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CLERK U.S. DISTRICT COURT
CENTRAL DIST. OF CALIF.
LOS ANGELES

BY _____

7 Attorneys for Plaintiff

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10 UNITED STATES DISTRICT COURT
11 CENTRAL DISTRICT OF CALIFORNIA

12 FEDERAL TRADE COMMISSION,

13 Plaintiff,

14 v.

15 MALL VENTURES, INC., a
California corporation doing
16 business as 2by2.net, JEFFREY P.
MORGAN, and DENNIS WONG,

17 Defendants.
18

CV04-0463 FMC PLA
Case No.

COMPLAINT FOR PERMANENT
INJUNCTION AND OTHER
EQUITABLE RELIEF

19
20 Plaintiff, the Federal Trade Commission ("FTC" or
21 "Commission"), by its undersigned attorneys, alleges:

22 1. The FTC brings this action under Section 13(b) of the
23 Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), to
24 secure a permanent injunction and other equitable relief against
25 Defendants for their unfair or deceptive acts or practices in
26 violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

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1 directs, controls, or participates in the acts and practices of
2 the corporate defendant. Morgan resides and transacts business
3 in the Central District of California.

4 7. Defendant Dennis Wong is a co-founder of Mall Ventures.
5 He has been referred to by defendant Morgan as Morgan's "partner"
6 in Mall Ventures. Further, defendant Wong is the person who is
7 responsible for training and supervising the training of
8 consumers who join 2by2.net. Individually or in concert with
9 others, Dennis Wong directs, controls, or participates in the
10 acts and practices of the corporate defendant. Wong resides and
11 transacts business in the Central District of California.

12 COMMERCE

13 8. At all times material to this complaint, Defendants'
14 course of business, including the acts and practices alleged
15 herein, has been and is in or affecting commerce, as "commerce"
16 is defined in Section 4 of the FTC Act, 15 U.S.C. § 44.

17 DEFENDANTS' BUSINESS PRACTICES

18 9. Since at least April 2000, Defendants have promoted
19 2by2.net as a multi-level marketing business opportunity, through
20 which consumers may earn compensation by selling 2by2.net's
21 products or recruiting new members into the organization.

22 2by2.net's Matrix Structure

23 10. Organizationally, 2by2.net has been structured as a
24 binary matrix. Consumers could join 2by2.net as either
25 "eCommerce Consultants" or "Independent Representatives." A
26 consumer could join 2by2.net as an eCommerce Consultant by paying
27 approximately \$420. A consumer who joined 2by2.net as an
28 "eCommerce Consultant" would be placed in the 2by2.net matrix

1 under the eCommerce Consultant who recruited him or her (also
2 called the eCommerce Consultant's "downline"). In this fashion,
3 each eCommerce Consultant would create a "downline" consisting of
4 all the people who are directly or indirectly sponsored by that
5 eCommerce Consultant.

6 11. Defendants have represented that once a consumer
7 becomes an eCommerce Consultant building a downline, he can earn
8 significant sums of money. Defendants have represented that an
9 eCommerce Consultant can earn substantial "match pay" bonuses
10 (also referred to by Defendants as "customer acquisition
11 bonuses") for recruiting new members (each of whom must sell
12 2by2.net's Internet service to two customers) and selling the
13 Internet service to customers themselves. Prior to December
14 2001, the requirement that eCommerce Consultants or their
15 recruits actually sell 2by2.net's products or services to others
16 in order for the Consultants to receive the match pay bonuses was
17 not enforced.

18 12. Defendant Mall Ventures has derived an overwhelming
19 portion of its revenues from the recruitment of new eCommerce
20 Consultants, rather than from the sale of 2by2.net products or
21 services.

22 13. In addition to the right to earn "match pay" bonuses
23 for recruiting other consumers into the 2by2.net program,
24 eCommerce Consultants would receive an electronic mail account
25 ("username@2by2.net"), a standard "business" web page
26 ("www.2by2.net/username"), and a "personal" web page
27 ("www.my2by2.net/username"), through which they could promote
28 their 2by2.net "business." 2by2.net has called this eCommerce

1 Consultant membership its "Complete Internet Package" ("CIP").

2 14. Defendants have encouraged consumers to purchase more
3 than one CIP (preferably three or seven CIPs), representing that
4 it is advantageous to purchase more than one 2by2.net CIP in
5 order to quickly make more money as a 2by2.net eCommerce
6 Consultant. Organizationally, a consumer who has purchased three
7 CIPs fills three positions (also referred to by Defendants as
8 "spots") in the pyramid (one spot to join the 2by2.net program,
9 plus the two spots in the first level of the new eCommerce
10 Consultant's downline, at approximately \$420 for each spot, for a
11 total cost of approximately \$1,260). Defendants also have
12 encouraged consumers to purchase seven 2by2.net spots (at a total
13 cost of approximately \$2,940) when they join the 2by2.net
14 program, in order to fill the first two levels of the eCommerce
15 Consultant's downline. Defendants have encouraged consumers to
16 purchase multiple CIPs even if the consumers do not own or have
17 access to computers or to the Internet. The true purpose of
18 owning CIPs appears to have been to grow the matrix, rather than
19 to sell websites with intrinsic value to consumers.

20 15. A consumer could also join the 2by2.net program as an
21 "Independent Representative" by paying \$70. Independent
22 Representatives were eligible to earn commissions and "overrides"
23 on the sale of 2by2.net's retail products, but they were not part
24 of the 2by2.net matrix structure.

25 16. Through both their marketing efforts and the
26 compensation scheme they have instituted for 2by2.net, Defendants
27 have strongly encouraged consumers to join the 2by2.net program
28 as eCommerce Consultants, rather than as Independent

1 Representatives. Defendants have represented that the money an
2 eCommerce Consultant can earn from commissions and overrides is
3 significantly less lucrative than the money the eCommerce
4 Consultant can earn from making recruitment matches. Thus, while
5 over 50,000 consumers have joined the 2by2.net program as
6 eCommerce Consultants, fewer than 500 have joined as Independent
7 Representatives.

8 17. The products 2by2.net has purported to sell include
9 various products sold through 2by2.net's "Internet shopping
10 mall," Internet access, vitamins, and prepaid long distance
11 telephone cards. However, the few eCommerce Consultants who have
12 made money through 2by2.net have done so by recruiting new
13 participants rather than by selling 2by2.net's retail products.
14 Further, while consumers have paid Mall Ventures in excess of \$34
15 million to become eCommerce Consultants, Mall Ventures has paid
16 less than \$475,000 to the eCommerce Consultants and Independent
17 Representatives as commissions and overrides for the sale of
18 2by2.net retail products. In contrast, Mall Ventures has paid
19 \$22.4 million as match pay bonuses to consumers for recruiting
20 new eCommerce Consultants.

21 18. Very few consumers who have joined 2by2.net have made
22 enough money through 2by2.net to recoup their initial investment.
23 Most, if not all, of the very few consumers who have recouped
24 their initial investment have done so as eCommerce Consultants
25 recruiting other eCommerce Consultants, rather than as eCommerce
26 Consultants or Independent Representatives earning commissions or
27 overrides from the sale of 2by2.net's retail products.

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1 Misrepresentations and Omissions

2 Inducing Consumers to Attend Recruitment Meetings

3 19. Defendants have promoted 2by2.net both directly and
4 through their network of recruited eCommerce Consultants.
5 Defendants have urged eCommerce Consultants to persuade their
6 friends, family, and acquaintances to attend 2by2.net recruitment
7 meetings (also referred to by Defendants as "opportunity
8 meetings" and "hotel meetings") given by Mall Ventures officers,
9 corporate-sponsored presenters and top eCommerce Consultants. By
10 example, deception, and direct instruction, Defendants have
11 encouraged eCommerce Consultants to make misrepresentations and
12 omissions and use deception, including misrepresenting the nature
13 of the recruitment meetings (e.g., portraying the meeting as a
14 one-on-one interview for a job), the existence of salaried or
15 hourly positions, the potential or likely earnings to be derived
16 from joining 2by2.net, the amount of earnings that others have
17 made through 2by2.net, and the financial condition of Mall
18 Ventures, in order to get people to attend these recruitment
19 meetings.

20 Misrepresentations and Omissions

21 Inducing Consumers to Join 2by2.net and Recruit Others

22 20. At the recruitment meetings, Defendants, both directly
23 and through their eCommerce Consultants, have made
24 misrepresentations and omissions of material fact to encourage
25 consumers to join the 2by2.net program as eCommerce Consultants.
26 They have told consumers about the opportunity to earn thousands
27 of dollars per week by recruiting new eCommerce Consultants into
28 the 2by2.net program. Defendants and their eCommerce Consultants

1 have not told consumers that the vast majority of eCommerce
2 Consultants lose money by participating in the 2by2.net program.

3 21. Defendants also have held company-wide conference
4 calls, in which they have encouraged eCommerce Consultants to
5 talk about the thousands of dollars the eCommerce Consultants
6 have earned in short periods of time. Defendants have
7 misrepresented, expressly or by implication, that other eCommerce
8 Consultants can earn comparable amounts of money through 2by2.net
9 with hard work. In reality, most eCommerce Consultants,
10 regardless of the effort expended, have made very little, if any,
11 money through 2by2.net.

12 22. To assist eCommerce Consultants in recruiting new
13 participants into the 2by2.net program, defendants Morgan and
14 Wong have made personal appearances at large recruitment meetings
15 to promote 2by2.net as a legitimate business opportunity in which
16 participants can make substantial sums of money. Defendants have
17 stated that each eCommerce Consultant is "limited" to earnings of
18 \$15,000 per week, implying that it is reasonable to hope to earn
19 that much money as an eCommerce Consultant. In fact, very few,
20 if any, eCommerce Consultants have ever earned that much money
21 over any period of time through 2by2.net.

22 23. To assist eCommerce Consultants in recruiting new
23 participants into the 2by2.net program, Defendants have also
24 prepared, provided, and/or offered for sale, corporate marketing
25 materials for eCommerce Consultants to use in recruiting new
26 eCommerce Consultants into the 2by2.net program. These materials
27 include, but are not limited to, a "flip chart" presentation and
28 video testimonials from top 2by2.net eCommerce Consultants.

1 24. Through various presentations, including but not
2 limited to 2by2.net's video testimonials, live presentations and
3 one-on-one meetings, Defendants, directly and through their
4 eCommerce Consultants, have represented to consumers that they
5 can earn substantial sums of money participating in the 2by2.net
6 program. Representations have included describing how
7 participants went from low-paying jobs to earning a substantial
8 income with the 2by2.net program, how easy it is to make
9 significant earnings with the 2by2.net program, and specific
10 earnings claims, e.g., that participants can earn \$117,000 per
11 month in five years, or that if participants are just "1%
12 successful," they can earn over \$1,000 per month.

13 2by2.net Is a Pyramid Scheme

14 25. Defendants have operated what is commonly known as a
15 pyramid scheme. In a pyramid scheme, each participant pays money
16 to the scheme's promoter in exchange for the right to recruit new
17 participants. Participants then receive benefits for individuals
18 they recruit or who are added to their downline. Earnings in a
19 pyramid scheme are derived primarily from recruiting other
20 participants into the program, not from the retail sale of
21 products or services. The vast majority of 2by2.net eCommerce
22 Consultants have lost money through their participation in the
23 2by2.net program.

24 26. The 2by2.net program is structured so that a consumer's
25 financial gains are dependent upon his continued, successful
26 recruitment of additional participants, and the recruitment of
27 additional participants by others in his downline. Only those
28 individuals at the very top of the structure have received

1 significant compensation from the 2by2.net program. The vast
2 majority of 2by2.net eCommerce Consultants have enjoyed little or
3 no financial success from participating in the 2by2.net program.

4 VIOLATIONS OF SECTION 5 OF THE FTC ACT

5 Count One

6 27. In connection with the offering and sale of the right
7 to participate in the 2by2.net program, Defendants have
8 represented, expressly or by implication, that consumers who join
9 the 2by2.net program are likely to realize substantial financial
10 gain.

11 28. In truth and in fact, consumers who join the 2by2.net
12 program are not likely to realize substantial financial gain.

13 29. Therefore, the representations set forth in Paragraph
14 27 are false and misleading and constitute deceptive acts or
15 practices in violation of Section 5(a) of the FTC Act, 15 U.S.C.
16 § 45(a).

17 Count Two

18 30. By furnishing 2by2.net eCommerce Consultants with
19 promotional materials to be used in recruiting new participants
20 that contain false and misleading representations, Defendants
21 have provided the means and instrumentalities for the commission
22 of deceptive acts and practices.

23 31. Therefore, Defendants' practices, as described in
24 paragraph 30, constitute deceptive acts and practices in
25 violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

26 Count Three

27 32. In connection with the offering and sale of the right
28 to participate in the 2by2.net program, Defendants have

1 represented, expressly or by implication, that consumers who join
2 the 2by2.net program are likely to realize substantial financial
3 gain.

4 33. Defendants have failed to disclose that most consumers
5 who join the 2by2.net program are not likely to realize
6 substantial financial gain.

7 34. This additional information, described in paragraph 33,
8 would be material to consumers in deciding whether to join the
9 2by2.net program.

10 35. The Defendants' failure to disclose the material
11 information described in paragraph 33, in light of the
12 representations made in paragraph 32, therefore constitutes a
13 deceptive act and practice in violation of Section 5(a) of the
14 FTC Act, 15 U.S.C. § 45(a).

15 Count Four

16 36. As alleged herein, the compensation structure in the
17 2by2.net program has been based primarily on payments to
18 participants for the recruitment of new participants, not on the
19 retail sale of products or services, thereby resulting in a
20 substantial percentage of participants losing money.

21 37. This type of scheme, often referred to as a pyramid, is
22 a deceptive act and practice in violation of Section 5(a) of the
23 FTC Act, 15 U.S.C. § 45(a).

24 CONSUMER INJURY

25 38. Defendants' violations of Section 5 of the FTC Act, as
26 set forth above, have caused and continue to cause substantial
27 injury to consumers. Absent injunctive relief by this Court,
28 Defendants are likely to continue to injure consumers.

1 3. Award Plaintiff the costs of bringing this action, as
2 well as such other and additional relief as the Court may
3 determine to be just and proper.
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5 Dated: January 23, 2004 Respectfully submitted,

6 WILLIAM E. KOVACIC
7 General Counsel

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