

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
ALEXANDRIA DIVISION**

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

INTERNATIONAL PRODUCT DESIGN, INC.; THE
INNOVATION CENTER, INC.; NATIONAL IDEA
CENTER; AMERICAN INVENTION ASSOCIATES,
INC.; INVENTION CONSULTANTS, USA, INC.;
NEW PRODUCTS OF AMERICA, INC.; AZURE
COMMUNICATIONS, INC. dba LONDON
COMMUNICATIONS, INC.; INTERNATIONAL
LICENSING CORPORATION, INC.; ROBERT N.
WAXMAN; PETER DORAN; DARRELL MORMANDO;
JULIAN GUMPEL; AND GREG WILSON,

Defendants.

Case No. 1:97-cv-01114-GBL-TCB

**PLAINTIFF’S MEMORANDUM IN SUPPORT OF MOTION FOR
ORDER TO SHOW CAUSE WHY MICHAEL FLEISHER, DARRELL MORMANDO,
AND GREG WILSON SHOULD NOT BE HELD
IN CONTEMPT FOR VIOLATING THE STIPULATED ORDER FOR
PERMANENT INJUNCTION AND FINAL RELIEF**

Plaintiff, the Federal Trade Commission (“FTC” or “Commission”), files this memorandum in support of its Motion for an Order to Show Cause why Michael Fleisher (“Fleisher”), Darrell Mormando (“Mormando”), and Greg Wilson (“Wilson”) (together, “New Contempt Defendants”) Should not be Held in Civil Contempt for Violating the Stipulated Order for Permanent Injunction and Final Relief in this case.¹ Fleisher, Mormando, and Wilson, all of

¹ The Commission is simultaneously filing a Motion to Modify the Permanent Injunction as to Mormando and Wilson.

whom had notice of and were subject to the Stipulated Order, have violated its core provisions in their capacities as managers and salespersons of defendant Julian Gumpel's ("Gumpel") invention promotion scheme. Specifically, Fleisher, Mormando, and Wilson have played key roles in a business, that, as a matter of course: (1) falsely represents to consumers that they will reap financial benefits; (2) falsely claims to expertly assess consumers' inventions; and (3) fails to disclose to consumers the business's dismal invention-commercialization record. They too should be held in contempt.

I. INTRODUCTION

In 1997, the Commission sued Gumpel, Mormando, Wilson, and several co-defendants, including American Invention Associates (AIA), of which Fleisher was vice president. The lawsuit accused defendants of violating the Federal Trade Commission Act, 15 U.S.C. § 45, by falsely representing that purchase of their invention promotion services would likely result in financial gain for consumers. In November 1998, this Court entered a Stipulated Order for Permanent Injunction ("Stipulated Order") that, *inter alia*, barred Gumpel, Mormando, Wilson, AIA, and those, like Fleisher, who acted in concert with them and received actual notice of the Order, from making false representations with respect to invention promotion services and that affirmatively required them to disclose their success (or lack thereof) in commercializing consumers' inventions.

On January 8, 2007, the Commission initiated contempt proceedings against Gumpel and eight corporate contempt defendants² known collectively as the Patent & Trademark Institute

² The corporate contempt defendants are Technical Lithographers, Inc., d/b/a Patent & Trademark Institute of America; United Licensing Corp.; International Patent Advisors, Inc.; Datatech Consulting, Inc.; International Product Marketing, Inc.; Unicorp Consulting, Inc.; Azure

(PTI). On January 10, 2007, the Court issued an *ex parte* Temporary Restraining Order (TRO) and an Order to Show Cause why Gumpel and the corporate contempt defendants should not be held in contempt for violating the Stipulated Order. Pursuant to the TRO, the Court appointed a Receiver, granted the Receiver and the FTC immediate access to PTI's business premises, and authorized expedited discovery. On January 17, 2007, the Court entered a Preliminary Injunction continuing the terms of the TRO.

Evidence obtained through expedited discovery shows that Fleisher, like Mormando and Wilson, had notice of the Stipulated Order, and that all three violated its core provisions while carrying on the same fraudulent business practices that gave rise to the original litigation. From the time of the Order's entry, Fleisher, Mormando, and Wilson served in key roles at PTI. In this regard, Fleisher operated as second in command to Gumpel and supervised the sales force. Mormando, an original owner of the business, sold it to Gumpel during the original litigation and, pursuant to the sales agreement, continued to run the sales office in Reno, Nevada for PTI. Wilson oversaw the work of lower-level salespersons who assisted him in sales from the Reno office. In sum, in their capacities as managers and salespersons for PTI, Fleisher, Mormando, and Wilson all made false earnings claims, falsely claimed to assess inventions, and failed to disclose PTI's dismal record in commercializing consumers' inventions. In the process, they defrauded consumers of millions of dollars. For these actions, Fleisher, Mormando and Wilson should be held in contempt.

Communications, Inc.; and London Communications, Inc.

II. STATEMENT OF FACTS

For a full discussion of the factual background of this case, the Commission respectfully refers the Court to its Motion for an Order to Show Cause Why Julian Gumpel and Eight Corporate Entities Under His Control Should Not be Held in Contempt (“Gumpel Contempt Motion”) and supporting brief (“Gumpel Contempt Memorandum”), which it incorporates by reference. In the interests of economy, the FTC also incorporates by reference the nine-volume set of exhibits originally filed in support of the Gumpel Contempt Motion.³ Additional evidence, which supplements the original filing and pertains to the New Contempt Defendants, is cited herein and attached in a separate volume filed in support of the instant motion.⁴

A. Defendants’ Violative Business Practices

As set out in the Gumpel Contempt Memorandum, PTI invited consumers to submit information about their inventions through the website inventorshelpline.com. A consumer who made such a submission was then called by a PTI telemarketer, who stated that the invention had passed an initial screening process and been “approved.” The PTI telemarketer then urged the consumer to purchase a “Phase I” assessment for \$895 to \$1295. As discussed below, the assessment was invariably positive and was used to sell the more expensive “Phase II” services,

³ The FTC is serving a complete set of the pleadings and exhibits filed to date in support of the Gumpel Contempt Motion on Fleisher, Mormando, and Wilson.

⁴ This new volume continues the pagination from the original set of exhibits. Therefore, each exhibit is given an FTC number (starting with FTC20), and each page is given a bates number (starting with PX3026). Pursuant to Local Rule 7(c), all personal identifiers have been removed. As in the earlier pleadings, the exhibits will be referenced by exhibit number and page number.

which ranged in cost from \$5,000 to \$40,000, and purportedly included assistance in patenting and licensing the consumer's invention.

In selling both phases, salespersons routinely informed consumers that PTI's purported services would result in financial gains for consumers. Indeed, in a survey of 265 PTI consumers conducted by Phillip Stenger, the Court's Receiver in this matter, 75 percent of consumers said that a company representative informed them that their invention idea would make money. FTC 26 ¶ 10(a), PX3133. As set out in the Gumpel Contempt Memorandum, PTI salespersons repeatedly told consumers that their proposed inventions would earn huge sums.

PTI buttressed its earnings claims by emphasizing, in sales literature and telemarketing, that, through its "licensing affiliate" United Licensing, it derived substantial income in royalties from successful consumer inventions. PTI also bolstered its earnings claims by prominently featuring items from reputable companies such as Conair's Cord-Keeper hair dryer and Zelco's "Itty Bitty Booklight" on its website, even though officials with these corporations said the inventions were developed by their own employees, that the companies paid no licensing or distribution fees to PTI or United Licensing, and that they did not authorize the promotion of their products on PTI's website. FTC 15 ¶¶ 6, 7, 9, 10, PX1523-PX1524; FTC 16 ¶¶ 4, 5, PX1528.

The earnings claims were false. Gumpel admitted to the Receiver that United Licensing never earned income from any source and that it had not successfully negotiated any licensing agreements for any PTI customers. FTC 26 ¶ 8, PX3132. Moreover, Gumpel admitted he was not aware of any consumers who had profited as a result of corporate contempt defendants'

services. FTC 25 ¶ 5, PX3127 (reflecting that Gumpel did not keep track of whether PTI customers obtained licensing agreements through sources other than United Licensing).

In addition to making false earnings claims, PTI falsely represented that it assessed the merit, marketability, and patentability of inventions. In the survey of 265 clients of PTI conducted by the Receiver, 90 percent answered “yes” to the question, “Did a representative of the company indicate that they assess or evaluate the market potential, patentability, technical feasibility or merit of your idea?” FTC 26 ¶ 10(b), PX3133. This assessment, as set out in the Gumpel Contempt Memorandum, was supposed to occur at two levels. First, PTI claimed that it screened each initial submission and rejected many if not most of them, approving only “viable” proposals that satisfied “strict criteria.” Second, PTI promised to provide an objective, thorough evaluation of inventions to consumers who purchase “Phase I” reports. In fact, both the initial screening and Phase I reports were merely vehicles for further sales.

Gumpel himself admitted to the Receiver that at the initial screening stage, more than 80 percent of submissions were approved. *Id.* ¶ 7(a), PX3131. Moreover, as detailed in the Gumpel Contempt Memorandum, PTI’s initial “screening” process approved even ideas with obvious flaws, such as the submission, by an undercover investigator, of a “safety” turkey fryer that employed high-pressure water to suppress an oil fire. FTC 19 ¶ 7(c), PX2383; *Id.*, PX3021-PX3022.

Consumers who purchased the Phase I report were promised a “complete, objective, and honest evaluation” that would examine ideas “from an *unemotional*, more critical viewpoint.” *See, e.g.*, FTC 4 ¶ 5, PX0083; *Id.*, PX0106 (emphasis in original). In fact, the Phase I report invariably provided a positive assessment, as indicated on a 5-point rating system. In an

interview with the Receiver, Gumpel said that PTI recommended “Phase II” services for all invention ideas for further development that received a score of 2.25 or higher. FTC 26 ¶ 7(b), PX3132. The FTC reviewed 90 Phase I reports obtained from imaging Gumpel’s hard drive. All but two had a score above 2.25, and the vast majority had scores above 3.0. FTC 23 ¶ 4, PX3066. Similarly, former sales consultant Paul Kokoris stated that every report he saw in five years at PTI provided a positive assessment. FTC 3 ¶12, PX0028-29.

These uniformly positive results demonstrate that PTI did not provide a true assessment of inventions. In this regard, Gerald Udell, a professor of marketing and an expert in invention assessment at Missouri State University who has been retained by the Commission, states that only a very small percentage of inventions succeed, and that this percentage is even smaller for the very preliminary “invention ideas” commonly submitted to invention assessment companies. FTC 17 ¶ 9, 12, PX1536-37, PX1541. Thus, any assessment process that always or nearly always recommends further development fails, by definition, to provide an objective evaluation of inventions. As further described in the Gumpel Contempt Memorandum, Udell also found that the Phase I reports failed to consider key criteria and consisted largely of irrelevant and potentially misleading boilerplate.

Although the Phase I reports failed to provide valid assessments, they served PTI’s purpose of serving as a launching pad for selling Phase II services, which ranged in cost from \$5,000 to \$40,000.⁵ Once the Phase I report was issued, either the original salesperson or a

⁵ Former sales consultant Kokoris stated that the Phase I report’s main purpose was to promote sales of Phase II services, FTC 3 ¶ 12, PX0028-29, a point underscored by an internal PTI memo that emphasizes using reports to increase “conversions” to Phase II sales. *Id.*, PX0036.

“closer” called to congratulate the consumer on the report’s results, claiming PTI had particularly selected the invention for further development. In fact, PTI attempted to sell Phase II services to all Phase I purchasers.

A key part of the Phase II sales pitch was PTI’s promise that consumers who purchased this phase would receive patenting services and representation at trade shows by PTI’s “affiliate,” United Licensing. PTI representatives used the “no cost” benefit of trade show representation as an inducement to sell patenting services. FTC 4 ¶¶ 5, 7, 8, PX0083-84; *Id.*, PX093, PX0101, PX0111, PX0141-42. Specifically, PTI representatives told consumers it was essential to pay for Phase II immediately so that their inventions could be included in upcoming trade shows, at which United Licensing would seek licensing agreements on their behalf.

However, after consumers paid for Phase II services, PTI virtually disappeared. First, consumers lost the ability to reach any live person at PTI. Indeed, phone messages were not returned. FTC 11 ¶ 8, PX1016-PX1017; FTC 9 ¶ 8, PX0812; FTC 4 ¶ 10, PX0085; FTC 8 ¶ 11, PX0458.

Second, the promise of active trade show representation was false. Fleisher, who attended all trade shows in the United States on behalf of United Licensing, admitted that he did not even bring information about particular inventions to the trade shows, nor did he discuss particular inventions with manufacturers’ representatives. FTC 28, PX3294, PX3295-96. Instead, he simply obtained the names and addresses of manufacturers that were *generally* interested in reviewing product ideas. *Id.*, PX3296, PX3310-11. Form letters were then sent out to consumers advising them of a manufacturer’s purported interest. *Id.*, PX3283-84

(acknowledging that trade show letter was a “form letter”). Given this deceptive practice, it is not surprising that such contacts did not bear fruit for consumers.

Third, patenting services often proved illusory. After consumers paid several thousand dollars for such services, it took several months – and in some cases years – before consumers were even contacted by an attorney. FTC 9 ¶ 15, PX0813 (two-year wait); FTC 6 ¶ 11, PX0458; FTC 10 ¶¶ 9-10, PX906. When consumers finally heard from an attorney by letter, the attorney usually did not even provide a telephone number. FTC 9 ¶ 15, PX0813; FTC 6 ¶¶ 10-12, PX0458; FTC 10 ¶¶ 9-10, PX0906. Often, consumers learned that their ideas were not unique and had already been patented. *See, e.g.*, FTC 4 ¶¶ 7, 11, 17, PX0083-84, 86; *Id.*, PX0187; FTC 10 ¶¶ 5, 12, PX0904-05, 07; *Id.*, PX1000-06; FTC 11 ¶ 14, PX1018.

In many instances, PTI referred this patenting “work” to “Aaron’s & Fleisher.” Unfortunately, Aaron’s & Fleisher did not provide the high quality legal service that PTI had promised in its sales materials. In fact, as further discussed below, Aaron’s & Fleisher was a one-man operation run out of PTI’s Las Vegas office by Fleisher, who is neither an attorney nor a registered patent agent.

Significantly, one communication was conspicuously absent from the aggressive sales pitches, both oral and written, made by PTI to consumers: the Affirmative Disclosure required by the Stipulated Order. In an interview with the Receiver, Gumpel admitted that PTI did not use the Affirmative Disclosure. FTC 25 ¶ 4, PX3127.

B. Violations by Fleisher, Mormando, and Wilson

1. Michael Fleisher

Fleisher, like Gumpel, Mormando, and Wilson, has a long history with this case; he

started as a salesperson for original defendant International Product Design, Inc. (IPD) in 1991, FTC 28, PX3267, and ended up as second in command to Gumpel at PTI. IPD consultants sold the same two-phase scheme that was later sold by PTI: 1) a bogus, written evaluation of a consumer's invention idea; and then 2) promotion of the idea to industry through trade show representation. *Id.*, PX3269.

Fleisher admitted in his deposition that he was working for IPD and serving as an officer of AIA at the time of the original case.⁶ Correspondence found in his office, including a letter signed by Fleisher as AIA's vice president to the California Secretary of State, shows that he was vice president of AIA during the original FTC litigation. FTC 27, PX3263, PX3264. Although he claims not to recall the Stipulated Order itself, he admitted recalling that the FTC brought the initial proceedings in this case, that AIA was a named defendant, and that it was ordered to pay consumer redress. FTC 28, PX3271-72, PX3285 (named as defendant). Indeed, he even recalled administering the Order's redress fund. *Id.*, PX3272. Moreover, a draft copy of the Stipulated Order, as well as a cover letter from an FTC attorney to the counsel for AIA in the original litigation, was found in Fleisher's personal office in the Las Vegas office of PTI. The draft order was attached to a cover letter from David Fix, counsel for the FTC in the original litigation, to Mark Davidson, counsel for AIA. FTC 27 ¶ 16, PX3165; *Id.*, PX3247. The draft included the

⁶ AIA split into two companies during the pendency of the initial proceedings. Both companies kept the name "American Invention Associates," but one was based in Florida while the other was based in Troy, Michigan. The Florida AIA was eventually dismissed, see Docket Entry 60 ("Notice of Dismissal"), while AIA of Michigan remained in the case and entered into the November 18, 1998 Stipulated Permanent Injunction at issue in these proceedings. See FTC 2, PX0022 (reflecting Mormando's signature as "authorized representative of American Invention Associates, Inc. (Troy Michigan [sic])"). For purposes of this motion "AIA" refers to the Michigan AIA and its predecessor corporation.

same conduct prohibitions as the final version and also required affirmative disclosure of the company's track record. *Id.*, PX3251-53.⁷

After entry of the Stipulated Order, Fleisher continued to work for the business after it "changed" to PTI. FTC 28, PX3270. Fleisher, known as PTI's "head coach," *Id.*, PX3290, served as operations manager for PTI and United Licensing Corp. *Id.*, PX 3273, PX3293. As operations manager for PTI and United Licensing, Fleisher was consulted on major decisions affecting the business, speaking with Gumpel multiple times per week. *Id.*, PX3291. Fleisher also supervised all consultants, making recommendations on whether to discipline or terminate them if they failed to meet expectations, *Id.*, PX3274-75, PX3276, and determining which consultants would be promoted. *Id.*, PX3277.

In addition to supervising contumacious behavior, Fleisher personally made misrepresentations to consumers. For example, in selling a Phase I report, he told consumer Benjamin Stevens that his idea was a unique, patentable "winner" that PTI wanted to take to trade shows. FTC4 ¶ 4, PX1151. Fleisher also told Stevens that PTI made its money through royalties of successful inventions. *Id.*

Fleisher knew these claims were false. In his work for United Licensing Corp., Fleisher ostensibly attended trade shows on behalf of PTI consumers. However, as noted above, Fleisher did not actually bring consumer ideas with him to the trade shows. Instead, he simply asked

⁷ While the FTC has not yet discovered a copy of the final, signed Stipulated Order in Fleisher's files, he should have received a copy of the Order when he started working at PTI, as Section IV of the Order required Gumpel to distribute copies to all PTI personnel in management and sales positions. FTC 2, PX0016-17.

representatives of manufacturers whether they would review new product ideas if submitted to them. FTC 28, PX3295-96, PX3297.

Fleisher's participation in the fraud did not end with sale of Phase II. He also received much of PTI's patenting "work" as the sole employee, officer, and director of a corporation called "Aaron's & Fleisher." *Id.*, PX3299. In this regard, PTI promised in its Phase II contracts that consumers would be "refer[red] . . . to a registered Patent Attorney/Agent" for patenting services." *See, e.g.*, FTC 7 ¶ 10, PX0564; *Id.*, PX0640 (reflecting that as part of the services offered in "Plan-2," "PTI will provide referred attorney with all documents relating to inventor's ideas . . . , upon inventor's approval of referred attorney"). However, following purchase of Phase II, PTI often forwarded that consumer's file to Fleisher for preparation of the provisional application. *See, e.g.*, FTC 22 ¶ 12, PX3033; *Id.*, PX3036 (email from PTI employee to Fleisher), PX3037-65 (attachments to email); FTC 6 ¶ 10, PX0458. Aaron's & Fleisher communicated with consumers exclusively by mail, sending letters claiming that it would file the provisional patent application. FTC 6 ¶ 10, PX0458; *Id.*, PX0554. However, Fleisher admitted at his deposition that he is neither an attorney nor a registered patent agent, FTC 28, PX3298, and he invoked his Fifth Amendment right against self-incrimination when asked about Aaron's & Fleisher's business practices. *Id.*, PX3301-09.

Fleisher received more than \$2.3 million from his contumacious conduct. According to an analysis by the Receiver, since 2000, Fleisher, who received a percentage of PTI's gross sales, was personally paid \$1,379,447 by PTI, while he received another \$1,084,564 through Aaron's & Fleisher. FTC 26 ¶ 6, PX3131; *Id.*, PX3139, PX3150.

2. Darrell Mormando

Mormando has deceptively marketed invention promotions and managed deceptive marketing by others for well over a decade. As discussed below, he played a crucial role in Gumpel's business by serving as a senior sales consultant and managing the Reno, Nevada sales office, for which he received millions in compensation.

Mormando's involvement in fraudulent invention promotion schemes dates to at least the 1990s, when he worked as a sales consultant for, and eventually became president of, original defendant International Product Design, Inc. (IPD). FTC 28, PX3279; FTC 2, PX0022 (signing Stipulated Order as "President" of IPD). In 1997, the FTC brought suit against Mormando, and he subsequently signed the Stipulated Order in his individual capacity, and as president of IPD and two other original defendants (now contempt defendants): London Communications, Inc. ("LCI") and Azure Communications, Inc. ("Azure"). FTC 2, PX0022.

However, by the time the Stipulated Order was entered in November 1998, Mormando had already sold LCI and Azure to Gumpel as part of a reorganization of the business into PTI. A contract for the sale found in Gumpel's office at PTI's New York headquarters specifically provided that Mormando would remain with the business as both a sales consultant and as manager of the Reno, Nevada office. FTC 26 ¶ 4, PX3131; *Id.*, PX3136. In fact, he served in both capacities until the business was placed in receivership in January of 2007.⁸ FTC 28, PX3279. Mormando's duties as manager of the Reno office included supervising sales

⁸ Although Gumpel operated his invention promotion business through some new corporate entities, such as PTI, it was understood that these entities were simply a continuation of the old business. FTC 28, PX3270 (reflecting Fleisher's understanding that IPD "changed [its] name" to AIA, and then to PTI).

consultants working out of that office. *Id.*, PX3280. As detailed above and in the Gumpel Contempt Memorandum, these consultants engaged in conduct violating Sections I(1) and I(3) of the Stipulated Order by falsely representing that PTI evaluates invention ideas and by promising consumers that they would profit financially from PTI's invention promotion services.

Furthermore, the Reno office mailed promotional materials to consumers, but did not mail the Affirmative Disclosure Statement required by Section II of the Order. *See* FTC 28, PX3281 (stating that nothing besides initial, promotional "kits" were sent from the Reno office).

Mormando not only supervised order violations; he also affirmatively engaged in them as a sales consultant. Using the alias of "Darrell Johnson," *id.*, Mormando sold both Phase I and Phase II invention promotion services to consumers. As part of selling the Phase I report, Mormando would have instructed PTI to send letters to consumers describing the report as an "objective and honest evaluation" of their ideas, and that the assessment would be from an "*unemotional*, more critical viewpoint" *See, e.g.*, FTC 4 ¶ 5, PX0083; *Id.*, PX0106 (emphasis in original). After the invariably positive reports were sent to consumers, Mormando then tried to persuade them to purchase patenting and trade show services for their purportedly marketable product. Indeed, in selling Phase II, Mormando sent letters to consumers asking, "Would you like to receive a nice royalty check every month?" FTC 22 ¶ 12, PX3033; *Id.*, PX3034.

Mormando received millions of dollars taken from defrauded consumers. Since 2000, Mormando has received at least \$2,114,146 in compensation from PTI. FTC 26 ¶ 6, PX3131; *Id.*, PX3151. Mormando funneled this money through a shell entity, "Neverland Corporation,"

for which he is the sole officer. FTC 19 ¶ 3(a)(vii)(4), PX2379; *Id.*, PX2994-95 (checks to Neverland “c/o Darrell Mormando”); FTC 24 ¶ 2, PX3118; *Id.*, PX3120-21.

3. Greg Wilson

Much like Mormando, Wilson worked as a consultant and officer of an original defendant, signed the Stipulated Order, and then continued to engage in deceptive marketing practices as an employee of Gumpel. Also like Mormando, Wilson has funneled more than a million dollars in consumer funds through a shell corporation.

In the 1990s, Wilson was a salesperson for IPD, peddling the worthless invention promotion services described above. FTC 28, PX3292. In 1997, the Commission sued Wilson in his individual capacity and as Vice President of Invention Consultants, USA, Inc. Wilson signed the Stipulated Order in both capacities. FTC 2, PX0022.

Despite signing the Order, Wilson continued to work as a senior sales consultant for the business after it was sold to Gumpel. His work for PTI continued until at least December 2006. FTC 28, PX3282. Working with Mormando in the Reno office, Wilson sold invention promotion services to consumers using PTI’s standard, deceptive, and order-violative techniques. His efforts included arranging for consumers to be sent letters representing that the Phase I reports were “honest,” “objective,” and “unemotional” evaluations of invention ideas. *See, e.g.*, FTC 4 ¶ 5, PX0083; *Id.*, PX0106 (emphasis in original). He also sent consumers letters asking them if they wanted to receive royalty checks. FTC 22 ¶ 12, PX3033; *Id.*, PX3035.

As a senior consultant, Wilson directly supervised several “report consultants,” who sold violative assessments to consumers. These assessments and other written communications failed to include the required Affirmative Disclosure. FTC 25 ¶ 4, PX3127.

PTI richly rewarded Wilson for his contumacious behavior. Since 2000, PTI paid at least \$1,029,835 to a corporation called Noyta, Inc., of which Wilson is president. See FTC 26 ¶ 6, PX3131; *Id.*, PX3151 (total amount paid); FTC 19 ¶ 3(a)(vii)(1), PX2379; *Id.*, PX2988 (check to Noyta “c/o Greg Wilson”); FTC 24 ¶ 3, PX3118; *Id.*, PX3123-25.

III. LAW AND DISCUSSION

“It has long been recognized that federal courts have inherent jurisdiction to protect and enforce their orders and judgments.” *Roadtechs, Inc. v. MJ Hwy. Tech., Ltd.*, 83 F. Supp.2d 677, 685 (E.D. Va. 2000) (citing *Riggs v. Johnson Co.*, 73 U.S. (6 Wall.) 166, 187 (1867)). As a party to the original action, the Commission may invoke the Court’s order-enforcement power by initiating a proceeding for civil contempt in the same action. *Gompers v. Bucks Stove & Range Co.*, 221 U.S. 418, 444-45 (1911). Once the Commission establishes by clear and convincing evidence that Fleisher, Mormando, and Wilson have knowingly violated the Court’s Order, the burden shifts to them to produce evidence showing why they were unable to comply with the Order. *United States v. Butler*, 211 F.3d 826, 832 (4th Cir. 2000); *FTC v. Affordable Media*, 179 F.3d 1228, 1239 (9th Cir. 1999).

As shown below in Section III.A, clear and convincing evidence in this case establishes that Fleisher, Mormando and Wilson had notice of the Stipulated Order and have violated several of its provisions. In addition, as discussed in Section III.B, Fleisher, Mormando and Wilson should be required to provide monetary relief to consumers harmed through their contumacious conduct.

A. All of the New Contempt Defendants are in Contempt.

The Commission has established each of the elements of contempt by clear and convincing evidence. The elements of contempt are:

(1) the existence of a valid decree of which the alleged contemnor had actual or constructive knowledge; (2) . . . that the decree was in the movant's "favor"; (3) . . . that the alleged contemnor by its conduct violated the terms of the decree, and had knowledge (at least constructive) of such violations; and (4) . . . that [the] movant suffered harm as a result.

JTH Tax, Inc. v. H&R Block E. Tax Servs., Inc., 359 F.3d 699, 705 (4th Cir. 2004) (quoting *Ashcraft v. Conoco, Inc.*, 218 F.3d 288, 301 (4th Cir. 2000) and *Colonial Williamsburg Found. v. The Kittinger Co.*, 792 F. Supp. 1397, 1405-06 (E.D. Va. 1992)) (alteration in original), *aff'd* 38 F.3d 133 (4th Cir. 1994).

1. The New Contempt Defendants Have Knowledge of the Order.

Rule 65(d) specifically provides that injunctions are binding on both parties to an action and persons or entities "in active concert or participation with them who receive actual notice of" them. FED. R. CIV. P. 65(d). "Actual notice," however, need not be through personal service. *See id.* (providing that "notice of the order" may be "by personal service or otherwise"). Rather, "actual notice" "is derived from the common law doctrine that a decree of injunction not only binds the parties defendant but also those . . . subject to their control. In essence it is that defendants may not nullify a decree by carrying our prohibited acts through aiders and abettors, although they were not parties to the original proceeding." *Regal Knitwear Co. v. NLRB*, 324 U.S. 9, 14 (1945). Moreover, "actual notice" is notice of the Order's existence, not of its precise terms. *See Perfect Fit Indus., Inc. v. Acme Quilting Co.*, 646 F.2d 800, 808 (2d Cir. 1981).

Fleisher, Mormando and Wilson have actual notice of and are bound by the Stipulated Order. Mormando and Wilson have notice because they are signed parties to the Order. *SEC v. Current Fin. Servs., Inc.*, 798 F. Supp. 802, 806 n.11 (D.D.C. 1992) (assuming that parties to the action had notice of its orders). Fleisher, though not a signed party, also has notice. He served as Vice President of AIA, an original corporate defendant, during the initial proceedings. As discussed above in Section II.B.1, Fleisher was aware of the litigation and participated in the consumer redress process. Moreover, a draft of the Stipulated Order containing the same conduct prohibitions as the final version was discovered in his personal office. This is more than sufficient to demonstrate that Fleisher had notice of the Order's existence.

2. The Permanent Injunction was in the Commission's Favor.

The terms of the injunction favored the Commission, and the injunction explicitly contemplated that the Commission would be able to invoke this Court's jurisdiction to ensure compliance with it. Injunctions, even those entered with the consent of all parties, are in a party's "favor" for purposes of civil contempt when their terms constrain or place requirements on the other party. *Roadtechs*, 83 F. Supp.2d at 685-86 (consent order was in movant's favor because it restrained defendant's behavior in relation to plaintiff); *Colonial Williamsburg Found.*, 792 F. Supp. at 1406 (same).

Here, the injunction specifically prohibits Gumpel, Mormando, Wilson, and anyone, such as Fleisher, acting with notice and in concert with them, from making certain misrepresentations to consumers in marketing invention promotion services or making any other misrepresentation "material to a consumer's decision to purchase invention promotion services." FTC 2, PX0014. The injunction also requires that specific affirmative disclosures be made to consumers.

Moreover, the Order gives the Commission authority to monitor compliance and, if necessary, to invoke this Court's jurisdiction if its terms are violated. Section III of the Order required the corporate defendants to keep certain records relating to their invention promotion business, and Section V authorized the Commission to review defendants' records and interview their employees upon seven days' notice.

Most significantly, Section XI provided that this Court would retain jurisdiction for purposes of enforcement of the Order – specifically contemplating a contempt action by the Commission. In sum, the Permanent Injunction was entered in favor of the Commission with the intent to prevent Gumpel, Mormando, Wilson, and those, such as Fleisher, acting in concert with them from misleading consumers.

3. The New Contempt Defendants Have Violated and are Continuing to Violate the Order.

In order to show a “knowing” violation of the Order, the Commission need not show that Fleisher, Mormando, and Wilson willfully or intentionally violated its terms. *In re General Motors*, 61 F.3d 256, 258 (4th Cir. 1995) (“Willfulness is not an element of civil contempt.”). Instead, all the Commission need show is that they have violated the order and that they had constructive knowledge of the violations. *Colonial Williamsburg Found.*, 792 F. Supp. at 1405. Constructive knowledge of a violation can be inferred by a contemnor taking affirmative steps in violation of the order. *Omega World Travel, Inc. v. Omega Travel, Inc.*, 710 F. Supp. 169, 170 (E.D. Va. 1989).

Fleisher, Mormando, and Wilson have repeatedly and egregiously violated the Stipulated Order. As discussed above, they have actively participated in a business that, as a matter of

course, misrepresents the likelihood that its services will result in financial gain to inventors, and falsely claims to assess the market potential, patentability, and merit of invention ideas. Indeed, they actively participated in PTI's scheme and exercised supervisory authority over salespersons making the false claims. In addition, despite having managerial authority, none of the New Contempt Defendants sent or directed anyone to send out the Affirmative Disclosure statement disclosing their dismal track record commercializing inventions, as required by Section II of the Order.

a) The New Contempt Defendants' Misrepresentations Regarding the Likelihood of Financial Gain to Consumers Violated Section I(1) of the Order.

Section I(1) of the order specifically forbids Gumpel, Mormando, Wilson, and those, like Fleisher, acting in concert with them, from misrepresenting "the likelihood that defendants' invention promotion services will result in financial gain for any customer." As shown in Section II (B) above, Fleisher,⁹ Mormando, and Wilson each exercised supervisory authority over sales persons making such representations as a matter of course, and each sent or approved sales materials describing royalty checks, licensing agreements, and active licensing negotiations that did not exist.

⁹ In addition, Fleisher's actions in regard to Aaron's & Fleisher violated Section I(7) of the Stipulated Order, which prohibits the misrepresentation of "any fact material to a consumer's decision to purchase invention promotion services." Fleisher oversaw the sale of Phase II contracts that promised referral of consumers' cases to independent patent attorneys, but he knew that in fact such consumers would be sent back to him in the guise of Aaron's & Fleisher. Whether a patent application would be handled by a licensed, independent professional or a PTI sales manager is material to consumer's determination of whether to purchase PTI's services.

b) The New Contempt Defendants' False Claims that PTI Evaluated Invention Ideas Violated Section I(3) of the Order.

Section I(3) of the Stipulated Order prohibits Gumpel, Mormando, Wilson, and those acting with notice and in concert with them, from “[f]alsely representing, directly or by implication, that [they] assess or evaluate the market potential, patentability, technical feasibility, or merit of ideas submitted by any customer.” As demonstrated in Section II.B above, in selling the Phase I report, Mormando and Wilson represented to consumers that they would receive an “honest” and “objective” evaluation of their idea. Fleisher was responsible for these written statements as head of the sales force. However, the Phase I reports consistently recommend further development of those ideas, regardless of their merit. Furthermore, Dr. Udell concluded that the reports are not at all helpful to inventors as evaluations because they failed to consider critical factors necessary to determining whether an invention idea warranted further development. Finally, Fleisher, Mormando and Wilson all supervised sales persons that routinely made false representations regarding PTI’s purported evaluations of consumer invention ideas.

c) The New Contempt Defendants Failed to Make the Affirmative Disclosure Required by Section II of the Order.

Section II of the Stipulated Order requires Gumpel, Mormando, Wilson, and those acting with notice and in concert with them, to include in the initial materials sent to each consumer “two copies of a separate Affirmative Disclosure Statement regarding the difficulties of invention promotion . . . in the form of Appendix A” Stipulated Order, Section II. Appendix A to the Order requires disclosure of, among other things, the business’ track record in commercializing

invention ideas. In interviews with the Receiver, Gumpel has admitted that his business never sent out this disclosure.

As discussed in Section II.B above, none of the New Contempt Defendants sent or directed anyone to send the Affirmative Disclosure document to consumers. This violated Section II of the Stipulated Order. Given that the Affirmative Disclosure would have revealed PTI's complete lack of success in helping other consumers to commercialize their inventions, this failure also violated Section I(7) of the Order, which prohibits the misrepresentation, directly or by implicated, of "any fact material to a consumer's decision to purchase invention promotion services."

d) The New Contempt Defendants Have Facilitated Gumpel's Order Violations.

In addition to their direct violations, Fleisher, Mormando and Wilson have facilitated Gumpel's violations of the Stipulated Order's core provisions through their supervisory roles in the business. "[I]t has long been recognized that a nonparty may be held in civil contempt if, and to the extent that, he knowingly aids or abets an enjoined party in transgressing a court order." *Goya Foods, Inc. v. Wallack Mgmt. Co.*, 290 F.3d 63, 75 (1st Cir. 2002).¹⁰ Fleisher, Mormando and Wilson all helped Gumpel by ensuring that his salespersons were effective in deceiving consumers, in violation of Sections I(1) and I(3) of the Order. In addition, their inaction facilitated Gumpel's refusal to provide consumers with the disclosure statement required by Section II of the Order.

¹⁰ In *Goya Foods*, the alleged contemnors had facilitated a party's sale of property subject to an asset freeze. The court upheld the finding of contempt against the third parties (including an unrelated purchaser) because they knew of the decree and participated in actions that violated it. *Id.* at 76.

4. **The Commission is Harmed by Defendants' Violations.**

The Commission is harmed by the acts of Fleisher, Mormando and Wilson because their violations of the Stipulated Order harm consumers. "Congress established the FTC at least in part 'to protect consumers from economic injuries.'" *FTC v. Kuykendall*, 371 F.3d 745, 753 (10th Cir. 2004) (quoting *FTC v. Febre*, 128 F.3d 530, 536 (7th Cir. 1997)). The Commission is therefore justified in seeking civil contempt for violation of an order that provided for consumer redress and for "ongoing regulation of the defendants' business practices" where those regulations were intended in part to prevent further consumer injury. *Id.* at 753-54; *see also SEC v. Dowdell*, No. 301CV00116, 2002 WL 31248028, at *2 (W.D. Va. Sept. 30, 2002) (holding in civil fraud case that "the fourth element - that movant suffered harm as a result - can be easily disposed of in favor of' the SEC"); *cf. SEC v. Moss*, 644 F.2d 313, 316 (4th Cir. 1981) (affirming district court's grant of public agency's petition for civil contempt against defendant for failure to comply with consent judgment).

B. The New Contempt Defendants Should Be Liable for Any Compensatory Sanctions Imposed in the Final Contempt Order.

As set forth in Section III.B of the Contempt Memorandum, which is herein incorporated by reference, the final contempt order should provide for civil sanctions to compensate the victims of contempt defendants' invention promotion scheme, and the monetary relief should be entered jointly and severally since each defendant is responsible for the repeated Order violations. *NLRB v. AFL-CIO*, 882 F.2d 949, 955 (5th Cir. 1989) ("Where . . . parties join together to evade a judgment, they become jointly and severally liable for the amount of damages resulting from the contumacious conduct."); *Colonial Williamsburg Found.*, 792 F. Supp. at

1406 (holding contempt defendants jointly and severally liable because all defendants had actively violated consent judgment). Like Gumpel and the corporate contempt defendants, Fleisher, Mormando, and Wilson are likewise responsible for repeated Order violations; therefore, they too should be held liable for any monetary sanctions imposed by the Court.

C. A Hearing Is Not Necessary Prior to Issuing Show Cause Order.

Although the Commission has noticed a hearing on this motion for March 9, 2007, it respectfully requests, in the interests of judicial economy, that the Court dispense with the motion hearing and instead issue the proposed Show Cause Order, which compels Fleisher, Mormando, and Wilson to appear on March 13, 2007,¹¹ to show cause why they should not be held in contempt. The clear and convincing evidence set forth above establishes a *prima facie* case of contempt, shifting the burden to Fleisher, Mormando, and Wilson to demonstrate that they have not violated the Stipulated Order. *Chicago Truck Drivers Union Pension Fund v. Brotherhood Lab. Leasing*, 207 F.3d 500, 505 (8th Cir. 2000). Therefore, the issues raised in the instant motion can be resolved at a single, show cause hearing.

¹¹The proposed order sets the show cause hearing for March 13, 2007, the same day currently scheduled for the contempt hearing for Gumpel and the eight corporate contempt defendants. Conducting a joint hearing as to all contempt defendants will avoid duplication of judicial resources. However, given the short amount of time before the show cause date, the Commission will not oppose a timely filed request from Fleisher, Mormando, or Wilson for a brief continuance of the March 13, 2007 hearing.

V. CONCLUSION

For all of the reasons stated above, the Commission requests that its motion be granted.

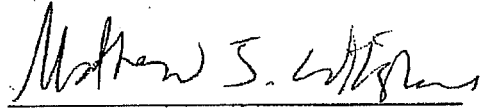
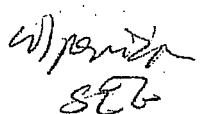
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