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FEDERAL TRADE COMMISSION

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

Federal Trade Commission; Plaintiff, v. **Vemma Nutrition Company**, a corporation; **Vemma International Holdings, Inc.**, a corporation; **Benson K. Boreyko** a/k/a **B.K. Boreyko**, an individual; and **Tom Alkazin**, an individual; Defendants, and **Bethany Alkazin**, an individual; Relief Defendant.	**No. CV-15-01578-PHX-JJT** **PLAINTIFF FEDERAL TRADE COMMISSION'S OMNIBUS REPLY TO DEFENDANTS' RESPONSES REGARDING THE SEPTEMBER 15 PRELIMINARY INJUNCTION HEARING**

I. INTRODUCTION

Plaintiff Federal Trade Commission (FTC) filed its Complaint for Equitable Relief (Dkt. 3) on August 17, 2015, alleging that Defendants violated the Federal Trade Commission Act, 15 U.S.C. § 45(a), by using deceptive earnings claims to promote an illegal pyramid operation, and providing others the means and instrumentalities to do the same. *Id*. Simultaneous with its complaint, and as authorized by the Second Proviso of the FTC Act,[1] Plaintiff sought an *ex parte* temporary restraining order and preliminary injunction against Defendants. (Dkts. 4, 9). Plaintiff supported its motion for immediate injunctive relief with four volumes of declarations and supporting documents from witnesses. (*See* Dkts. 10-14, 21, 30; Plaintiff's Exhibits (PE) 1-128). Defendants' have responded to Plaintiff's motion, misconstruing law and facts regarding this action.

II. ARGUMENT

A. Defendants Improperly Reclassify Affiliates as Customers

Consistent with their misleading marketing materials, and in an attempt to disguise Vemma's actual purchase patterns which are consistent with illegal pyramid activity, Defendants attempt to re-classify self-designated Affiliates as Customers. The clearest example of this tactic comes from the declaration of Dr. E. Emre Carr (Vemma.App.000440). While recognizing that participants self-designate as Affiliates or

[1] Defendants incorrectly cite to the First Proviso of the FTC Act, 15 U.S.C. § 53(b) in their pleadings to assert that the FTC was required to provide advance notice of their request for preliminary relief. (*See, e.g.*, Dkt.70, pp. 3-4) In fact, the First Proviso and its procedural conditions requiring notice, relate to administrative proceedings. This action is brought in federal court pursuant to the Second Proviso of the FTC Act, which states that, "*Provided further*, That in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction." 15 U.S.C. § 53(b). *See FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1110-11 (9th Cir. 1982).

Customers on Vemma's website, Dr. Carr decides that this classification is not "meaningful." (Vemma.App.000445, ¶ 15). He advocates defining Customers as buyers who never received a commission, never enrolled another individual, and did not purchase an affiliate pack, regardless of whether the participant self-designated as an Affiliate. (Vemma.App.000447, ¶ 17). Vemma used a similar tactic in its 2013 U.S. Disclosure statement and reclassified 149,431 Affiliates as Customers, changing its Customer versus Affiliate ratio from 28% Customers and 72% Affiliates to 70% Customers and 30% Affiliates. (Dkt. 50-1, p. 4).

This tactic allows Vemma to categorize failed Affiliates as Customers and serves two purposes: 1) making it appear that Vemma's marketing is product-oriented rather than recruitment-oriented; and 2) obscuring the natural consequences of Vemma's pyramid scheme—large numbers of failed affiliates.

B. Vemma's Overwhelming Focus Is on the Purported Business Opportunity

The FTC has presented overwhelming evidence, through Vemma's marketing materials and the words of its CEO and other representatives, that Vemma was marketing a classic pyramid scheme by training Affiliates to make bonus-qualifying purchases and to recruit others to do the same. Faced with this evidence, Vemma's response essentially argues that the pyramid marketing was not effective in practice. It is true that to determine whether a business is a pyramid, a court must look at how the business operates in practice. *FTC v. BurnLounge, Inc.*, 753 F.3d 878, 883 (9th Cir. 2014). However, Defendants ignore the fact that a major factor of how the program operates in practice is how the program is promoted—*i.e.*, whether the program has a recruitment

bias. *See Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 782 (9th Cir. 1996) ("mere structure of the scheme suggests that [defendant's] focus was in promoting *the program* rather than selling *the products*") (emphasis in original); *BurnLounge*, 753 F.3d at 881, 883 ("The district court also found that [defendant's] marketing focus was on recruiting new participants through the sale of packages").

Defendants' attempts to minimize the inherent recruitment focus of their own marketing materials should be disregarded. Whether Defendants also talk about products in some materials is inconsequential. The extensive materials quoted in the FTC's Memorandum (Dkt. 9) plainly demonstrate that the Vemma program has a recruitment bias and that the business opportunity is the major thrust of the program.

C. Affiliates "Pay to Play"

As the court in *Omnitrition* noted, the "payment of money" element of a pyramid scheme can be met where the participant is required to purchase inventory in order to receive the *full benefits* of the program.[2] *Omnitrition*, 79 F.3d at 782; *see also FTC v. Equinox Int'l Corp.*, No. CV-S-99-0969-JBR (RLH), 1999 U.S. Dist. LEXIS 19866, at *16 (Sept. 14, 1999). While Vemma Affiliates can technically join without purchasing an Affiliate Pack, such a purchase is necessary for full participation in the program. The frenzy, double-frenzy, premier club, and affiliate pack flag bonuses all require such a purchase. (PE 13, 69; App. 832-34; 1530-31, 1532-33 ¶¶ 28, 34). Moreover, the purchase of an Affiliate Pack and personal enrollment in auto-delivery to maintain eligibility for

[2] Here, if Affiliates return their product purchases, they will not be able to participate fully in the program.

bonuses are heavily marketed as necessary investments to become successful in the business. (*See, e.g.*, PE 20, 45, 62, 64, 100, 117, 119; App. 956-571243:24-1244:2, 1243:24-1244:13, 1446:10-17, 1466:9-11, 1467:1-3, 1468:5-9, 1816, 1834; 1836). The double-frenzy bonus also explicitly requires the enrollment of auto-delivery. (PE 13, 69; App. 834, 1531 ¶ 28).

D. Defendants Failed to Show their Purported Anti-Pyramid Safeguard Policies Are Effective

Defendants bear the burden of establishing that their *Amway* safeguard policies are effective. *United States v. Gold Unlimited, Inc.*, 177 F.3d 472, 482 (6th Cir. 1999). The FTC has already pointed out the fallacies in Defendants' purported anti-pyramid safeguard policies. (Dkt. 9, pp. 40-43). In addition, Defendants have provided no evidence that Vemma enforces the 70% rule, which requires that distributors sell at least 70% of their products purchases each month. While Vemma speaks to 15 Affiliates each month to seek certification that Affiliates have met the 70% rule, the scripted call generically asks whether the Affiliate is "consuming or retailing at least 70% of the products [he or she] purchased for the month," without inquiring as to the motivation of the purchases.[3](PE 72; App. 1786). Vemma's own filings indicate that Affiliates are not sanctioned for violating the rule. (*See* Doc. 78-1, ¶ 31; Vemma.App.00061-164). Instead, in the event that an Affiliate cannot make the certification, Vemma simply "remind[s]

[3] Vemma defines inventory loading similar to how courts have defined it—"buy[ing] product inventories to qualify for commissions and bonuses." *Compare* PE 14; App. 842 ¶ 29 with *Omnitrition*, 79 F.3d at 782, n. 3 and *Equinox Int'l*, 1999 U.S. Dist. LEXIS 19866, at *19. In direct contravention of Vemma's own rules, Vemma and its CEO explicitly encourage the practice. (*See, e.g.*, PE 21, 64, 119; App. 956-57; 1468:5-9, 1836).

them that . . . they can place their monthly autoship on hold." (PE 72; App. 1786). There is clearly no evidence that this superficial certification requirement "actually serves to deter inventory loading"—indeed, "the crucial evidence of [its] actual *effectiveness* . . . is missing." *Omnitrition*, 79 F.3d at 783-84.

Further, Defendants' argument that a 10 customer rule is inapplicable to Vemma's business model is ill-conceived. (*See* Doc. 78-2, ¶ 58). It *does* make sense to require a minimum number of customers or customer purchases per Affiliate—otherwise, there is no mechanism under the compensation plan to encourage or incentivize retail sales. *See Omnitrition*, 79 F.3d at 782 ("The promise of lucrative rewards for recruiting others tends to induce participants to focus on the recruitment side of the business at the expense of their retail marketing efforts, making it unlikely that meaningful opportunities for retail sales will occur.).

E. Defendants' Deceptive Income Claims Are Indisputable

The FTC has submitted multiple marketing materials made by the Defendants themselves that feature misleading income claims. (*See* Dkt. 9, pp. 17-24, 43-47). The FTC is not required to show that every reasonable consumer would have been, or in fact was, misled. *See FTC v. Stefanchik*, 559 F.3d 924, 929 (9th Cir. 2009) (holding that the FTC is not required to show that all consumers were deceived). Nor is the FTC required to show that consumers subjectively relied on the deceptive representations or omissions. "[T]he FTC need merely show that the misrepresentations or omissions were of a kind usually relied upon by reasonable and prudent persons, that they were widely disseminated, and that the injured consumers actually purchased the defendant's

products." *FTC v. Security Rare Coin & Bullion Corp.*, 931 F.2d 1312, 1316 (8th Cir. 1991).

While Vemma asserts that its earnings claims were sales pitch puffery, they are clearly not. In *Cook, Perkiss and Liehe, Inc. v. Northern California Collection Service*, 911 F.2d 242, 246 (9th Cir. 1990), the Ninth Circuit noted:

> In the FTC context, we have recognized puffery in advertising to be 'claims [which] are either vague or highly subjective.' *Sterling Drug, Inc. v. FTC*, 741 F.2d 1146, 1150 (9th Cir. 1984), cert. denied, 470 U.S. 1084 (1985). The common theme that seems to run through cases considering puffery in a variety of contexts is that consumer reliance will be induced by specific rather than general assertions.

Here, the misleading claims were not vague or merely suggestive pronouncements, but rather specific references to actual (or purportedly actual) income amounts earned by individuals or groups of participants. Vemma has made multiple specific earnings claims that are clearly designed to induce consumers to participate in its purported business opportunity.

F. <u>Defendants' Purported Disclosures Are Woefully Inadequate</u>

Defendants assert that their disclosures cure the deception of the false earnings claims. (*See* Dkt. 74 at 30-31). However, nothing could be further from the truth.

Numerous courts have held that the "net impression" formed by a reasonable consumer based upon deceptive initial claims is not remedied by later truthful disclaimers. *E.g., FTC v. Direct Marketing Concepts*, 624 F.3d 1, 12 (1st Cir. 2010) (disclaimers are not effective unless they . . . change the apparent meaning of the claims and leave an accurate impression."); *Resort Car Rental v. FTC*, 518 F.2d 962 (9th Cir.

1975) (citing *Exposition Press, Inc. v. FTC*, 295 F.2d 869 (2nd Cir. 1961)) (law is violated if defendant induces first contact through deception, even if buyer becomes fully informed before entering contract). It is also well settled that "[d]isclaimers or qualifications in any particular [presentation] are not adequate to avoid liability unless they are sufficiently prominent and unambiguous to change the apparent meaning of the claims and to leave an accurate impression. Anything less is only likely to cause confusion by creating contradictory double meanings." *Removatron Int'l Corp. v. FTC*, 884 F.2d 1489, 1497 (1st Cir. 1989); *FTC v. US Sales Corp.*, 785 F. Supp. 737, 751 (N.D. Ill. 1992).

"[D]isclaimers do not automatically exonerate deceptive behavior and disclaimers are particularly inadequate when they appear in a different context then the claims they purport to repudiate." *FTC v. Connelly*, No. SACV 06-701 DOC (RNBx), 2006 U.S. Dist. LEXIS 98263, at *33 (C.D. Cal. Dec. 20, 2006). *See also In re Cliffdale Associates, Inc.*, 1984 FTC LEXIS 71, at *184 (F.T.C. March 23, 1984) ("[I]n many circumstances, consumers do not read the entirety of an ad or are directed away from the importance of the qualifying phrase by the acts or statements of the seller."). Disclaimers that "are difficult to read, do not accurately indicate the amount of earnings that can be expected do not immunize [defendant's] exaggerated claims of income." *FTC v. Equinox Int'l Corp.*, 1999 U.S. Dist. LEXIS 19866, at *17-18 (D. Nev. Sept. 14, 1999) (granting preliminary injunction) ("Distributors are given unrealistic hypothetical examples that their profits will increase geometrically if distributors focus on recruitment . . . [While] video presentations and [company] materials . . . contain disclaimers as to the amount of

profits obtainable . . . [they] are difficult to read, do not accurately indicate the actual amount of earnings that can be expected and do not immunize Equinox's exaggerated claims of income.").

Defendants' purported disclosures do not effectively qualify their express earnings claims and leave consumers with an accurate net impression. As set forth in the FTC's memorandum (Dkt. 9, pp. 22-24, 46-47), Defendants' purported disclaimers are ineffective qualifiers—Defendants lead consumers to believe that if they put forth the right effort, they can and will earn substantial sums of money through Vemma.

G. Preliminary Injunctive Relief is Proper

Defendants argue in their reply brief that the court's issuance of a temporary restraining order was improperly granted (Dkt. 70, pp. 4-5) and that a preliminary injunction is not warranted. (Dkt. 70, pp. 6-8). However, the restraining order has already been issued and is not before the court on review. And Defendants did not seek to dissolve the temporary restraining order as permitted under Fed. R. Civ. P. 65(b)(4).

In deciding whether to grant preliminary relief, the court must: (1) consider the likelihood that the FTC will ultimately succeed on the merits; and (2) balance the equities. *FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1233 (9th Cir. 1999). The FTC need not show irreparable harm, which is presumed in a statutory law enforcement action, to obtain a preliminary injunction. *Id.* at 1233 (quoting *FTC v. Warner Communications, Inc*., 742 F.2d 1156, 1159 (9th Cir. 1984)). The FTC has shown a likelihood that it will ultimately succeed on the merits. Based upon the evidence presented, there is good cause to believe that Defendants have violated Section 5(a) of the

FTC Act in the manner described in Plaintiff's complaint. Further, a proper balance of the equities favors the FTC: enjoining deceptive or unfair acts or practices that violate the law and injure consumers serves the public interest.

III. CONCLUSION

The overwhelming evidence demonstrates that Defendants are operating a pyramid scheme, which they promote through misleading income claims, and that they provide others with the means and instrumentalities to do the same. The court should enter the requested preliminary injunction that prohibits Defendants from further law violations, retains the court's independent receiver to oversee the business, and preserves certain assets pending adjudication of the case.

DATED this 12th day of September, 2015.

Respectfully submitted,

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FEDERAL TRADE COMMISSION

CERTIFICATE OF SERVICE

I certify that on September 12, 2015, Plaintiff Federal Trade Commission electronically transmitted the attached Document to the Clerk's Office using the CM/ECF System for filing and transmittal of a Notice of Filing to all CM/ECF registrants including:

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