

**IN THE CHANCERY COURT FOR SHELBY COUNTY, TENNESSEE
THIRTIETH JUDICIAL DISTRICT AT MEMPHIS**

STATE OF TENNESSEE, <i>ex rel.</i>)	
ROBERT E. COOPER, JR., ATTORNEY)	
GENERAL and REPORTER,)	
)	No. CH-08-1979-1
Plaintiff,)	
v.)	JURY DEMAND
)	
BLUEHIPPO FUNDING, LLC, et al.)	
)	
Defendants.)	

**MEMORANDUM OF LAW IN SUPPORT OF MOTION FOR ORDER REQUIRING
DEFENDANTS TO SHOW CAUSE WHY THEY ARE NOT IN CIVIL CONTEMPT OF
COURT**

The State submits the following memorandum in support of its Motion for an Order Requiring the Defendants to Show Cause Why They Are Not in Civil Contempt of Court at a hearing and by, at least, producing select financial records described below at the hearing for this Motion on March 9, 2009.

BRIEF HISTORY

On January 7, 2009, this Court heard and granted the State's Motion for Temporary Injunction, Asset Freeze, and Other Equitable Relief. Under the terms of the accompanying Order, the Defendants were ordered to deposit \$1,000,000.00 in an interest-bearing registry account with the Shelby County Clerk and Master by the close of business on February 6, 2009. In that Order, the Defendants' approximately \$2.6 million in sales in Tennessee was found to comprise only .875% of the Defendants' total sales nationwide.

At the January 7, 2009, hearing, aside from arguments about the authority of the court to issue an asset freeze and the proper legal standard, the Defendants relied almost exclusively on the Affidavit of John Burcham for their assertion of the economic hardship that an asset freeze order would pose. On this point, the Affidavit of John Burcham stated only general concerns about the effects of a loss of capital.¹ Notably, Mr. Burcham's affidavit mentions the FTC Stipulated Order, but contains no statement that the FTC's Stipulated Order would conflict or potentially conflict with the Defendants' ability to comply with the portion of the State's order requiring a deposit of funds. Aff. of John Burcham, at paras. 19-21. At the January 7, 2009 hearing, the Defendants did not assert that the FTC's Stipulated Judgment potentially conflicted with the asset freeze sought by the State.

On February 4, 2009, this Court heard the Defendants' Motion to Stay or Revise Order Entering Asset Freeze, which in substance was a motion to reconsider the issuance of the asset freeze. The Defendants again made no attempt at that hearing to advance the argument concerning the FTC's Stipulated Order that they now attempt to argue.

On February 6, 2009, the Defendants did not remit \$1,000,000 to the Shelby County Clerk and Master as ordered. Instead, on February 6, 2009, the Defendants filed a settlement with the Washington Attorney General in a state court in Seattle. See Attach. A to State's Mot. to Show Cause. Under the terms of that settlement, the Defendants are required to pay the Washington Attorney General \$25,000.00 within thirty days after entry of the settlement. In addition, within sixty days, the Defendants have to give Washington consumers who have a paid-

¹ "For a number of reasons, issuing an injunction, an asset freeze, and ordering BlueHippo to deposit over \$2.5 million into a registry account will cause significant financial damage to BlueHippo. . . . An asset freeze and order to deposit funds into the Court will deprive the Company from having sufficient funds to meet operational costs, including payroll and advertising expenses. BlueHippo is currently doing business and needs operating funds to continue as a going concern." Aff. of John Burcham, at paras. 22-23.

in-full order a full refund, the merchandise ordered, or a store credit of 125% of the consumer's original purchase price.

On February 9, 2009, the Defendants submitted a Notice acknowledging their failure to meet the deadline of complying with the Order Granting Temporary Injunction, Asset Freeze and Other Equitable Relief. In their Notice, the Defendants assert *for the first time* that select monetary components of the Stipulated Judgment the Defendants entered into with the Federal Trade Commission on February 25, 2008 *potentially* conflict with this Court's Order requiring placement of \$1,000,000 with the Clerk and Master.

ARGUMENT

Tenn. Code Ann. § 47-18-103 vests every court "with the power to punish for contempt as provided for in [the Tennessee Code]." Tenn. Code Ann. § 29-9-102(3) authorizes courts to use their contempt authority in instances involving, "[t]he willful disobedience or resistance of any officer of the such courts, party, juror, witness, or any other person, to any lawful writ, process, order, rule, decree, or command of such courts." This provision enables the courts to maintain the integrity of their orders. *Wilson v. Wilson*, 984 S.W.2d 898, 904 (Tenn. 1998). "Punishment for civil contempt is designed to coerce compliance with the court's order and is imposed at the insistence and for the benefit of the private party who has suffered a violation of rights." *Doe v. Board of Prof'l Responsibility*, 104 S.W.3d 465, 474 (Tenn. 2003). Elsewhere, the Tennessee Court of Appeals has implicitly recognized that the State, though not a private party, can seek civil contempt. *See State ex rel. Gibbons v. Smart*, No. W2007-01768-COA-R3-CV, 2008 WL 4491729, at *8 (Tenn. Ct. App. Oct. 8, 2008).

"Civil contempt claims based upon an alleged disobedience of a court order have four essential elements. First, the order alleged to have been violated must be 'lawful.' Second, the

order alleged to have been violated must be clear, specific, and unambiguous. Third, the person alleged to have violated the order must have actually disobeyed or otherwise resisted the order. Fourth, the person's violation of the order must be 'willful.'" *Konvalinka v. Chattanooga-Hamilton County Hosp. Authority*, 249 S.W.3d 346, 354-355 (Tenn. 2008). Elsewhere, the Tennessee Supreme Court has stated that the party must have the ability to comply with the order at the time of the contempt hearing. *See, e.g. Ahern v. Ahern*, 15 S.W.3d 73, 79 (Tenn. 2000). In such cases, the burden of proof is on the contemnor to show the inability to pay. *State ex rel. Flowers v. Tennessee Trucking Ass'n Self Ins. Group Trust*, 209 S.W.3d 602, 612 (Tenn. Ct. App. 2006).

In assessing the factors the Tennessee Supreme Court set forth in *Konvalinka*, the Defendants appear to be in contempt of this court's previous order. As the Supreme Court explained in *Konvalinka*:

The threshold issue in any contempt proceeding is whether the order alleged to have been violated is 'lawful.' A lawful order is one issued by a court with jurisdiction over both the subject matter of the case and the parties. An order is not rendered void or unlawful simply because it is erroneous or subject to reversal on appeal. Erroneous orders must be followed until they are reversed. However, an order entered without either subject matter jurisdiction or jurisdiction over the parties is void and cannot provide the basis for a finding of contempt.

Konvalinka, 249 S.W.3d at 355 (internal citations omitted).

The first *Konvalinka* prong is satisfied. This Court has both jurisdiction over the subject matter of the case and the Defendant parties. Tenn. Code Ann. § 16-11-105 specifically authorizes chancery courts to "hear and determine ***all controversies*** between the state and corporations . . . upon a bill filed by the attorney general and reporter on behalf of the state." This court has personal jurisdiction over the Defendants by virtue of Tennessee's long-arm

statute, Tenn. Code Ann. § 20-2-214(a)(1), (2), and (7), because they have transacted business in whole or in part within Tennessee, advertised in Tennessee, and omitted material facts concerning transactions with Tennessee consumers. Defendants' counsel previously indicated that he believed that the Shelby County Chancery Court had jurisdiction.² In their Answer, the Defendants have not asserted any affirmative defense based on personal jurisdiction. *See* Defs. Answer. As they unsuccessfully asserted twice before, the Defendants do assert that this Court does not possess subject matter jurisdiction to assess individual, customer specific relief based on the arbitration provisions contained in the Defendants' sales contracts. However, such an argument is in direct contravention to the express language of the TCPA,³ comparable United States Supreme Court case law,⁴ Tennessee case law holding that contracts cannot bind non-parties,⁵ and common sense.

The second and third *Konvalinka* factors are satisfied. The Order Granting Temporary Injunction, Asset Freeze, and Other Equitable Relief stated explicitly that the Defendants were required to remit \$1,000,000.00 to the Shelby County Clerk and Master's office by the close of

² Attach. B. to Show Cause Mot., Tr. of Nov. 12, 2008 hearing. (Mr. Neenan: "I believe you stated it exactly right, Your Honor. They can, kind of, pick any county in Tennessee to sue, as long as they have a consumer there and does business with BlueHippo." The Court: "Do you contest jurisdiction of Shelby County Chancery Court?" Mr. Neenan: "I guess I'm lazy, Your Honor. I'd rather not have to drive to Shelby County. But, based on my initial reaction, I think venue is probably available anywhere in Tennessee that can find a consumer. And maybe it's even broader than that. But I think if you find a consumer, I believe that the statute gives them that venue.")

³ Tenn. Code Ann. § 47-18-113(b) provides, "Further, no action of a consumer or other person can alter, amend, obstruct or abolish the right of the attorney general and reporter to proceed to protect the state of Tennessee and consumers or other persons within this state or from other states who are victims of illegal practices of persons located, wholly or in part, in Tennessee's borders."

⁴ *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 294 (2002) ("It goes without saying that a contract cannot bind a nonparty. Accordingly, the proarbitration goals of the FAA do not require the agency to relinquish its statutory authority if it has not agreed to do so.")

⁵ *See, e.g., Cousins Properties of Tennessee, Inc. v. Karr*, 526 S.W.2d 498, 501 (Tenn. Ct. App. 1975) (holding that a non-party to a contract cannot be bound by the contract).

business on February 6, 2009. The Defendants acknowledged their understanding of the Order and their failure to comply with the Order in their Notice dated February 9, 2009, in which they explicitly state, “Defendants failed to meet the deadline of complying with the Asset Freeze on Friday, February 6, 2009.” Defs. Not., at 1.

The fourth *Konvalinka* factor concerning willfulness appears satisfied by the record before the Court.

In the context of a civil contempt proceeding under Tennessee Code Annotated § 29-2-102(3), acting willfully does not require the same standard of culpability that is required in the criminal context. Rather willful conduct consists of acts or failures to act that are intentional or voluntary rather than accidental or inadvertent. Conduct is ‘willful’ if it is the product of free will rather than coercion. Thus, a person acts ‘willfully’ if he or she is a free agent, knows what he or she is doing, and intends to do what he or she is doing. Thus acting contrary to a known duty may constitute willfulness for the purpose of a civil contempt proceeding.

Konvalinka, 249 S.W.3d at 356 (internal citations omitted).

As previously mentioned, the Tennessee Supreme Court has assessed whether a party has an ability to pay in weighing this factor in contempt cases involving monetary payments. *See, e.g. Ahern v. Ahern*, 15 S.W.3d 73, 79 (Tenn. 2000). Based on the record before the Court, the Defendants have the ability to pay. In their February 9, 2009 Notice, the Defendants assert for the first time, after the February 6, 2009 deadline, despite two previous chances to do so, that the Stipulated Judgment they entered into with the FTC on February 25, 2008, ***potentially*** conflicts with the asset freeze component of this Court’s order. The Defendants go out of their way to frame their excuse for failure to comply as a potential rather than actual conflict.

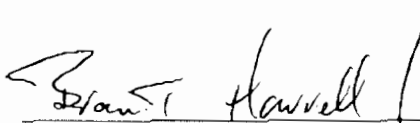
The Defendants’ assertion appears highly dubious based on the facts generated so far. Based on the amount in gross sales made in Tennessee as of September 2008, (\$2,629,870.91),

and this Court's undisputed finding that the Defendants' sales in Tennessee comprise only .875% of the Defendants' total sales nationwide, the Defendants ***have generated a staggering \$300,556,675.43 in gross sales nationwide as of September 2008.*** Further, the FTC Stipulated Judgment did not prevent the Defendants from filing a settlement with the Washington Attorney General's office on February 6, 2009, the exact date that the funds were due under this Court's order. *See Attach. A to State's Show Cause Mot.* Under the terms of that settlement, the Defendants are required to pay the Washington Attorney General \$25,000 within thirty days of entry of the settlement. Further, the Defendants are required to provide each consumer who has made each required payment their option of a full refund, shipment of ordered merchandise, or store credit at 125% of the consumer's original purchase price. *Attach. A to State's Show Cause Mot., at 6.* Further, the affidavit of John Burcham, which the Defendants relied on in opposition to the State's Temporary Injunction Motion, mentions the FTC Stipulated Judgment but contains no argument or reference that the terms of the FTC's Stipulated Judgment would impair the Defendants' ability to pay money into the Court.

CONCLUSION

Based on the above, there is good cause to believe that the Defendants are in civil contempt of this Court's Order Granting Temporary Injunction, Asset Freeze, and Other Equitable Relief and that the Defendants should be made to show how they are unable to comply with this Court's Order. The State's Motion should be granted.

Respectfully submitted,

 (By Admission):

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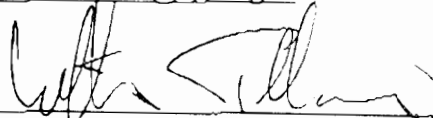
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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing was sent via electronic mail and via U.S Mail on this the 23rd day of February to:

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