

CAUSE No. _____

STATE OF TEXAS,
Plaintiff,

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IN THE DISTRICT COURT OF

v.

HARRIS COUNTY, TEXAS

NORVERGENCE, INC.
Defendant.

_____ JUDICIAL DISTRICT

**PLAINTIFF'S ORIGINAL PETITION
AND REQUEST FOR INJUNCTIVE RELIEF**

Plaintiff, STATE OF TEXAS, acting by and through the Attorney General of Texas, Greg Abbott's Consumer Protection Division, complains of NORVERGENCE, INC. ("Defendant") and for cause of action would respectfully show as follows:

DISCOVERY CONTROL PLAN

1. The discovery in this case is intended to be conducted under Level 2 pursuant to Tex. R. Civ. P. 190.2(b)(3); 190.3(a).

JURISDICTION AND VENUE

2. This action is brought by Attorney General Greg Abbott, through his Consumer Protection Division, in the name of the State of Texas and in the public interest under the authority granted him by § 17.47 of the Texas Deceptive Trade Practices-Consumer Protection Act, Tex. Bus. & Com. Code Ann. § 17.41 et seq. (Vernon 2002 and Supp. 2004) ("DTPA") upon the ground that Defendant has engaged in false, deceptive and misleading acts and practices in the course of trade and commerce as defined in, and declared unlawful by, §§ 17.46(a) and (b) of the DTPA.

3. Venue is proper in Harris County because, although Defendant is headquartered in New Jersey, it had offices in Houston and Dallas and marketed telecommunications services to small businesses with good credit ratings in Texas. It was forced into Chapter 11 bankruptcy by its creditors this past summer and the case was converted to Chapter 7 liquidation. Pursuant to 11 USC 362(b)(4), the commencement or continuation of an action or proceeding by a governmental unit to enforce that unit's police or regulatory powers is not stayed by the bankruptcy proceeding.

4. Defendant is a New Jersey corporation with its principal place of business located at 550 Broad Street, Newark, New Jersey. NorVergence is in Chapter 7 bankruptcy in Docket 04-32079-RG in Newark, New Jersey and can be served through its Chapter 7 Trustee, Charles Forman, at Forman, Holt & Eliades, L.L.C., 218 Route 17 North, Rochelle Park, NJ, 07662.

DEFINITIONS AND PREREQUISITES TO SUIT

5. The DTPA (Section 17.45(1)) defines "goods" as meaning tangible chattels or real property purchased or leased for use.

6. Section 17.45(2) defines services as work, labor or service, purchased or leased for use, including services furnished in connection with the sale or repair of goods.

7. Section 17.45(4) defines consumer and includes an individual, partnership or corporation who seeks or acquires by purchase or lease any goods or services unless a business consumer has assets of \$25 million or more.

8. Section 17.45(6) defines trade and commerce as meaning the advertising, offering for sale, sale, lease, or distribution of any good or service.... tangible or intangible... wherever situated, and shall include any trade or commerce directly or indirectly affecting the people of this state.

9. Section 17.47 authorizes the consumer protection division to seek injunctive relief

and civil penalties, as well as to obtain restitution for identifiable persons. It also has a provision for informing potential Defendants of the allegations against them.

TRADE AND COMMERCE

10. Defendants have, at all times described below, engaged in conduct which constitutes "trade" and "commerce" as those terms are defined by DTPA § 17.45(6).

ACTS OF AGENTS

11. Whenever in this Petition it is alleged that Defendants did any act, it is meant that:

- A. Defendants performed or participated in the act, or
- B. Defendants' officers, agents, or employees performed or participated in the act on behalf of and under the authority of Defendant.

NOTICE BEFORE SUIT

12. The Consumer Protection Division informed Defendants in general of the alleged unlawful conduct described below, at least seven days before filing suit, as may be required by § 17.47(a) of the DTPA.

DEFENDANT'S BUSINESS ACTIVITIES

13. NorVergence's principal business since at least 2002, and continuing until shortly before its bankruptcy filing in July 2004, has been reselling telecommunications services, purchased from common carriers or others, principally to small businesses, non-profit organizations, and churches. (Exhs. 3, 4 [para. 2] & 5 [para. 2]). NorVergence marketed its services as integrated, long-term packages, including landline and cellular telephone service and Internet access. (Exhs. 1-5).

14. NorVergence marketed itself as "Drastically Reducing Telecommunications Costs." (Exhs. 4 [para. 3], 5 [para. 3]). It marketed its telecommunications service packages to small businesses. (Exhs. 4 [para. 2], 5 [para. 2]). It represented to these small businesses that they had been specially selected for a limited offer of discount services. [Exh. 1]. It set its price for the service packages without regard to its cost of providing the services, which was likely to be much higher. [Exhs. 4 [para. 5], 5 [para. 5]]. Instead, it set a price based on a discount, usually 30%, from the amount the customer was previously paying for those services. (Exhs. 1, 3, 4 [para. 3 & 5], 5 [para. 3 & 5]). It also typically promised unlimited free minutes for both long distance and cellular calls at no extra cost. (Exhs. 1, 3, 4 [para. 2], 5 [para. 2]). The promised savings were laid out in writing so the customer could see what it would be paying and saving on a monthly and annual basis.

15. NorVergence explained to the customers that NorVergence could produce the dramatic savings and free minutes by installing a "black box" on the customer's premises. (Exhs. 4 [para. 3], 5 [para. 3]). The most commonly offered black box was called the Matrix (or Matrix 850), and would supposedly route telecommunications in a manner to provide the savings. (Exhs. 4 [para. 3], 5 [para. 3]). NorVergence's contract with its principal supplier of the Matrix set a price of \$1,500 for the box, although there are reports that the typical market price may have been as low as \$500. (Exh. 3).

16. In fact, the Matrix was a standard integrated access device, or IAD, commonly used to connect telephone equipment to a long-distance provider's T-1 or similar data line. It is wholly unrelated to cellular phone access. It does not establish or change the costs of the long distance service significantly, if at all. (Exhs. 4 [para. 4], 5 [para. 5]). It cannot provide unlimited minutes, and NorVergence was actually obligated to pay its own suppliers, Qwest Communications

Corporation, Sprint Communications Company, and T-Mobile, USA, on a per minute basis. (Exhs. 4 [para. 7], 5 [para. 7]).

17. Some of NorVergence's customers were offered a Matrix Soho, a smaller device that is a standard firewall/router used to access Internet services. It did not provide access to telephone or cell phone services. NorVergence typically paid under \$350 for each Matrix Soho it provided to its customers.

18. NorVergence procured customers' signatures on a set of forms, including "non-binding applications" for services and a "rental agreement." (Exhs. 4 [para. 6], 5 [para. 6]). The papers were presented by the sales people, called "screening managers" in such a manner so that the consumers became used to signing applications and non-binding agreements and then were essentially "slipped" the rental agreement, with its more onerous provisions, last, or they were told they needed to sign the rental agreement before the equipment was installed so they could get the promised services. (Exhs. 4 [para. 6], 5 [para. 6]). The NorVergence sales people told customers they were signing up for long-term telecommunications services. In fact, what the customer usually received was a cancellable, price-variable service agreement or commitment, and a purportedly non-cancellable "rental agreement." The only piece of equipment listed on the rental agreement was the Matrix box. (Exhs. 4 [para. 5], 5 [para. 5]).

19. Most of the customer's payment was allocated to the rental agreement for the Matrix (or similar product). (Exhs. 4 [para. 5], 5 [para. 5]). Service applications or agreements signed at the same time as the rental agreement were for a small fraction of the rental amount and were unrelated to the actual costs of providing the telecommunications services.

20. While the market price of the various Matrix boxes has been reported to be between \$350 and \$1,500, NorVergence rental agreements for the Matrix varied greatly. (Exhibits 4 [para. 5], 5 [para. 5]). Texas consumers complaining to this Office have reported payments from a few hundred to over \$1,000 a month for 60 months. (Exhs. 1-3). The rental agreements were titled simply "Rental Agreement," with the only indication that they were non-cancellable appearing in the fine print. The total cost to the customer was \$12,000 to over \$60,000 for "renting" this box. (Exhs. 4 [para. 5], 5 [para. 5]).

21. The price of the rental agreement had nothing to do with the cost of the Matrix. (Exhs. 4 [para. 5], 5 [para. 5]). In its sales documents, NorVergence tells consumers that an engineering department would calculate the cost of the box. (Exhs. 4 [para. 3], 5 [para. 3]). In fact, sales people were directed to calculate the amount the consumer would pay NorVergence for both the box and the service agreement so the total charge for telecommunications services NorVergence promised to provide would add up to 30% less than the customers' previous bills. (Exhs. 4 [para. 4], 5 [para. 5]). Most of the payments were loaded onto the "rental agreement." (Exhs. 4 [para. 5], 5 [para. 5]).

22. After obtaining the customer's signature on the various "non-binding" applications, forms, and the rental agreement, NorVergence sold or assigned the rental agreement to a third-party finance company, either for the full five-year term or for some part of that term. (Exhs. 4 [para. 9], 5 [para. 9]). The finance company paid NorVergence a discounted portion of the total rental price. The FTC believes that NorVergence received over \$200 million in upfront payments for the rental agreements it sold or assigned to various finance companies.

23. NorVergence included in the rental agreements various provisions that would make them more readily saleable to finance companies. For example, they contained so-called "hell or

high water" waiver of defenses clauses. These purport to require the customer to pay the full amount regardless of any fraud or deception perpetrated by NorVergence in making the original sale or in failing to provide the promised services. Typical language includes:

Your duty to make the rental payments is unconditional despite equipment failure, damage, loss or any other problem. If the equipment does not work as represented by the vendor, or if the vendor or any other person fails to provide any service, or if the equipment is unsatisfactory for any other reason, you will make any such claim solely against the vendor or other person and will make no claim against us.

In the example language above, the word "us" refers to the rentor, which could be NorVergence, a designated finance company, or an assignee not designated at the time of signing.

24. NorVergence's rental agreements also provided, in very fine print, that any disputes under the contract would be resolved in a forum distant from the customer's place of business and, in many cases, unknown at the time the customer signed the contract:

This agreement shall be governed by, construed and enforced in accordance with the laws of the State in which the Rentor's principal offices are located or, if the lease is assigned by Rentor, the laws of the state in which the assignee's principal offices are located, without regard to such State's choice of law considerations and all legal actions relating to this lease shall be venued exclusively in a state or federal court in that State, such court to be chosen exclusively at Rentor or Rentor's assignee's sole option.

In some cases, NorVergence may have made multiple assignments of the same contract, adding to the ambiguity of what law applied and in what forum a dispute might be brought. Moreover, even though, for contracts of \$50,000 or less, the Texas Business & Commerce Code requires that these types of forum selection clauses be "set out conspicuously in print, type, or other form of writing that is bold-faced, capitalized, underlined, or otherwise set out in such a manner that a reasonable person

against whom the provision would operate would notice." The provision in the NorVergence agreements was in small print that was not distinguishable from the other fine print in these agreements. See Tex. Bus. & Comm. Code Sec. 35.53. Texas business consumers have been sued in distant forums. (Exh. 2).

25. Further, the Rental Agreements contained another fine print clause that stated that if the agreement was a Uniform Commercial Code Article 2A lease, then all the protections of Article 2A could be utilized by the assignee.

26. Other misrepresentations that NorVergence made to consumers include, but are not limited to: a) telling consumers that they had unlimited free long distance; b) telling consumers that the costs of switching their phone and internet service would be covered by NorVergence; c) telling consumers that they were not locked into a price, but instead they had "price protection" against cost increases because they could find lower cost service annually; d) in some cases, telling consumers in writing that the Matrix box was free; e) representing to consumers that service would be uninterrupted if NorVergence ceased existence; f) representing to consumers when they had the equipment installed that they had sixty (60) days before payments would be due, when in fact the finance companies frequently began seeking payments immediately. (Exhs. 1-5]).

27. NorVergence also failed to disclose to customers material facts about the transaction that would lead them to question whether they should enter into it. For example, it failed to tell customers that it did not have any long-term commitment from any service provider for the long-term services it was promising. It also did not tell them that the Matrix box would be of little or no value to the customer if NorVergence failed to provide the promised telecommunications services.

28. After selling or assigning the rental agreements, NorVergence was left with its only ongoing income being payments on telecommunications service agreements with its customers. That income was only a small fraction of the cost of providing the promised services. NorVergence could not meet its long-term obligations to customers from this income, but would instead have had to set aside most or all of the income from the assignment or sale of the rental agreements to do so, and even that would likely have been insufficient. Based on the Chapter 7 case, it appears that NorVergence did not set aside any substantial portion of the rental contract income to cover promised services. Nor does it appear that it kept in the company any of the funds obtained from the sale or assignment of the rental agreements.

29. Initially, NorVergence did provide some below cost services to some of its early customers. For others, the Matrix installation or connection was never completed and functional. Delays or problems in installation or connection began as early as Fall 2003. By mid-2004, NorVergence had stopped installing or connecting the Matrix boxes it had sold and ceased paying the common carriers or other service providers and its employees. It was then placed into involuntary bankruptcy by a number of creditors including some of the finance companies to whom it had sold some of the rental agreements and from whom it had borrowed additional funds. Initial filings from the Chapter 7 trustee indicate that virtually none of the hundreds of millions of dollars in up-front payments received by NorVergence can be found and there are no other substantial assets.

30. NorVergence's customers are no longer receiving any services from NorVergence. (Exhs. 1-3, 4 [para. 4], 5 [para. 5]). Many of the finance company assignees are insisting on full payment under the rental agreements despite the fact that they know or should know that the black boxes are essentially worthless without the promised services, and that customers are receiving no

services. Some of the finance companies are threatening, and some are in fact filing, collection suits in forums distant from the customer.

31. In deciding to do business with NorVergence based on information provided by or available from NorVergence, the finance companies did due diligence and knew or should have known that NorVergence was primarily selling a discounted package of telecommunications services and the Matrix was an incidental part of the promised services. Additionally, in receiving contracts from NorVergence where the total price might vary from about \$12,000 to over \$100,000 for a piece of equipment with a retail value of between \$350 to \$1500, those finance companies knew or should have known at a minimum that the rental agreements were actually contracts for services, and possibly that the contracts might have been part of a scheme to defraud consumers. (Exhs. 4 [para. 5], 5 [para. 5]).

32. NorVergence currently has more than 1,000 rental agreements not assigned to any finance company, but that are allegedly collateral for at least one creditor of NorVergence. NorVergence is providing none of the promised services associated with those agreements. If these contracts are assigned, sold, or abandoned either by the Chapter 7 Trustee, or by NorVergence if the bankruptcy action is dismissed, or if the Bankruptcy Court lifts the stay and the allegedly secured creditor forecloses on the contracts and attempts to collect on them, the customers could be subject to the same type of collection actions as for the contracts already assigned. They could be forced to pay tens or hundreds of thousands of dollars for a worthless black box and services they will never receive.

33. NorVergence also has a residual interest in an unknown number of rental agreements that were assigned to finance companies for limited terms. These finance companies would be

expected to return the rental agreements to NorVergence, who theoretically could then begin collecting on the contracts or resell the contracts to other third parties who might attempt collection while still providing none of the promised services.

VIOLATIONS OF THE DTPA

34. The State adopts by reference the information contained in paragraphs 1-33 above. The actions of NorVergence alleged above violate the following provisions of the Texas Deceptive Trade Practices Act: Sections 17.46(a); 17.46(b)(1), (b)(2), (b)(3),(b)(5),(b)(7)(b)(9)(b)(11)(b)(12)(b)(14), (b)(24).

PRAYER FOR RELIEF

The State of Texas requests that this Court grant the following relief:

(a) Enter judgment against Defendant and in favor of the State of Texas for each violation alleged in this petition.

(b) Permanently enjoin and restrain Defendant from violating the Texas Deceptive Trade Practices Act, §§ 17.46(a) and (b).

(c) Award such relief as this Court finds necessary to redress injury to consumers resulting from the Defendant's violations of the Texas Deceptive Trade Practices Act, §§ 17.46(a) and (b), including but not limited to, reformation or rescission of contracts, and the cancellation of purported debts.

(d) Impose a civil penalty pursuant to § 17.47(c) of the DTPA of not more than \$20,000 per violation.

(e) Award the State of Texas attorneys' fees and costs for bringing this action, as well as such other and additional equitable relief as this Court may determine to be just and proper.

Respectfully submitted,

GREG ABBOTT
Attorney General of Texas

BARRY R. McBEE
First Assistant Attorney General

EDWARD D. BURBACH
Deputy Attorney General for Litigation

PAUL D. CARMONA
Chief, Consumer Protection and Public Health
Division

LEELA R. FIRESIDE
Assistant Attorney General
State Bar No. 07038750
Office of the Attorney General
Consumer Protection and Public Health Division
P.O. Box 12548
Austin, Texas 78711-2548
(512) 475-4233 (telephone)
(512) 473-8301 (facsimile)

JOHN OWENS
Assistant Attorney General
State Bar No. 15379200
808 Travis, Suite 300
Houston, Texas 77002
713-223-5886, ext. 107
713-223-5821 fax