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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Case No. 02 Civ. 3720

FEDERAL TRADE COMMISSION,

Plaintiff,

vs.

MORRONE'S WATER ICE, INC.,
a Pennsylvania corporation;

FRANCHISE CONSULTANTS
CORPORATION,
a Pennsylvania corporation, d/b/a;
FRANCHISE CONSULTANTS GROUP;

ICE AMERICA CORPORATION,
a Pennsylvania corporation;

WATER ICE SYSTEMS, INC.
a Pennsylvania corporation;

JMS SALES, INC.,
a Pennsylvania corporation

STEPHEN D. ALEARDI, aka STEVE ALEARDI
individually and as an officer of
FRANCHISE CONSULTANTS CORPORATION,
ICE AMERICA CORPORATION,
WATER ICE SYSTEMS, INC.,
JMS SALES, INC., and

JOHN J. MORRONE, III
individually and as an officer of ICE AMERICA
CORPORATION, WATER ICE SYSTEMS, INC.,
and JMS SALES, INC.

Defendants.

COMPLAINT FOR INJUNCTIVE AND OTHER EQUITABLE RELIEF

Plaintiff, the Federal Trade Commission ("FTC" or "Commission"), for its Complaint alleges:

1. The FTC brings this action under Sections 5(a), 13(b) and 19 of the Federal Trade Commission Act, 15 U.S.C. §§ 45(a), 53(b), and 57b, to obtain temporary, preliminary and permanent injunctive relief, rescission of contracts, restitution, disgorgement, appointment of a Receiver, and other equitable relief for the defendants' violations of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), and the FTC's Trade Regulation Rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" ("Franchise Rule" or "Rule"), 16 C.F.R. § 436.

JURISDICTION AND VENUE

2. This Court has subject matter jurisdiction over this action pursuant to 28 U.S.C. §§ 1331, 1337(a), and 1345, and under 15 U.S.C. §§ 53(b) and 57b. This action arises under 15 U.S.C. § 45(a)(1).

3. Venue in the District for the Eastern District of Pennsylvania is proper under 28 U.S.C. §§ 1391(b) and (c), and 15 U.S.C. § 53(b).

THE PARTIES

4. Plaintiff, the Federal Trade Commission, is an independent agency of the United States Government created by statute. 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, as well as enforcement of the Franchise

Rule, 16 C.F.R. § 436. The Commission is authorized to initiate federal district court proceedings, by its own attorneys, to enjoin violations of the FTC Act in order to secure such equitable relief as may be appropriate in each case, and to obtain consumer redress. 15 U.S.C. §§ 53(b) and 57b.

5. Defendant Morrone's Water Ice, Inc. is a Pennsylvania corporation with its principal place of business at 200 North 63rd Street, Philadelphia, Pennsylvania 19139. Morrone's Water Ice, Inc. promotes and sells Morrone's Italian Ices & Homemade Ice Cream business ventures either directly or through Franchise Consultants Group and defendant Aleardi. Morrone's Water Ice, Inc. has transacted business in the Eastern District of Pennsylvania.

6. Defendant Franchise Consultants Corporation is a Pennsylvania corporation with its registered business address at 39 E. Langhorne Ave., Havertown, Pennsylvania 19803. Franchise Consultants Corporation promotes and sells Morrone's Italian Ices & Homemade Ice Cream business ventures. Franchise Consultants Corporation has transacted business in the Eastern District of Pennsylvania.

7. Defendant Ice America Corporation is a Pennsylvania corporation with its registered business address at 117 South 69th Street, Upper Darby, Pennsylvania 19082. Ice America had a principal place of business at 117 South 69th Street, Upper Darby, Pennsylvania 19082 during times relevant to this complaint. Ice America Corporation purchased substantially all of the assets of Water Ice Systems, Inc. on October 16, 1998 and merged with WIF Sales Corp. on August 25, 1999. WIF Sales Corp. had purchased trademark rights and formulas from JMS Sales, Inc. WIF Sales Corp. was also an approved supplier of pre-mixed Italian ice and ice cream formulas. Ice America Corporation has promoted and sold Morrone's Italian Ices &

Homemade Ice Cream business ventures since on or about October 16, 1998. Ice America Corporation has transacted business in the Eastern District of Pennsylvania.

8. Defendant Water Ice Systems, Inc. is a Pennsylvania corporation with its registered business address at 39 E. Langhorne Ave., Havertown, Pennsylvania 19083 in state corporation records. Water Ice Systems, Inc. had a principal place of business at 117 South 69th Street, Upper Darby, Pennsylvania 19082 during times relevant to this complaint. Water Ice Systems, Inc. promoted and sold Morrone's business ventures from on or about January 23, 1996 to on or about October 16, 1998. Water Ice Systems, Inc. has transacted business in the Eastern District of Pennsylvania.

9. Defendant JMS Sales, Inc. is a Pennsylvania corporation with its registered business address at 8 Overhill Rd., Upper Darby, Pennsylvania 19802. JMS Sales had a principal place of business at 117 South 69th Street, Upper Darby, Pennsylvania 19082 during times relevant to this complaint. JMS Sales, Inc. was involved with the marketing of Morrone's business ventures from on or about May 1996 to on or about July 2000. JMS Sales, Inc. has transacted business in the Eastern District of Pennsylvania.

10. Defendant Stephen D. Aleardi is the Chief Executive Officer of Franchise Consultants Corporation. He also does business as Franchise Consultants Group. Defendant Aleardi is also an officer of corporate defendants Ice America Corporation, Water Ice Systems, Inc. and JMS Sales, Inc. He became the President of Ice America Corporation at the corporation's inception on or about October 16, 1998, and is still listed as the Chief Executive Officer in state corporation records. Defendant Aleardi became the President of Water Ice Systems, Inc. on or about September 9, 1998. Previously, defendant Aleardi was the Vice

President of Water Ice Systems, Inc., from the corporation's inception on or about January 23, 1996 until approximately September 9, 1998. Defendant Aleardi is the Chief Executive Officer and Secretary of JMS Sales, Inc. He also was the Chief Executive Officer of WIF Sales Corp. At all times material to this Complaint, acting alone or in concert with others, he has formulated, directed, controlled or participated in the acts or practices of the corporate defendants, including the acts and practices set forth in this Complaint. He resides or has transacted business in the Eastern District of Pennsylvania.

11. Defendant John J. Morrone, III formulates, directs, controls or participates in the acts or practices of Morrone's Water Ice, Inc. Defendant Morrone is also an officer of Ice America Corporation, Water Ice Systems, Inc. and JMS Sales, Inc. Defendant Morrone became the Vice President and Treasurer of Ice America Corporation at its inception, and is still listed as the Vice President and Treasurer in state corporation records. Defendant Morrone became the Vice President of Water Ice Systems, Inc. on or about September 9, 1998. Previously, he was the President of Water Ice Systems, Inc. from its inception until on or about September 9, 1998. Defendant Morrone is the Treasurer of JMS Sales, Inc. Defendant Morrone also was the Vice President of WIF Sales Corp. At all times material to this Complaint, acting alone or in concert with others, he has formulated, directed, controlled, or participated in the acts or practices of the corporate defendants, including the acts and practices set forth in this Complaint. Defendant Morrone resides or has transacted business in the Eastern District of Pennsylvania.

COMMERCE

12. At all times relevant to this Complaint, the defendants have maintained a substantial course of trade in the offering for sale and sale of business ventures, in or affecting

commerce, as "commerce" is defined in Section 4 of the FTC Act, 15 U.S.C. § 44.

DEFENDANTS' BUSINESS ACTIVITIES

13. Since on or about January 30, 1996, defendants have offered and sold Morrone's business ventures. Defendants promote their Morrone's business ventures over the internet and through classified advertisements.

On or about January 1996 to on or about the end of 2001.

14. Defendants Alardi and Morrone decided to begin franchising Morrone's on or about January 1996.

15. Defendants or their agent frequently sent brochures to prospective purchasers who expressed interest in the business ventures. One of the titles of the brochures, for example, was *Proven Profit Maker*.

16. In a number of cases, defendants or their agent also provided prospective purchasers with a written document entitled Morrone's Italian Ices & Homemade Ice Cream Cost Breakdown and Approximate Return. This document, among other things, detailed the cost per case for particular flavors of water ice and the approximate return per case. For example, one version of the documents showed that cherry water ice cost \$105.00 per case and the approximate return per case was \$1,632.00.

17. Defendants or their agent also made pre-sale oral representations to prospective purchasers about income. For example, defendants or their agent told prospective purchasers that they could net \$40,000 to \$60,000 in the first year, that making a thousand dollars a week would be no problem, and that all stores were grossing between \$150,000 and \$300,000.

18. Members of the public in a number of states and the District of Columbia

purchased the business ventures. In numerous instances, however, the purchasers did not earn substantial incomes including but not limited to profits and revenues. In fact, many purchasers lost money as a result of their investment in the business ventures.

19. Defendants charged an initial fee of approximately \$15,000 to \$20,000 to purchase a Morrone's business venture. After paying the initial fee, purchasers spent additional funds for inventory, equipment, lease-hold improvements or other expenses. The defendants' own estimate of the initial investment ranged from around \$88,000 to approximately \$173,500, depending on the year that the business venture was sold. Purchasers also incurred additional expenses in operating their business ventures, including but not limited to, the costs of goods bought from the defendants and approved suppliers, and royalties and advertising fees paid to the defendants. Some purchasers also paid for an area license. A number of purchasers needed to obtain loans to open and operate their business ventures. Defendants or their agent provided financial projections that the purchasers used to obtain the loans or referred purchasers to accountants or accounting firms for the projections.

20. The purchasers entered into continuing commercial relationships whereby they sold or were given the right to sell or distribute Italian ices and ice cream which were associated with the Morrone's trade name, commercial symbol, trade mark or service mark.

21. Defendants offered to provide or provided substantial assistance to prospective and actual purchasers such as assistance in selecting a location, assistance in store lay out, training of the purchaser and employees, participation in an advertising program, and continuing consultation and advice.

22. Defendants exerted or had authority to exert a significant degree of control over the

purchasers' method of operation, such as requiring that the site locations be acceptable to the defendants as well as the purchaser, only allowing the offering and sale of those goods and services approved by the defendants, requiring the purchaser to buy ingredients from an approved supplier, requiring the purchaser to comply with the operations and procedures manual, and requiring the purchaser to use products, supplies, signs, fixtures and equipment that complied with the standards and specifications established by the defendants.

23. In a number of cases, defendants or their agent gave prospective purchasers a document titled Franchise Offering Circular. This document, however, failed to disclose required information, including but not limited to, the number and percentage of prior purchasers known by the defendants to have achieved the same or better results and the basis and assumptions for the earnings claims.

24. Moreover, defendants' Franchise Offering Circular affirmatively represented that the franchisor does not furnish or authorize its salesperson to furnish any oral or written information concerning the actual or potential sales, costs, income or profits of a Morrone's unit. In reality, the defendants or their agent made representations to prospective purchasers about actual or potential sales, costs, income or profits.

25. A number of purchasers eventually filed a demand in arbitration against Ice America Corporation. On August 13, 2001, an arbitrator issued an award in the action. The arbitrator found that Ice America Corporation entered into a franchise relationship by providing certain written information prior to the execution of each franchise agreement that was negligently misleading, confusing, or false. The arbitrator also found that Ice America Corporation falsely and in writing led the claimants to believe that a company-owned store was a "proven profit

maker” which could be regarded as an example of the business opportunity available to the claimants as franchisees.

Continuing After the Arbitration Award into 2002

26. Defendants continue to promote Morrone’s business ventures over the Internet and through classified advertising.

27. Prospective purchasers of the so-called “licenses” are offered an opportunity to enter into a continuing commercial relationships whereby they will sell or will be given the right to sell Italian ices and ice cream that are associated with the Morrone’s trade name, commercial symbol, trade mark or service mark.

28. Defendants continue to offer to provide substantial assistance, such as training, site evaluation assistance, marketing support, exclusive programs and ongoing support designed to help a buyer continue to improve and grow on an ongoing basis. Defendants also continue to exercise substantial control over the operation of the Morrone’s business ventures, such as requiring purchasers to buy the product to make the Italian ice and ice cream from Morrone’s Water Ice, Inc.

29. Defendants or their agent continue to make pre-sale income claims to prospective purchasers such as the following statements by defendant Aleardi : “I could say a store could do anywhere from \$100,000 a year to, you know, \$175,000 a year . . . The return on these stores can be anywhere from 35 to 45 percent return.”

30. Defendants or their agent send prospective purchasers an information package containing documents which show that Franchise Consultants Group represents Morrone’s Water Ice, Inc. The information package also includes an unsigned letter from “The Morrone’s Family”

stating that they are offering licenses which do not involve royalties or advertising fees. Other parts of the information package inform prospective purchasers that they are required to pay an initial license fee of \$20,000, and that the total investment will be in the \$115,000 to \$160,000 range.

31. The information package does not include a UFOC. When asked for a UFOC, defendant Aleardi has stated that he does not provide a UFOC since he is selling a license and not a franchise.

THE DEFENDANTS' VIOLATIONS OF SECTION 5 OF THE FTC ACT

32. Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), provides that "unfair or deceptive acts or practices in or affecting commerce are hereby declared unlawful."

COUNT I

Misrepresentations Regarding Income

33. Paragraphs 1 through 32 are incorporated by reference.

34. In numerous instances in the course of offering for sale and selling their business ventures, the defendants, directly or indirectly, represent, expressly or by implication, that consumers who purchase defendants' business ventures are likely to earn substantial income.

35. In truth and in fact, consumers who purchase the defendants' business ventures are not likely to earn substantial income.

36. Therefore, the defendants' representations set forth in Paragraph 34 are false and misleading and constitute a deceptive act or practice in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

THE FRANCHISE RULE

37. The business ventures sold by the defendants are franchises, as “franchise” is defined in Section 436.2(a)(1)(i), (a)(2) and (a)(5) of the Franchise Rule, 16 C.F.R. §§ 436.2(a)(1)(i), (a)(2), and (a)(5).

38. The Franchise Rule requires a franchisor to provide prospective franchisees with a complete and accurate basic disclosure statement containing twenty categories of information, including information about the litigation and bankruptcy history of the franchisor and its principals, the terms and conditions under which the franchise operates, and information identifying existing franchisees. 16 C.F.R. § 436.1(a)(1)-(a)(20). The pre-sale disclosure of this information required by the Rule enables a prospective franchisee to contact prior purchasers and take other steps to assess the potential risks involved in the purchase of the franchise.

39. As a matter of policy, the FTC has authorized franchisors to comply with the Rule by furnishing prospective franchisees with disclosures in a format known as the Uniform Franchise Offering Circular (“UFOC”). Authorization to use the UFOC format to comply with the Rule’s disclosure requirements was first granted by the Commission in the Final Interpretive Guides to the Rule, 44 Fed. Reg. 49966, 49970-71, and expressly requires adherence to the UFOC disclosure requirements in their “entirety.” This conditional authorization has been ratified by the Commission following subsequent amendments to the UFOC requirements by the North American Securities Administrators Association, most recently on December 30, 1993. 58 Fed. Reg. 69224. The defendants have elected to use the UFOC disclosure format.

40. Item 19 of the UFOC Guidelines requires the franchisor to disclose whether or not an earnings claim is made. Item 19 further requires that “[a]n earnings claim made in connection

with an offer of a franchise must be included in full in the offering circular and must have a reasonable basis at the time it was made” and that “[a]n earnings claim shall include a description of its factual basis and the material assumptions underlying its preparation and presentation.”

Item 19 recognizes an income multiplication table to be an earnings claim.

41. The Franchise Rule specifically prohibits franchisors from making any claim or representation that contradicts information required to be disclosed pursuant to Section 436.1 of the Rule. 16 C.F.R. § 436.1(f).

42. The Franchise Rule additionally requires that a franchisor:

- (a) have a reasonable basis for any oral, written, or visual earnings claim it makes, 16 C.F.R. § 436.1(b)(2), (c)(2) and (e)(1);
- (b) disclose, in immediate conjunction with any earnings claim it makes, and in a clear and conspicuous manner, that material which constitutes a reasonable basis for the earnings claim is available to prospective franchisees, 16 C.F.R. § 436.1(b)(2) and (c)(2); and
- (c) provide, as prescribed by the Rule, an earnings claim document containing information that constitutes a reasonable basis for any earnings claim it makes, 16 C.F.R. § 436.1(b) and (c).

43. Pursuant to Section 18(d)(3) of the FTC Act, 15 U.S.C. § 57a(d)(3), and 16 C.F.R. § 436.1, violations of the Franchise Rule constitute unfair or deceptive acts or practices in or affecting commerce, in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

VIOLATIONS OF THE FRANCHISE RULE

COUNT II

Claim Or Representation That Contradicts A Required Disclosure

44. Paragraphs 1 through 43 are incorporated by reference.
45. In connection with the offering of franchises, as "franchise" is defined in Section 436.2(a) of the Rule, the defendants violate Section 436.1(f) of the Rule and Section 5(a) of the FTC Act by making claims or representations to prospective franchisees which are contradictory to the information required to be disclosed by Section 436.1 of the Rule.

COUNT III

Basic Disclosure Violations

46. Paragraphs 1 through 43 are incorporated herein by reference.
47. In connection with the offering of franchises, as "franchise" is defined in Section 436.2(a) of the Franchise Rule, the defendants violate Section 436.1(a) of the Rule and Section 5(a) of the FTC Act by failing to provide prospective franchisees with complete and accurate basic disclosure documents as prescribed by the Rule.

COUNT IV

Earnings Disclosure Violations

48. Paragraphs 1 through 43 are incorporated by reference.
49. In connection with the offering of franchises, as "franchise" is defined in Section 436.2(a) of the Franchise Rule, the defendants violate Sections 436.1(b)-(c) of the Rule and Section 5(a) of the FTC Act by making earnings claims to prospective franchisees while, *inter alia*,: (1) lacking a reasonable basis for each claim at the times it is made; (2) failing to disclose,

in immediate conjunction with each earnings claim, and in a clear and conspicuous manner, that material which constitutes a reasonable basis for the claim is available to prospective franchisees; and/or (3) failing to provide prospective franchisees with an earnings claim document, as prescribed by the Rule and/or earnings disclosures, as prescribed by Item 19 of the UFOC Guidelines.

CONSUMER INJURY

50. Consumers in a number of states have suffered or will suffer substantial monetary loss as a result of defendants' violations of Section 5(a) of the FTC Act and the Franchise Rule. Absent injunctive relief by this Court, defendants are likely to continue to injure consumers and harm the public interest.

THIS COURT'S POWER TO GRANT RELIEF

51. Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), empowers this Court to grant injunctive and other ancillary relief, including consumer redress, disgorgement and restitution, to prevent and remedy any violations of any provision of law enforced by the Federal Trade Commission.

52. Section 19 of the FTC Act, 15 U.S.C. § 57b, authorizes this Court to grant such relief as the Court finds necessary to redress injury to consumers or other persons resulting from defendants' violations of the Franchise Rule, including the rescission and reformation of contracts, and the refund of money.

53. This Court, in the exercise of its equitable jurisdiction, may award ancillary relief to remedy injury caused by the defendants' law violations.