consumer) Dec., ¶¶ 8, 9]; PX 21, p. 502 [Huttenlock (Consumer) Dec., ¶ 2].

F.2d 397, 403 (7<sup>th</sup> Cir. 1963). At the same time, a temporary receiver can help the Court determine the extent of defendants' fraud, trace the proceeds of the fraud, and prepare an accounting. The Commission believes that an accounting is essential to determine the whereabouts of the substantial sums of money defendants have fraudulently obtained from consumers. See

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<sup>127</sup> Inasmuch as both the Commission and defendants will need to prepare for any preliminary injunction hearing, the Commission's Proposed TRO directs the temporary receiver to provide both the Commission and defendants with reasonable access to defendants'

This Court is authorized to depart from normal discovery procedures when circumstances warrant. FED.R.CIV.P. 26(d), 33(a) & 34(b). See also Federal Express Corp. v. Federal Expresso, Inc., No. 97-CV-1219, 1997 U.S. Dist. LEXIS 19144, \*6 (N.D.N.Y. Nov. 24, 1997) (early discovery "'will be appropriate in some cases, such as those involving requests for a preliminary injunction.'" (citation omitted); Benham Jewelry v. Aron Basha Corp., No. 97 CV 3841, 1997 U.S. Dist. LEXIS 15957, at \*58 (S.D.N.Y. July 18, 1997) (courts have broad powers to grant expedited discovery).

**D. The Temporary Restraining Order Should be Issued Ex Parte and Without Notice**

A temporary restraining order ("TRO") may be entered ex parte when it appears that "irreparable injury, loss, or damage will result" before the defendants are heard in opposition. FED.R.CIV.P. 65(b). That standard is satisfied when the evidence demonstrates that notice to the defendants would render the TRO fruitless. In re Vuitton et Fils, S.A., 606 F.2d 1, 5 (2d Cir. 1979); Cenergy Corp. v. Bryson Oil & Gas P.L.C., 657 F. Supp. 867, 870 (D. Nev. 1987). The fraudulent nature of defendants' scheme, coupled with the possibility that defendants may conceal assets or business records absent ex parte relief, justifies dispensing with notice.

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premises.

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<sup>128</sup> See Declaration and Certification of Evan Siegel Pursuant to Federal Rule of Civil Procedure 65(b) in Support of Ex Parte Motion

**V. CONCLUSION**

For the foregoing reasons, the Commission respectfully requests that the Court issue the proposed Ex Parte Temporary Restraining Order with Asset Freeze and Order to Show Cause.

Dated: \_\_\_\_\_ 1999

Respectfully submitted,

DEBRA A. VALENTINE  
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