NOT FOR PUBLICATION

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

FEDERAL TRADE COMMISSION, Plaintiff, v. DUTCHMAN ENTERPRISES, LLC; UNITED COMMUNITY SERVICES OF AMERICA, INC., also doing business as UCSA DEALERS GROUP, LLC; AND DENNIS LEE, Defendants.	Civ. Action No. 09-141(FSH)(MAS) **Report and Recommendation**

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SHIPP, United States Magistrate Judge

On January 14, 2009, the Honorable Faith S. Hochberg, U.S.D.J., granted the Ex Parte Motion of the Federal Trade Commission ("FTC" or "Plaintiff") for a Temporary Restraining Order ("TRO") against Defendants Dutchman Enterprises, LLC ("Dutchman"), United Community Services of America, also doing business as UCSA Dealers Group, LLC ("UCSA"), and Dennis Lee

("Lee") (collectively "Defendants") pursuant to Federal Rule of Civil Procedure 65(b)(1). The TRO provided, in pertinent part, that a hearing would be held on January 26, 2009, at which time Defendants could show cause why the Court should not enter a preliminary injunction.[1] With the consent of the parties, the Court adjourned that hearing until February 5, 2009 in order for Defendants to retain adequate counsel.

This Report and Recommendation is issued pursuant to *28 U.S.C. § 636(b)(1)(B)*. The Court has jurisdiction over this action pursuant to *28 U.S.C. §§ 1331*, *1337(a)* and *1345*, and *15 U.S.C. § 53(b)*.

I. PARTIES

The FTC is an independent agency of the United States Government created by statute. *15 U.S.C. § 41 et seq.* The FTC is charged with, *inter alia,* enforcement of 15 U.S.C.A. *§ 45 (a)(1)* which prohibits unfair and/or deceptive acts or practices affecting commerce. The FTC is authorized to initiate federal district court proceedings, by its own attorneys, to enjoin violations of the Federal Trade Commission Act, *15 U.S.C. § 45*, ("FTCA"), and to secure such equitable relief as may be appropriate in each case, including consumer redress. *15 U.S.C. § 53(b)*. (Pl. Compl. ¶ 4.)

Defendant Dutchman is a Delaware limited liability company with headquarters located at 3002 Route 23 North, Newfoundland, New Jersey 07435. (Pl.'s Compl. ¶ 5.) Dutchman transacts or has transacted business in the District of New Jersey and throughout the United States. *Id.*

[1]Despite reference to the hearing as Defendants' opportunity to 'show cause', the Court notes that the burden of proof remains on the FTC to justify issuance of the preliminary injunction.

Defendant UCSA is a Delaware corporation with headquarters located at 3002 Route 23 North, Newfoundland, New Jersey 07435. (Pl.'s Compl. ¶ 6.) UCSA transacts or has transacted business in the District of New Jersey and throughout the United States. *Id.*

Defendant Lee is the Chief Operating Officer and Director of Marketing of Dutchman and President of UCSA. (Pl.'s Compl. ¶ 7.) Plaintiff alleges that at all times relevant to this complaint, acting alone or in concert with others, Defendant Lee has formulated, directed, controlled, or participated in the acts and practices of Corporate Defendants Dutchman and UCSA, including the acts and practices set forth in this complaint. *Id.* Defendant Lee resides in and transacts or has transacted business in the District of New Jersey. *Id.*

II. BACKGROUND AND FACTS

Plaintiff filed its Complaint for Injunctive Relief and Equitable Relief ("Complaint") on January 12, 2009 and, at the same time, filed an *Ex Parte* Motion for a TRO and an Order to Show Cause, including provisions for expedited discovery and preservation of assets and evidence. (*Ex Parte* Mot. 22.) The Court required Plaintiff to serve its motion on Defendants and scheduled a hearing on Plaintiff's application for January 26, 2009. (Ct.'s TRO 12.) Defendants were unable to obtain adequate counsel for the hearing because of the asset freeze and after hearing opening statements from both Plaintiff and Defendants, the Court determined that in the interest of justice it would adjourn the hearing until February 5, 2009 to allow Defendants to obtain adequate counsel. (Ct.'s Order to Modify TRO 3-4, Jan. 28, 2009.) The Court modified the TRO and released certain funds to be used exclusively for attorneys and expert fees in connection with the preliminary hearing. *Id.* The Court then instructed Defendants to submit an opposition brief to Plaintiff's *Ex Parte* Motion and Plaintiff to submit a reply brief. (Ct.'s Order 1, Jan. 28, 2009.) The Court conducted a preliminary injunction hearing on February 5, 2009.

Defendants are engaged in the business of manufacturing, advertising, selling and distributing a product called the "Hydro-Assist Fuel Cell" ("HAFC") that purportedly increases automobile gas mileage. (Defs.' Opp'n Br. 3.) In its Complaint, Plaintiff alleges that the practices Defendants employ in marketing and selling the HAFC violate Section 5(a) of the FTCA which prohibits unfair or deceptive acts or practices in or affecting commerce. (Pl.'s Compl. ¶ 4.) Plaintiff's first count alleging false and unsubstantiated efficacy claims is based on Defendants' representations that the "HAFC substantially increases gas mileage, including from 50% to 261%." (Pl.'s Compl. ¶ 14.) Plaintiff's second count of false establishment arises from Defendants' assertions that "[t]he HAFC system will likely double your gas mileage! The kit is ABSOLUTELY GUARANTEED to increase your gas mileage by at least 50% . . .." *Id.* at ¶ 10(B). Plaintiff asserts that Defendants' claims "for the HAFC violate basic scientific laws and well-established physical principles – their claims are false and cannot be sustained." (Pl.'s *Ex Parte* Mot. 1.)

Defendants deny these allegations and stand behind their advertisements.

III. SUMMARY OF ARGUMENTS

The FTC argues that it is entitled to a preliminary injunction because: (1) the FTC has probable cause to believe that Defendants are in violation of the FTCA, *15 U.S.C.A. § 45(a)(1)*, by falsely advertising the HAFC kit; (2) there is a reasonable likelihood that Defendants will continue to violate the FTCA; and (3) it is in the public interest to issue a preliminary injunction. (Pl.'s *Ex Parte* Mot. 18.)

William P. Halperin, PhD., an expert in the field of physics, testified on behalf of the FTC and opined that Defendants' product violates the laws of thermodynamics, principles of physics, and has no foundation in science. (Halperin Hr'ing Test. on Feb. 5, 2009). According to Plaintiff's expert, the HAFC cannot possibly do what Defendants state that it can do. (Pl.'s *Ex Parte* Mot. 19.)

The FTC contends that the FTCA requires a vendor to support its advertising claims with scientific proof. (Pl.'s Reply Br. 12.) The FTC further contends that Defendant Lee's history of illegal conduct, which includes prior sanctions and violations of court orders, indicates that there is a reasonable likelihood that Defendants will continue to illegally market his product in violation of § 45. *Id.* at 20. Lastly, the FTC contends that there is a strong public interest in enjoining Defendants; the FTC is concerned that if the TRO is lifted, Defendant Lee will abscond with the assets of Defendants making consumer redress impossible. *Id.* at 22.

Conversely, Defendants make four arguments in opposition to the motion for a preliminary injunction: (1) the FTC has failed to demonstrate that Defendants violated the FTCA; (2) even if Defendants violated the FTCA, it is not reasonably likely that these violations will continue; (3) balancing the equities for issuing an injunction strongly favors Defendants; and (4) the requested injunction is overly broad and burdensome. (Def.s.' Opp'n Br. 8, 15.)

Defendants' contend that the results of their proprietary rating system called the "orange test" is scientific proof that the HAFC increases fuel economy. (Defs.' Opp'n Br. 5). Defendants argue that in order to advertise their product, a vendor must only have a reasonable basis for believing the advertising claims they make to the public. (Defs.' Opp'n Br. 9.) Defendants claim that based upon test results they have submitted to this Court, both standards have been satisfied and that any discrepancy is moot. *Id.* at 10. Defendants maintain that Defendant Lee's past offenses should not weigh against him, as they are irrelevant to the marketing of the HAFC. *Id.* at 12.

According to Defendants, when balancing the equities, the device is not harmful to the public and even the purported harm alleged by the FTC is exclusively monetary. (Defs.' Opp'n Br. 13.) Granting an injunction would in effect put Defendants out of business without affording them a

full opportunity to prove their case in court. *Id.* at 14. Finally, Defendants maintain that the FTC's request for injunctive relief is overly broad. *Id.* at 15.

In reply, the FTC states that (1) Defendants fail to prove that their tests are accepted within the field, (2) Defendants' affiants are biased, (3) a money back guarantee does not defeat allegations of deceptive marketing, and (4) the requested relief is not overbroad. (Pl.'s Reply Br.)

IV. LEGAL STANDARD

A. Preliminary Injunction

"Where an injunction is sought pursuant to a statutory provision, the moving party must establish that (1) probable cause exists to believe that the statute in question is being violated, and (2) there is some reasonable likelihood of future violations." *FTC v. Check Investors, Inc.*, 2003 U.S. Dist. LEXIS 26941, at *12 (D.N.J. 2003) (*citing U.S. v. Focht,* 882 F.2d 55, 57 (3d Cir. 1989); *In re Nat'l Credit Mgmt.*, 21 F. Supp. 2d 424, 439-40 (D.N.J. 1998); *U.S. v. Toys "R" Us, Inc.*, 754 F. Supp. 1050, 1053 (D.N.J. 1991)). "Proving a violation of the statute sued upon is akin to the traditional requirement of proving likelihood of success on the merits." *Check Investors, Inc.*, 2003 U.S. Dist. LEXIS 26941, at *13-14. "Additionally, the public interest must also be examined." *Check Investors, Inc.*, 2003 U.S. Dist. LEXIS 26941, at *13 (*citing Nat'l Credit Mgmt.*, 21 F. Supp. 2d at 440-41).

B. Relevant Statute

The relevant portion of the FTCA, *15 U.S.C.A. § 45(a)(1)*, provides that "unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful." *Id.*

C. Legal Standard to Establish a Violation of the FTCA, 15 U.S.C.A. § 45(a)(1)

An advertisement is "deceptive if (1) there is a representation, omission, or practice that (2) is likely to mislead consumers acting reasonably under the circumstances, and (3) the representation,

omission, or practice is material." *FTC v. QT, Inc.*, 448 F. Supp. 2d 908, 959 (N.D. Ill. 2006) (*citing FTC. v. Pantron I Corp.*, 33 F.3d 1088, 1095 (9th Cir. 1994); *Kraft, Inc. v. FTC*, 970 F.2d 311, 314 (7th Cir. 1992)). The FTC may prove that an advertisement is deceptive under both (1) the "falsity" theory and (2) the "reasonable basis" theory. *QT, Inc.*, 448 F. Supp. 2d at 957 (*citing Pantron*, 33 F.3d at 1096; *FTC v. Sabal*, 32 F. Supp. 2d 1004, 1007 (N.D. Ill. 1998)).

"Under the falsity theory, the FTC has the burden of proving that the express or implied claim in the advertisement is false." *QT, Inc.*, 448 F. Supp. 2d at 959 (*citing Pantron*, 33 F.3d at 1096). Under the reasonable basis theory concerning establishment claims, "the advertiser must possess the level of proof claimed in the ad[vertisement]." *QT, Inc.*, 448 F. Supp. 2d at 959 (*citing Thompson Medical Co. v. FTC*, 791 F.2d 189, 194 (D.C. Cir. 1986)). An express or implied claim is a claim that contains express or implied representations about the level of support for a particular claim, for example, that a product is determined to be of higher quality based on scientific testing. *Id.*

V. DISCUSSION

The Court recommends that the FTC's motion for preliminary injunction be denied for the following reasons. First, the FTC has not established that there is probable cause that the Defendants' representations regarding the HAFC violated the FTCA.[2] An injunction is improper when the plaintiff fails to make a proper showing that it had reason to believe the public would be

[2]The FTC argues that since Judge Hochberg found probable cause when granting FTC's *Ex Parte* Motion for the TRO, then this Court should also find that probable cause exists. However, "[a]lthough the standards governing temporary and preliminary injunctions are the same, the procedures for obtaining them differ. The grant of a temporary restraining order is frequently *ex parte*, generally made on papers alone and in an expedited manner under severe time constraints. The issuance of a preliminary injunction requires notice, an evidentiary hearing and more extensive review of the underlying merits of the case. A temporary stay may validly issue although, under heightened scrutiny, a preliminary injunction should not . . ." *In re Keene Corp.*, 168 B.R. 285, 292 (Bnkr. S.D.N.Y. 1994).

misled. *FTC v. Sterling Drug, Inc.*, 317 F.2d 669, 678 (2d Cir. 1963). Second, the FTC has not established that there is a reasonable likelihood that Defendants will continue to violate the FTCA. Finally, the balance of the equities does not favor the public interest. Therefore, it is recommended that Plaintiff's motion for a preliminary injunction be denied.

A. Probable cause does not exist to believe that the statute in question is being violated.

"Proving a violation of the statute sued upon is akin to the traditional requirement of proving likelihood of success on the merits." *Check Investors, Inc.*, 2003 U.S. Dist. LEXIS 26941, at *13-14. An advertisement is "deceptive if (1) there is a representation, omission, or practice that (2) is likely to mislead consumers acting reasonably under the circumstances, and (3) the representation, omission, or practice is material." *QT, Inc.*, 448 F. Supp. 2d at 957 (*citing Pantron*, 33 F.3d at 1095); *Kraft, Inc.*, 970 F.2d at 314). Under the FTC Deception Policy Statement, an express claim is presumed to be material. *QT, Inc.*, 448 F. Supp. 2d at 960 (*citing Kraft, Inc.*, 970 F.2d at 322).

First, it is undisputed that Defendants made representations. Second, these representations were material because they were express claims. Therefore, the Court must decide if those material representations were misleading. Although the FTC is clearly proceeding under a falsity theory, for the reason stated below, the Court will address both the falsity and the reasonable basis theories.

1. Falsity Theory

"Under the falsity theory, the FTC has the burden of proving that the express or implied claim in the advertisement is false." *QT, Inc.*, 448 F. Supp. 2d at 959 (*citing Pantron*, 33 F.3d at 1096). The claims in issue are: (1) "HAFC substantially increases gas mileage, including from 50% to 261%" (Pl.'s Compl. ¶ 14) and (2) "[t]he HAFC system will likely double your gas mileage! The kit is ABSOLUTELY GUARANTEED to increase your gas mileage by at least 50% . . ." *Id.* at ¶ 10(B). This Court is skeptical of Defendants' representations regarding the HAFC. However, to

carry its burden of proving that Defendants' representations are false, the FTC relied exclusively on the sworn testimony of Dr. William P. Halperin. The Court finds this evidence inadequate for four reasons.

First, Defendants offered the results of their proprietary rating system called the "orange test" as scientific proof that the HAFC increases fuel economy. (Defs.' Opp'n Br. 4) Although the FTC suggests the "orange test" is not "an accepted, reliable scientific protocol for fuel economy tests," the FTC fails to explain why the "orange test" is unacceptable. (Pl.'s Reply Br. at 13.) Notably, any critique of the "orange test" was conspicuously absent from Dr. Halperin's sworn hearing testimony. Moreover, after Mr. Holler, a defense expert, described the "orange test" protocol on direct examination, the FTC chose not to challenge its acceptability or reliability on cross-examination. (Halperin Hr'g Test.) This is significant because when granting the FTC's Motion for Preliminary Injunction in *F.T.C. v. Sabal,* the Court relied heavily on the testimony of the FTC's expert who refuted the defendant's proffered scientific evidence with specificity. For instance, the FTC expert in *Sabal* noted that the defendant's scientific:

> study was neither published nor peer reviewed, . . . [that it] was inadequate to permit a thorough review of his research methods or independent verification of his test results . . . [that it] did not contain sufficient data from which it could be determined that the results were statistically significant, [and that it] did not explain how the control groups differed . . .

Sabal, 32 F. Supp. at 1008. Therefore, the Court finds it significant that the FTC failed to rebut Defendants' proffered scientific data with any specificity.

Second, this case centers on the intricacies of automotive internal combustion engines. By his own admission, Dr. Halperin is not an expert on automotive internal combustion engines. (Halperin Hr'g Test.) Dr. Halperin's testimony included the following: (1) he has never designed an internal combustion engine, (2) he has never constructed an internal combustion engine, (3) he does

not consider himself to be an expert in the design of internal combustion engines, and (4) he has never worked in the automotive industry. *Id.* Therefore, although Dr. Halperin is undoubtedly an accomplished physicist, his expertise in this case is inadequate.[3]

Third, and not insignificantly, Dr. Halperin never physically examined the HAFC at issue in this case. (Halperin Hr'g Test.) In the six months that Dr. Halperin worked with the FTC on this investigation, he never once physically touched an actual HAFC unit, he never tested it in a lab, and he never examined its component parts. *Id.* This is a fatal defect in the FTC's proofs. Instead, the FTC and Dr. Halperin deemed it sufficient to abstractly conclude the HAFC simply cannot work. *Id.* The FTC's lack of thoroughness calls into question the basis of its arguments.

Fourth, Dr. Halperin actually agrees that adding hydrogen to fuel, which is what the HAFC purportedly does, could increase fuel efficiency. (Halperin Hr'g Test.) Furthermore, Dr. Halperin acknowledged the potential of a similar device being developed by ArvinMeritor and the Massachusetts Institute of Technology. *Id.* at Exh. 3. The fact that the FTC's expert concedes that the technology employed by the Defendants' has potential to meet Defendants' challenged representations further handicaps the FTC's claim.

Because the FTC failed to meet its burden due to inadequate evidence, the Court recommends Plaintiff's Motion for Preliminary Injunction be denied. However, this Court *only* asserts that Plaintiff failed to meet its burden at the preliminary injunction stage.

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[3]The Court found Dr. Halperin to be knowledgeable in his field of expertise. Dr. Halperin displayed an obvious command of physics and, in particular, the laws of thermodynamics. Dr. Halperin also displayed a strong command of his source materials. However, the Court did not find Dr. Halperin's testimony persuasive as it related to the internal combustion engine. While the Court acknowledges that at times experts may cross-over fields, the attempted cross-over in the present case was not appropriate considering all of the factors discussed. This case clearly deals with internal combustion engines and Dr. Halperin's testimony failed to convince the Court that probable cause exists to believe that the statute in question is being violated.

2. Reasonable Basis Theory

Since the Court finds Dr. Halperin's testimony inapplicable and the remaining "substance of the FTC's case focuse[s] on the alleged lack of substantiation for Defendants' claims . . . the Court [will] analyze Defendants' claim under the reasonable basis theory." *QT, Inc.*, 448 F. Supp. 2d at 961 n.25.

Under the reasonable basis theory concerning establishment claims, that is claims containing express or implied representations about the level of support for a particular claim (i.e., the claim states that a product has been found to be superior by scientific tests), "the advertiser must possess the level of proof claimed in the ad[vertisement]." *QT, Inc.*, 448 F. Supp. 2d at 959 (*citing Thompson Medical Co.*, 791 F.2d at 194).

Here, Defendants make express representations that the HAFC is scientifically proven to increase fuel efficiency. (Pl.'s *Ex Parte* Mot. Ex. PX9 1.) Therefore, Defendants must possess scientific proof. Defendants rely on the results of a proprietary rating system called the "orange test" as scientific proof. (Defs.' Opp'n Br. 9.) The FTC suggests the "orange test" is not "an accepted, reliable scientific protocol for fuel economy tests." (Pl.'s Reply Br. at 13). However, any critique of this testing process was conspicuously absent from Dr. Halperin's sworn hearing testimony. Moreover, after Mr. Holler, a defense expert, described the "orange test" protocol on direct examination, the FTC chose not to challenge its acceptability or reliability on cross-examination. (Halperin Hr'g Test.). As stated above, in order to meet its burden the FTC was obligated to challenge Defendants' proffered scientific evidence with at least a modicum of specificity. *Sabal*, 32 F. Supp. 2d at 1008.

Because the FTC failed to meet its burden due to inadequate evidence, the Court recommends Plaintiff's Motion for Preliminary Injunction be denied. Again, this Court *only* asserts that Plaintiff failed to meet its burden at the preliminary injunction stage.

B. Future Violations

Although a defendant's past history is "highly suggestive" of future violations, it is not conclusive. (Pl.'s *Ex Parte* Mot. 20.) The Court agrees that Defendant Lee has a checkered past and the similarities between prior offenses and the current allegations are striking. However, it is insufficient to use this history as the only means of proving this necessary element.

C. Granting the Motion for a Preliminary Injunction does not serve the public interest.

"The statutory test for issuance of a preliminary injunction also involves a balancing of the equities . . ." *In re Nat'l Credit Mgmt.*, 21 F. Supp. 2d 424, 460 (D.N.J. 1998) (*citing FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1029 (7th Cir.1988)). "Although the court may consider private equities . . . public equities receive far greater weight." *FTC v. Sabal*, 32 F. Supp. at 1009 (*citing World Travel*, 861 F.2d at 1029). That said, the Court finds the balance of the equities militates in favor of Defendants because (1) there is no threat of further injury to the public and (2) they would suffer oppressive hardship if a preliminary injunction were entered.

First, there is no threat of further injury to the public. In *World Travel*, the Court affirmed the magistrate judge's recommendation "that the public interest required that the defendants' allegedly illegal business practices be enjoined to prevent further injury." *World Travel*, 861 F.2d at 1030. Here, as stated above, the FTC has failed to show a likelihood that Defendants have violated the FTCA, much less that they will continue to violate the FTCA. Although the FTC correctly states that it "need not prove scienter, reliance, or injury to establish a § 5 violation," the mere fact that Defendants do not sell directly to the public and not a single complaining consumer has come

forward demanding relief speaks directly to the minimal, if any, harm to public interests and warrants some consideration in weighing the public interests. *FTC v. Freecom Commc'ns*, 401 F.3d 1192, 1204 n.7 (10th Cir. 2005).

Second, the equities weigh in favor of the Defendants since they would suffer oppressive hardship if a preliminary injunction were entered. In *FTC v. World Wide Factors, Ltd.*, the Court found that the equities weighed in favor of the public where "there [was] no oppressive hardship to [the] defendants in requiring them to comply with the FTCA, refrain from fraudulent representation or preserve assets from dissipation or concealment," because, *inter alia*, the defendant had already been "convicted [of] the criminally fraudulent activities alleged in the FTC's complaint." *Id.* at 347. This case is easily distinguishable because Defendants have not been convicted of the activities alleged in this particular complaint. Furthermore, issuing a preliminary injunction will effectively close down the Defendants' business. Therefore, the balancing of the equities favors denying the motion for preliminary injunction.

VI. CONCLUSION

For the foregoing reasons, it is recommended that Plaintiff's Motion for a Preliminary Injunction be DENIED.[4]

s/ Michael A. Shipp
Michael A. Shipp
UNITED STATES MAGISTRATE JUDGE

Dated: February 9, 2009

[4]This Report and Recommendation was to be issued at 5 PM on February 6, 2009. However, without leave of court Defendants filed a letter with the Court raising new arguments. The Court allowed the FTC to file a response. Therefore, out of an abundance of caution the Court delayed entering the Order until today in order to consider the late submissions by the parties.