14-20128

In The United States Court Of Appeals For The Fifth Circuit

Juan Ramon Torres; Eugene Robison,

Plaintiffs-Appellees,

v.

S.G.E. Management, L.L.C.; Stream Gas & Electric, L.T.D.; Stream S.P.E. G.P., L.L.C.; Stream S.P.E., L.T.D.; Ignite Holdings, L.T.D.; et al.,

Defendants-Appellants

Appeal from the United States District Court for the Southern District of Texas

Brief of *Amicus Curiae* Truth In Advertising, Inc. in Favor of Appellees and in Support of Affirmance

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Corporate Disclosure Statement Of Truth In Advertising, Inc.

In accordance with Federal Rule of Appellate Procedure 29(c)(1), the undersigned counsel certifies that amicus curiae Truth in Advertising, Inc. is a 501(c)(3) nonprofit, non-stock corporation. It has no parent corporation, and no publicly traded corporation has an ownership interest in it of any kind.

Pursuant to Fifth Circuit Rule 29.2, the undersigned counsel certifies that the following listed persons and entities, in addition to those already listed in the parties' briefs, have an interest in the outcome of this case:

Truth in Advertising, Inc. - amicus curiae

Robert B. Gilbreath - counsel for Truth in Advertising, Inc.

Laura Smith – counsel for Truth in Advertising, Inc.

Respectfully submitted,

/s/ Robert B. Gilbreath
Robert B. Gilbreath

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Statement of Interest¹

Truth in Advertising, Inc. (TINA.org) is a 501(c)(3) nonprofit, nonpartisan organization whose mission is to combat the systemic and individual harms caused by deceptive marketing. To further its mission, TINA.org investigates deceptive marketing practices and advocates before federal and state government agencies, as well as courts.

With respect to pyramid schemes in particular, TINA.org has filed several complaints with the Federal Trade Commission ("FTC") regarding such fraudulent marketing ventures. Recently, TINA.org's efforts in this regard prompted the FTC to file suit for a permanent injunction against an Arizona-based pyramid scheme, a case in which TINA.org worked with the Commission, providing it with its investigation findings, as well as testimony at the preliminary injunction hearing in the District Court of Arizona. *See* FTC Acts to Halt Vemma as Alleged Pyramid Scheme, Press Release (Aug. 26, 2015), https://www.ftc.gov/news-events/press-releases/2015/08/ftc-acts-halt-vemma-alleged-pyramid-scheme.

¹ All parties have consented to TINA.org participating as amicus curiae. Pursuant to F.R.A.P. § 29(c)(5), TINA.org states that its brief was not authored in whole or in part by either party or its counsel, and that no person other than TINA.org, its members, or its counsel contributed any money that was intended to fund the preparation and submission of this brief.

TINA.org has also conducted informational congressional briefings in Washington, D.C. regarding pyramid schemes;² presented at a national conference of multi-level marketing ("MLM") executives focusing on pyramid scheme issues; has exposed several pyramid schemes through its investigative reporting; and is a resource for consumers nationwide to both educate themselves about and submit complaints regarding such schemes. See TINA.org's pyramid publications scheme https://www.truthinadvertising.org/?s=pyramid+scheme/ **Practices** Best Workshop featuring TINA.org's Executive Directory, Academy https://www.bestpractices.academy/events/best-practices-workshop/; TI-NA.org MLM Brochure, https://www.truthinadvertising.org/educationalresources/.3 In short, TINA.org has a unique expertise in the area of pyramid

² TINA.org's executive director presented along with Peter Vander Nat, Ph.D., former senior economist at the FTC, and William Keep, Ph.D., Dean of the School of Business at The College of New Jersey, both pyramid scheme experts who have co-written two seminal works analyzing the MLM industry.

³ Drawing on its accumulated expertise, when Herbalife, a multi-level marketing company alleged to be operating a pyramid scheme, reached a settlement agreement in the class-action lawsuit filed against it in the Central District of California, TINA.org filed a brief as *amicus curiae* opposing the terms of the settlement reached between the parties on the basis that the agreement was unfair to class members. *See Bostick v. Herbalife Int'l of Am., Inc.,* 13-cv-02488 C.D. Cal., Doc. 114, https://www.truthinadvertising.org/wp-content/uploads/2015/03/Herbalife-amicus.pdf. While there are limitations to the benefits consumers can derive from class-action lawsuits, they are none-

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schemes, the marketing used by such companies, and the impact these illegitimate businesses have on consumers, all of which will assist this Court in better understanding the allegations at issue in this case. Furthermore, the issue presented in this case is of central importance to TINA.org's work and mission.

Argument

Pyramid schemes cause far-reaching harm to consumers, honest competitors, and the national economy, and class-action litigation is an appropriate and necessary means of enforcing the laws designed to protect unwitting consumers from such illegal companies.

I. Class-Action Litigation Plays An Indispensable Role In Protecting Consumers From Pyramid Schemes

Is Stream Energy an illegal pyramid scheme? It is a question that defendants would have plaintiffs answer 200,000 times over. But the reality is that few consumers—and even fewer attorneys—would ever expend the time and effort required to sue an alleged pyramid scheme for a single individual's harm. That means that if defendants (and their amici) were to have their way,

theless a vital and necessary arrow in the quiver for consumer protection rights and the furthering of the laws' objectives.

⁴ According to the District Court's Jan. 13, 2014 Memorandum Opinion and Order, ECF No. 169, at 3, "The plaintiffs seek to certify a class of 236,544 people. The defendants do not challenge certification on this basis."

pyramid schemes would be largely immunized from liability. See Panel Dissent at 24 ("I am compelled to respectfully dissent today by the realization that the panel majority's opinion will vaccinate illegal pyramid schemes against all civil litigation . . ." (emphasis in original)); Reyes v. Netdeposit, LLC, 802 F.3d 469, 491 (3d Cir. 2015) ("Class actions are often the only practical check against the kind of widespread mass-marketing scheme alleged here. . . . This is particularly true when, as is often the case, the scheme targets unsophisticated consumers with little disposable income and without the means or wherewithal to seek assistance of legal counsel."); Carnegie v. Household Int'l, Inc., 376 F.3d 656, 661 (7th Cir. 2004) ("The realistic alternative to a class action is not 17 million individual suits, but zero individual suits."); cf. Nat'l Ass'n Consumer Advocates, Standards & Guidelines for Litigating and Settling Consumer Class Actions (3d ed. 2014) at 3 ("[R]ejecting class actions because [individual] recoveries are small encourages wrongful conduct and largely immunizes entities caught stealing millions of dollars in ten-dollar increments.")

The principal mechanism for overcoming such difficulties is the modern class action typified by Federal Rule 23. The class action device, by spreading the litigation costs across a large group suffering modest individual harms, ensures that "massive...fraud...will [not] go unpunished." *Carnegie*,

376 F.3d at 661. Indeed, cases like this one are especially well-suited for class-treatment because the central issue—whether Stream is or is not a pyramid scheme—is the quintessential allegation raised by every class member. See Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997) (noting the Rule 23 Advisory Committee "had dominantly in mind vindication of 'the rights of groups of people who individually would be without effective strength to bring their opponents into court at all.'")

Moreover, Defendants' contention that consumers defrauded by pyramid schemes should be stripped of their class action rights and instead look to "various government agencies" for compensation is both short-sighted and

⁵ For this reason, it is the rule rather than the exception that pyramidscheme cases proceed as class actions. See e.g., Webster v. Omnitrition Int'l, Inc., 79 F.3d 776 (9th Cir. 1996)(certified RICO fraud class action alleging pyramid scheme); Arata v. Nu Skin Int'l, Inc., No. 92-15380, 1993 U.S. App. LEXIS 21747 (9th Cir. 1993) (certified class action alleging pyramid scheme for purposes of settlement); Piambino v. Bailey, 610 F.2d 1306 (5th Cir. 1980)(same); Davis v. Avco Corp., 371 F. Supp. 782 (N.D. Ohio 1974), aff'd, 739 F.2d 1057 (6th Cir. 1984)(same); Marshall v. Holiday Magic, Inc., 550 F.2d 1173 (9th Cir. 1977)(same); In re Glenn W. Turner Enters. Litig., 521 F.2d 775 (3d Cir. 1975)(same); Stull v. YTB Int'l, Inc., No. 10-600, 2011 U.S. Dist. LEXIS 109376 (S.D. Ill. Sept. 26, 2011)(case brought as class action consolidated *sua sponte* with other cases making same pyramid scheme allegation); Nguyen v. FundAmerica, Inc., 1990 U.S. Dist. LEXIS 15031 (N.D. Cal. Aug. 16, 1990)(provisionally certified class action alleging pyramid scheme); In re Am. Principals Holdings, Inc. Sec. Litig., 1987 U.S. Dist. LEXIS 16945, M.D.L. No. 653 (S.D. Cal. July 9, 1987)(same).

unrealistic.⁶ The FTC, the agency primarily charged with prosecuting pyramid schemes, has, for much of its history, been a slow-moving and underfunded agency, dependent to a large extent on complaints from consumers who are not entitled to restitution in their own right, and its remedial powers have been closely cabined.

In fact, the FTC's track record with regard to pyramid schemes is illustrative of the inefficacy of this public remedy. Since the *In re Amway Corp*. decision 40 years ago,⁷ the FTC has brought only 25 complaints alleging that an MLM company was operating an illegal pyramid scheme. Of those cases, the FTC has a record of 21 settlements, three trial wins, no losses, and one pend-

⁶ It is also surprising that defendants and their *amici* advocate for public enforcement in lieu of private class-action lawsuits as they have attempted to limit that very mechanism. *See, e.g.,* Public Comments of The Direct Selling Association on FTC Trade Regulation Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, Apr. 30, 1997,

https://www.ftc.gov/es/system/files/documents/public_comments/2006/07/522418-12058.pdf, at 32.

⁷ In re Amway Corp., 93 F.T.C. 618 (1979), was one of the FTC's earliest actions against an MLM. In 1975, the FTC brought a five-count complaint against it alleging, among other things, that it was a pyramid scheme. After two years of extensive discovery and motions practice, the case was heard by an administration law judge. At the hearing, 150 witnesses testified, there were over 1,000 exhibits, and the trial transcript was almost 7,000 pages long. A final order was not issued in the case until four years later when in 1979 the court held that the Amway Corporation was, in fact, not a pyramid scheme.

ing action. See FTC Pyramid Cases Post-Amway (Sept. 18, 2015), https://www.truthinadvertising.org/ftc-pyramid-cases-by-the-numbers/. A commendable record, but an infinitesimal number of cases. In fact, in the last decade, the FTC has brought only three pyramid scheme cases: BurnLounge in 2007, Fortune Hi-Tech in 2013, and Vemma in 2015. See id.

Absent the availability of class actions, illegal pyramid schemes, which cause far-reaching harm to consumers, honest competitors, and the general public alike, will be shielded from civil litigation, and correspondingly, civil liability. Class-action litigation is an appropriate and necessary means of enforcing the laws to ensure that pyramid schemes masquerading as legitimate MLM businesses are held accountable.

II. Pyramid Schemes Inflict Broad and Serious Harm to Consumers, Legitimate Business Competitors, and The General Public Alike

As a result of the FTC's inability to adequately police pyramid schemes, consumers have been afforded little protection against these fraudulent operations in the United States. This is especially problematic when one considers that among the many MLM companies operating in the United States today, there are numerous pyramid schemes attempting to disguise themselves as legitimate MLM businesses. *See* FTC Action Against Alleged Pyramid Scheme Affirms DSA Membership Process, Press Release (Jan. 29,

2013), http://www.dsa.org/news/individual-press-release/ftc-action-againstalleged-pyramid-scheme-affirms-dsa-membership-process (the DSA "membership review process serves to identify pyramid schemes that are masquerading as legitimate direct selling companies."); Dana Mattioli and Emily Glazer, Amid the Latest Criticism, Herbalifers Stay Resolute, WALL ST. J., Jan. 6, 2013, at http://www.wsj.com/news/articles/SB10001424127887323689604578221430 526328400 ("Tupperware Brands Corp. stopped describing itself and a 'direct seller' and started using the phrase 'direct to consumer,' said Chief Executive Rick Goings. 'We didn't leave direct selling,' said Mr. Goings. 'Direct selling left us, because the industry became dominated by buying clubs and what look Illegal like pyramid schemes."); DSA: Schemes, http://www.dsa.org.uk/consumer-advice/illegal-schemes/ ("The popularity of direct selling sometimes motivates dishonest individuals and organizations to misrepresent themselves as legitimate direct selling businesses in hopes of enticing victims. People globally have lost millions of dollars participating in scams like pyramid schemes. Many victims thought they were paying for help in starting a small business of their own, when in fact they were being fooled by a slick pyramid scheme disguised to look like a legitimate business.")

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There can be no dispute among the parties to this litigation that pyramid schemes posing as legal operations are inherently deceptive and *per se* illegal. *See* Statement of Joseph N. Mariano, President, Direct Selling Association, in Reaction to the Federal Trade Commission's BurnLounge Announcement, Press Release (June 17, 2015), http://www.dsa.org/news/individual-press-release/statement-of-joseph-n.-mariano-president-direct-selling-association-in-reaction-to-the-federal-trade-commission-s-burnlounge-announcement ("'Pyramid schemes . . . have no place in our marketplace, are expressly banned by Direct Selling Association's Code of Ethics and should be prosecuted to the fullest extent of the law.'")

Indeed, courts have long recognized that pyramid schemes are inherently fraudulent and for good reason. See Webster v. Omnitrition Int'l, Inc., 79 F.3d at 788 (9th Cir. 1996) ("[T]he very reason for the per se illegality of Endless Chain schemes is their inherent deceptiveness and the fact that the 'futility' of the plan is not 'apparent to the consumer participant.'"). Pyramid schemes are ingenious frauds that capitalize on "blinding potential prospects to the realities of the scheme," and as such they present a surreptitious danger to consumers, business competitors, and the general public alike. Secs. Exch. Comm'n

v. Glenn W. Turner Enters., Inc., 348 F. Supp. 766, 772 (D. Ore. 1972), aff'd 474 F.2d 476 (9th Cir. 1973).

The FTC recognized over 40 years ago that:

the marketing plan [of pyramid schemes] is not primarily designed as an offer to knowledgeable businessmen competent to weigh and evaluate commercial risks. It is designed, rather, to appeal to uninformed members of the general public, unaware of and unadvised of the true nature of the risks run – persons with limited capital who are led to part with that capital by promises and hopes that are seldom, if ever, fulfilled.

FTC Advisory Opinion, 16 C.F.R. § 15.155(d) (1988). See also Sec. Exch. Comm'n v. Koscot Interplanetary, Inc., 497 F.2d 473, 475 n. 4 (5th Cir. 1974) ("Poor, unwary persons have been induced by high-pressure sales tactics to part with their money, and very few have harvested the large returns they were led to believe were common for those participating in the program." (quoting Sec. Exch. Comm'n v. Koscot Interplanetary, Inc., 365 F. Supp. 588, 590 (N.D. Ga. 1973))).

By making false, misleading, and deceptive representations regarding the commercial feasibility of these schemes for all participants, including the path of success followed by those promoted as examples, such illegal operations coax thousands of consumers to part with funds for an expected return on investment that declines in probability at a rate unknown and unknowable to participants. *See Koscot Interplanetary, Inc.*, 497 F.2d at 475 (a pyramid

scheme "thrives by enticing prospective investors to participate in its enterprise, holding out as a lure the expectation of galactic profits. All too often, the beguiled investors are disappointed by paltry returns."). This is so because pyramid schemes are premised on inherent fraud, which breeds economic instability and loss for the vast majority of distributors. The entire marketing program of pyramid schemes is a fraud because it contemplates a virtually endless recruiting of participants in which later purchasers necessarily must lose their investments, to the benefit of those who joined earlier, as the supply of new participants shrinks exponentially. *See Webster*, 79 F.3d at 781 (9th Cir. 1996). Even distributors who are initially successful end up losing with these *per se* fraudulent schemes.⁸

The promotional practices are as undesirable as the very structure of these schemes. The economic inducement held out to all prospects that they will make money is a common thread that runs through all illegal pyramid

⁸ Distributors who do not suffer economic loss will eventually be disenfranchised when the scheme collapses – losing their downlines and reputation. Moreover, such distributors risk exposure to possible litigation in which bankruptcy receivers of collapsed pyramid schemes sue to recover ill-gotten gains. *See, e.g.*, First Amended Complaint, Evans v. Armenta, No. 14-cv-00329 (E.D. Ky. Aug. 29, 2014), ECF No. 13; First Amended Complaint, Evans v. Burrell, No. 14-cv-00330 (E.D. Ky. Aug. 27, 2014), ECF No. 12 (bankruptcy receiver for Fortune Hi-Tech Marketing, which settled pyramid scheme allegations with the FTC, sued over 35 defendants to recover commissions and bonus payments made by Fortune Hi-Tech to these distributors).

schemes. The requisite commonality is the fact that the fortunes of all investors are inextricably tied to the efficacy of the recruitment process consummating in endless investments. *See Koscot Interplanetary, Inc.*, 497 F.2d at 478 ("The critical factor is not the similitude or coincidence of investor input, but rather the uniformity of impact of the promoter's efforts.") The effect is substantial injury to investors, the public, and legitimate competitors.

And to make matters worse, the damage resulting from pyramid schemes goes far beyond simple economic harm. Indeed, the injuries these schemes inflict go well beyond their affront to norms of honesty and even fair dealing as vulnerable consumers are targeted and lured into the illegal operation: families already in economic distress lose their savings; college students drop out of school in order to pursue illusory fortunes; relationships are compromised; and many suffer the irreparable loss of family and friends.⁹

⁹ Below is a sampling of consumer complaints TINA.org received concerning Vemma Nutrition Company, a DSA member that the FTC alleges operated an illegal pyramid scheme for approximately 10 years. *See* Preliminary Injunction Order, Fed. Trade Comm'n v. Vemma Nutrition Co., No. 15-cv-1578 (D. Ariz. Sept. 18, 2015), ECF No. 118 ("The evidence before the Court leaves little doubt that the FTC will ultimately succeed on the merits in demonstrating that Vemma is operating a pyramid scheme.")

^{• &}quot;Unfortunately, my son has been introduced to this company (about a year ago) and has dropped out of college with the pursuit of getting rich without having to go to college In my personal family life, this company has interfered with my sons [sic] desire to complete his col-

III. To Succeed, Pyramid Schemes Must Masquerade As Legitimate MLM Companies

While defendants have steadfastly maintained that Stream is a legitimate MLM business, defendants cannot deny that other companies with business structures similar to Stream have been the focus of FTC actions premised upon pyramid scheme allegations. *See Fed. Trade Comm'n v. BurnLounge, Inc.*, 753 F.3d 878, 886, 888 (9th Cir. 2014) ("The second prong of the *Omnitrition* test does not require that rewards for recruiting be 'completely' unrelated to the sale of products. If it did, any illegal MLM business could save itself from liability by engaging in *some* retail sales . . . The fact that some sales

lege degree. He was in his third year of college when he dropped out. ... Not only did he drop out of college, but he has been living on the streets in his car for the past three weeks."

- "My stepson has given up a four year, tuition free opportunity to attend university because Vemma has convinced him the college is just a financial burden. How is 'free' a 'burden'?"
- "I was approached by friends who I've known since middle school. They told me they wanted to talk about a business opportunity, and told me I would be perfect for the business. They told me about Vemma, After politely telling them know [sic] they preceded to belittle me. Tell me that attending college was a waste of time and that I was "doing nothing with your life". All members of Vemma proceeded to block me on social media sites. . . . I feel that Vemma has negatively affected social aspects of my life . . ."
- "My son was caught up in [Vemma's] YPR last fall. He failed classes and lost motivation toward his education. I could not reach him at all."
- "It was the first time I had a strained relationship with my son. He's never had an attitude with me."

occurred that were unrelated to the opportunity to earn cash rewards does not negate the evidence that the opportunity to earn cash rewards was the major draw of the BurnLounge Mogul scheme."). See also Preliminary Injunction Order, Fed. Trade Comm'n v. Vemma Nutrition Co., No. 15-cv-1578 (D. Ariz. Sept. 18, 2015), ECF No. 118 ("With regard to the first Koscot prong, Vemma's bonus structure and training materials are designed to make new Affiliates buy a \$600 Affiliate Pack, which makes payment for the right to sell a Vemma product if not a written requirement, a practical one. With regard to the second Koscot prong, the evidence shows that the bonuses Affiliates earn are primarily for recruitment of other Affiliates, not the sale of products.")

In fact, based on the record in this case, the Panel Opinion highlighted multiple pieces of evidence that could lead a trier of fact to conclude that Stream is operating an illegal pyramid scheme. *Torres v. S.G.E. Mgmt., L.L.C.*, 805 F.3d 145 (5th Cir. 2015). By way of example, that opinion highlighted the following:

- "In presentations to [distributors] and prospective [distributors], these officers repeatedly underscored that the way to make money was by *recruiting other [distributors]*, not *recruiting customers*." *Id.* at 154 (emphasis in the original)
- "A [distributor]'s success depends primarily on recruiting a 'downline' of other [distributors] who, in turn, recruit

other [distributors] and customers into the Ignite program." *Id.* at 147.

- "The record shows, for example, that Greg McCord admonished [distributors] in one presentation that 'if you keep concentrating on customers, you won't make money." *Id.* at 154.
- "Ignite predominately pushes recruiting over selling, and thus expanding the number of [distributor] participants, over customer acquisition." *Id*.

And yet despite such findings, defendants and their amici maintain the bedrock assumption that Stream presents a legitimate business opportunity. Tellingly, not one of Stream's Independent Associates ("IAs") who wrote in support of defendants' position asserted that they joined Stream to become a victim of fraud or to perpetuate a fraud in order to victimize others. Indeed, the IAs state that they "disagree wholeheartedly with Plaintiffs' allegation that Stream Energy is an illegal pyramid scheme." Brief of Independent Associates as *Amicus Curiae*, Apr. 18, 2016, at 2. Of course they do!

It is axiomatic that the success of a pyramid scheme is dependent upon blinding potential prospects to the realities of the scheme. See Glenn W. Turner Enterprises, Inc., 348 F. Supp. at 772. Pyramid schemes only flourish when they are able to mask their fraudulent structures as legitimate MLM companies, and it is precisely this sleight of hand that leads directly to injury to consum-

ers, honest competitors and the general public. See Opposed Motion for Stay Pending Petition and Appeal Pursuant to Federal Rule of Civil Procedure 23(f) at 13, Torres v. S.G.E. Mgmt., L.L.C., No. 09-cv-2056 (S.D. Tex. Jan. 29, 2014), ECF No. 171 ("The success of multilevel marketing distribution channels, such as the one employed by Stream Energy . . ., rests on (1) the reputation of the company and its associates; and (2) the trust and goodwill that is built up between the company, its associates, and its customers."). See also BurnLounge, Inc., 753 F.3d at 885 ("The district court's finding that BurnLounge paid rewards for recruitment unrelated to product sales is also supported by the effect the preliminary injunction had on BurnLounge's revenues. After the parties entered into a stipulated preliminary injunction in July 2007 that stopped BurnLounge from offering the ability to earn cash rewards, BurnLounge's revenues plummeted.") When it comes to pyramid schemes, the connection between the injury and the fraud is inseparable – both derive from the same set of operative facts that are withheld from the unwitting victims, which inevitably leads us back to where we started - to posit the fundamental question that should only have to be answered once in this case: Is Stream a pyramid scheme?

Conclusion

For the foregoing reasons, this Court should affirm the District Court's

January 13, 2014 Memorandum Opinion and Order.

Dated: May 16, 2016

Respectfully submitted,

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Compliance Certificate

1. This amicus brief complies with the type-volume limitations of Fed.

R. App. P. 29(d) because it contains 3,757 words, excluding the parts of the

brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P.

32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it

has been prepared in proportionally spaced typeface using Word 2007 in 14

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Date: May 16, 2016

/s/ Robert B. Gilbreath
Robert B. Gilbreath

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Service Certificate

I hereby certify that I electronically filed the foregoing Brief of Amicus

Curiae Truth in Advertising, Inc. in Favor of Appellees and in Support of Af-

firmance with the Clerk of the Court for the United States Court of Appeals

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All participants in the case are registered CM/ECF users and will be served by

the appellate CM/ECF system.

Date: May 16, 2016

/s/ Robert B. Gilbreath

Robert B. Gilbreath

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