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16 *Company and Vemma International Holdings,*
17 *Inc.*

18 **IN THE UNITED STATES DISTRICT COURT**
19 **FOR THE DISTRICT OF ARIZONA**

20 Federal Trade Commission,
21
22 Plaintiff,
23
24 vs.
25
26 Vemma Nutrition Company, *et al.*,
Defendants.

NO. CV-15-01578-PHX-JJT

CORPORATE DEFENDANTS'
QUARTERLY REPORT DATED
DECEMBER 18, 2015

20 Pursuant to Section V(B) of the Court's Preliminary Injunction Order, entered
21 September 18, 2015 ("the Order"), Vemma Nutrition Company and Vemma International
22 Holdings, Inc. (collectively, "Vemma" or the "Corporate Defendants") submit this
23 quarterly report describing the Corporate Defendants' business operations over the past
24 three months.

1 **I. BACKGROUND**

2 Set out below is background to provide context for the discussion of the Corporate
3 Defendants' business operations since September 18, 2015.

4 On August 24, 2015, the Receiver took control of Vemma and, by the next day,
5 laid off all but five of Vemma's 110 employees. In addition, over 80 international
6 employees were terminated. The Receiver shuttered Vemma's operations in the United
7 States and in all 50 international markets and made no meaningful effort to repatriate
8 assets.¹ The Receiver's activities caused significant harm to the Corporate Defendants'
9 business operations as discussed below.

10 The Receiver's decisions to close shop and go radio silent with respect to
11 international operations for nearly four weeks caused the company's global entities to
12 default on their respective legal and financial obligations and be placed in liquidation.
13 Further, Vemma's Asian licensee has made a claim against Vemma that the shutdown
14 breached its International License Agreement.

15 As a result, Vemma has lost significant international sales and assets. In calendar
16 year 2014, Vemma's international sales were \$93,284,964 (excluding Canada). These
17 sales have evaporated and cannot be replaced. In addition, the Receiver's actions
18 effectively reduced assets in excess of \$10,000,000 relating to international operations to
19 zero.

20 Because Vemma has only been able to restart business in the United States and
21 Canada, approximately 184,000 of Vemma's international Affiliates and Customer's no
22 longer have the ability to buy Vemma products.

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24

¹ Although the Receiver was purportedly "skilled at tracking assets and getting
25 assets back from overseas," the Receiver's only effort to repatriate international assets
26 consisted of asking Vemma's accounting team to email the international managers to wire
any money they had to Vemma's US bank account.

1 **II. THE FTC'S RENEWED INTEREST IN THE NEW VISION CONSENT ORDER**

2 As the Court is aware, Mr. Boreyko and the Corporate Defendants are the subject
3 of a March 3, 1999 Consent Order in *In re New Vision International*. The FTC could
4 have commenced its investigation of Vemma under the Consent Order with a simple letter
5 requesting evidence of compliance with the Order rather than pursuing the ex parte TRO
6 that it filed in August 2015. Instead, the FTC commenced this investigation only after the
7 Court entered its Order providing for a preliminary injunction that was narrower in scope
8 than what the FTC sought, and which did not provide for the continuing appointment of a
9 receiver or asset freeze that the FTC requested.

10 In the past, both New Vision and Vemma had provided the FTC with information
11 pursuant to the Consent Order and had a history of being fully cooperative. Had the FTC
12 requested further information in regards to either the Consent Order, or the activities that
13 are the subject of this action before filing its ex parte TRO application, the Corporate
14 Defendants would have cooperated (as they have in the past) and much of the damage that
15 has affected the Corporate Defendants' business operations discussed below would have
16 been avoided.

17 In fact, even before the commencement of this Action and without any
18 communication from the FTC, Vemma had already significantly changed its marketing.
19 While the FTC contends that Vemma's business opportunity was "specifically marketed
20 toward young people" and was "a cold-blooded scheme to exploit young people", as of
21 late 2014 Vemma had materially reduced its marketing efforts that appealed to a younger
22 audience, including eliminating the term "YPR – Young People's Revolution" from
23 Vemma's advertising materials. Concerned by some of the young Affiliates' aggressive
24 marketing on social media, Vemma also made many changes to address the young
25 affiliate's marketing practices. This included limiting social media and hiring a web
26 search firm to conduct searches on social media. By the spring of 2015, the Vemma youth

1 movement was over and the lead Affiliate involved in YPR (and his team) had left
 2 Vemma to join several competing companies. Over Vemma's 11-year history, its best-
 3 selling product is and has been a liquid supplement designed for the baby boomer
 4 marketplace, not the Verve energy drink that has been the predominant focus of the FTC's
 5 arguments in this action. Although the social media "noise" painted Vemma as an energy
 6 drink company for young people, the primary market and the majority of the company's
 7 product sales relate to the "baby boomer" age group. Fortunately, the demand for
 8 Vemma's products has remained strong despite the FTC's action.

9 **III. FINANCIAL ANALYSIS**

10 Although Vemma's owners resumed control of the company on September 18,
 11 2015, Vemma was not able to start selling products until October 8, 2015. Accordingly,
 12 there were no sales for the month of September 2015. As part of restarting operations,
 13 Vemma introduced a "Thank You Sale", where it reduced product prices up to 40%. The
 14 following table sets forth Vemma's revenue and operating results:

16 North America:	<u>October 2015</u>	<u>November 2015</u>
17 Revenue:	\$ 862,371	\$ 701,927
18 Cost of sales:	460,155	260,238
19 Merchant Fees:	60,369	54,406
20 General and Administrative Expenses	586,516	514,053
21 Operating Income/(Loss)	(244,669)	(126,770)
22 Other Income and (expense)	(76,761)	(76,637)
23 Net Operating Income/(Loss)	(321,430)	(203,407)
Gain on Sales of Assets	77,771	
Extraordinary Income*	130,226	
Income/(Loss) before income taxes	(113,433)	(203,407)
24 * Includes prior period adjustments related to commissions and royalty programs.		

25 Vemma's revenue for December 1-15, 2015, has been \$407,937.
 26

1 During the 25-day period when the business was in the hands of the Receiver,
2 many of Vemma's U.S obligations were not paid and the company defaulted on some of
3 its commitments. The Receiver allowed critical operational functions to lapse, including
4 commitments to Vemma's shipping vendor, third party logistic warehouses, transportation
5 companies and other important vendors. Although the Receiver set aside the funds to pay
6 the company's landlord, that payment was not made by the Receiver, causing Vemma to
7 default on the lease of its corporate and operational headquarters. The company had to
8 work out payment plans with various vendors to restart operations.

9 During the shutdown, from August 24 until October 8, no revenue was generated.
10 The Receiver withheld over \$400,000 in funds as a reserve for its fees.² Further,
11 Vemma's merchant bank withheld approximately \$800,000 in revenue that would have
12 normally been transferred to the company (more on that below). Due to the cash flow
13 issues, Benson Keith Boreyko loaned the company the sum of \$1,031,500.

14 **IV. MERCHANT ACCOUNT**

15 From an operating standpoint, Vemma's biggest challenge in restarting its business
16 was its difficulty in securing a merchant to process its credit card orders. When the
17 business was shut down, Vemma's North American merchant, Propay, immediately
18 terminated the account and held back over \$800,000 in revenue as a reserve for potential
19 charge backs (despite Vemma's prior excellent history in this regard). Unable to process
20 orders, the company began applying to various merchants to establish an account.
21 Because of the FTC action against Vemma, the company was placed on a Match List
22 (black list) making it impossible to secure a domestic merchant account. To date, the
23 company has applied to 32 different merchant processors, and only two foreign merchants

24 ² In October, 2015, the court ordered the Receiver to transfer \$237,801.51 to
25 Vemma. The Receiver complied with the Order. The Court also ordered Vemma to
26 deliver payment to the Receiver by December 25, 2015, in the amount of \$66,966.96 for
fees and costs approved by the Court. Vemma has complied with the Order.

1 have agreed to work with Vemma.

2 On October 8, 2015, twenty days after taking back control of the company, Vemma
3 began to process credit card orders with Paysafe, a foreign merchant processing through
4 the Bank of Mauritius. As a foreign merchant processor, Paysafe charged a very high fee
5 of 10% per transaction with a rolling six-month reserve of 10%. As a comparison, prior to
6 the shutdown, Propay had been charging Vemma a fee of 2.5% per transaction. Due to
7 Vemma's low number of charge backs, on December 15, 2015, Paysafe reduced its fees to
8 7% and its rolling six-month reserve to 5%.

9 In addition to the exorbitant transaction fee and rolling reserve, Vemma has also
10 experienced a high percentage of credit card declines through Paysafe because it is not a
11 domestic merchant. Prior to the FTC action, Vemma's decline rate was 10-15%.
12 Currently, it is experiencing a decline rate of 25-30%. The reason for the increase is that
13 when Vemma's orders are processed, the credit card holder's local bank identifies the
14 processor as The Bank of Mauritius, a foreign bank. Depending on the local bank's fraud
15 protection program, charges are often declined. Vemma must then call the credit card
16 holder and conference in the local bank to get the charge approved.

17 The last challenge with securing a merchant account is that Paysafe's merchant
18 processing services were not integrated with Vemma's Customer Relationship
19 Management System ("CRM") or Vemma's gateway (authorize.net) for its Auto Delivery
20 Orders. Accordingly, Vemma was unable to process one-time online orders through
21 Paysafe. Instead, the company's Customers and Affiliates had to either fax orders into the
22 company or call Vemma's customer service center. Hold times to place orders ranged
23 from 30 minutes and up to 2 hours. Despite these obstacles, a significant number of
24 Vemma customers placed orders, as described below in the discussion relating to sales.

25 Vemma was finally able to offer one time online orders on December 1, 2015.
26 However, to date, it has not yet been able to process its Auto Delivery orders. In July

1 2015, U.S. Auto Delivery orders generated \$2,490,168.30 in revenue. As part of its PC
2 compliance program, Vemma's credit card data for its Auto Deliveries are stored in a
3 third party "vault." The gateway to the vault is through authorize.net, a domestic
4 pathway. As a foreign merchant, Paysafe is not integrated into authorize.net. Vemma is
5 currently working on integrating Paysafe into authorize.net so that the company can
6 process Auto Deliveries. Vemma hopes to process these orders in mid-January 2016.

7 **V. SQUARE, PAYPAL, AMAZON PAY AND HYPER WALLET**

8 While Vemma worked on obtaining a merchant account, the company started to
9 process some orders through Square, a financial services, merchant services aggregator
10 and mobile payment company. However, three days after processing orders, Square
11 unilaterally terminated the account and withheld approximately \$90,000 in revenue. No
12 explanation was provided. Vemma also attempted to partner with PayPal, but was
13 rejected.

14 Vemma did partner with Amazon Pay, beginning in October, 2015. Affiliates or
15 Customers with an Amazon account were able to purchase Vemma products using their
16 Amazon account. Vemma fully disclosed the FTC matter to Amazon at the beginning of
17 the relationship. However, on November 20, 2015, after processing orders for almost five
18 weeks, Amazon Pay unilaterally terminated Vemma's account citing the FTC matter.
19 Vemma continues its effort to understand what caused Amazon to change its position.
20 During this period, Vemma generated \$579,410.46 in revenue through Amazon Pay, with
21 only five returns.

22 Vemma had also used the services of Hyper Wallet, which is a web based payment
23 solution for some of its international payments. Due to the FTC shut down, Hyper Wallet
24 terminated its contract with Vemma and stopped payments that were due to various
25 persons.

26

1 **VI. CHARGE BACKS**

2 Notwithstanding the FTC litigation and the Receiver's decision to shut the business
3 down worldwide, credit card charge backs for Vemma's products were extremely low:

4	September	\$105,409.26 (Propay and Authorize.net)
5	October	\$44,644.00
6	November	\$11,268.91
7	December (1-15 th)	\$2,214.25

8 Although September charge backs were higher, that was due in part to the Receiver's
9 decision stop the shipment of over \$30,000 in product that had been ordered and paid for
10 prior to the Receiver closing the business. To put this in perspective, assuming that all
11 charge backs were for July and August sales, the percentage is .026%.

12 **VII. CUSTOMERS AND AFFILIATES**

13 Despite the significant operational obstacles discussed above, since restarting
14 operations, 1,307 new Customers and 43 Affiliates have joined Vemma. Vemma has also
15 continued its analysis of whether Affiliates in its system are properly classified as
16 Affiliates, or whether they should be considered Customers because their purchases were
17 not motivated primarily by a desire to engage in the business opportunity. The Vemma
18 plan—even before the FTC action—is unique in that the product price is the same for
19 Customers and Affiliates and there are no sign up or annual renewal fees. During the
20 preliminary injunction hearing, Vemma presented evidence that approximately 75-80% of
21 the individuals designated as Affiliates were in fact just Customers. Vemma explained
22 that because it did not financially distinguish between Affiliates and Customers, many
23 new people who were truly just consumers, were enrolled as Affiliates. In its Order, the
24 Court rejected this argument stating:

25 Defendants' proposed reclassification of Affiliates to
26 customers as urged by Defendants' expert, Dr. Carr is not

1 based in fact. Defendants have offered no evidence to support
2 a finding that a Vemma participant who intended to be just a
3 customer accidentally identified himself or herself as an
4 Affiliate, or had any motivation to do so.

5 However, since the preliminary injunction hearing, Vemma has collected
6 additional evidence that shows that many of the persons designated as Affiliates in
7 Vemma's system, are more accurately described as Customers because they are not
8 primarily interested in the business opportunity.

9 This additional evidence includes the fact that many Vemma participants did not
10 personally sign themselves up with Vemma. The Enroller would sign up the new
11 participant in order to eliminate any possible errors in contact details or placement in the
12 system. There are two main avenues for new participants to join Vemma. First, the new
13 participant could sign up on their Enroller's personal website. Second, the Enroller could
14 sign the new participant up himself in his "back office", which is a web tool that Affiliates
15 use to monitor their business. Since in the Enroller's mind there was no financial
16 difference between signing up as an Affiliate or Customer, many Affiliates would enroll a
17 new person as an Affiliate with the hope that one-day, the new person would build the
18 business. The company can quantify the number of new participants that were signed up
19 by their Enroller or signed up on their own. Vemma's computer system identifies whether
20 a new participant was enrolled through an Affiliate's back office or signed up on their
21 own through the Affiliate's website. According to Vemma's records, approximately
22 501,338 new participants joined Vemma from January 2013 to date. Of these, 245,470
23 (almost 49%) of the new participants were signed up by the Enroller through the
24 Enroller's back office and never selected their own designation as Affiliate or Customer.
25 Only 136,236 of these participants (about 36%) signed up on their own through the
26 Affiliate's website.³

³ The rest of the enrollees came in through Vemma's Mobile App, vemma.com and

1 In addition, from April 1, 2014 through December 31 2014, Vemma changed its
 2 enrollment process and required every person who joined the company to sign up first as a
 3 Customer. There was no option to enroll as an Affiliate. If the participant engaged in
 4 business building activities, which the company defined as buying a pack or enrolling a
 5 new person, their designation was automatically converted to Affiliate. The data indicates
 6 that from April 1, 2014 through December 31, 2014, 104,451 people were enrolled as
 7 customers and 16,911 converted to Affiliates. Accordingly, about 16% of the participants,
 8 by way of their business building activities, converted to Affiliate status during this time
 9 period. This is in line with the company's position that the vast majority of Affiliates are
 10 truly just consumers. In January, 2015, Vemma changed its sign up process and allowed
 11 people to self-select between Customers and Affiliates.

12 After the preliminary injunction hearing, Vemma continued to evaluate the proper
 13 classification of its participants, and the company entered into a stipulation with the FTC
 14 regarding this matter. The stipulation permitted the company to place a "pop up" in the
 15 back office and allow Affiliates who had not earned a check, enrolled anyone or bought a
 16 pack to reclassify themselves as a customer or elect to remain an Affiliate. There were
 17 27,365 people that fell into this category. As of December 15, 2015, 1,872 Affiliates have
 18 visited their back office so far and responded to the pop-up

19	Total Selected to View Popup:	27,365
20	Total who have answered:	1,827
21	Total who Opted to become Customers:	1,372
22	Total who Remained Affiliates:	455

23 _____
 24 fax or phone applications. Of the 245,470 people, 136,236 were signed up by the enroller
 25 as an Affiliate and 109,234 were signed up by the enroller as a Customer. Of the 136,236
 26 people signed up by the Enroller as an Affiliate, 71,974 of those people were really
 customers who did not buy a pack, enroll anyone or earn a commission. 64,262 people
 did some or all of these three activities.

1 75% of the people who viewed the pop up changed their status to customer. Based on this
2 limited survey, Vemma believes that if the remaining 25,538 Affiliates in this group
3 actually visited their back office (not normally done by Customers), over 70% would
4 classify themselves as a customer. An estimated additional 1,500 people have called and
5 emailed the company asking for their status to be changed.

6 Relying only upon the label in Vemma's system, from January 1, 2014 through
7 today, in the US, the company has enrolled 123,849 Customers and 65,700 Affiliates.
8 From April 2013 to the present; Vemma has enrolled 180,623 customers and 172,577
9 Affiliates.

10 **VIII. COMMISSIONS**

11 Pursuant to the Order, Vemma revised its compensation plan and implemented it in
12 November, 2015. Since restarting operations, the company has made one commission
13 payment on December 9, 2015. One hundred nineteen Affiliates earned commissions.
14 The total commission payout was \$30,969.98.

15 On December 8, 2015, Vemma presented a new Compensation Plan to the FTC for
16 its review. The proposed plan emphasizes retail sales and is simple in scope. Like the
17 plan currently in operation, the "51/49" Customer sales rule is the overriding factor in
18 determining if commissions are paid. Under this new plan, to become an Affiliate, the
19 new participant would pay an annual fee of \$19.95 for Vemma's internet tools and
20 develop two teams (legs). Customers, on the other hand, would join for free. The
21 proposed new plan provides for three ways to earn commissions:

- 22 1. Retail Bonus. Affiliates may buy product at a discount and resell the
23 product to consumers. In addition, any Affiliate who introduces a Customer to
24 Vemma that purchases products directly from the company, would earn a 20%
25 retail profit on all of that Customer's non-Auto Delivery purchases.
- 26 2. Team Bonus. The new proposed plan eliminates "cycles" and the

1 team bonus pays a qualified Affiliate either 10% or 15% percent of their Profit
2 Team volume (the leg with lower points).

3 3. Matching Bonus. This bonus pays a qualified Affiliate up to 5% on
4 all of their personally enrolled Affiliates' Team Bonus commissions, up to four
5 tiers.

6 There are also one time rank advancement rewards. Vemma is currently in discussions
7 with the FTC concerning this proposed new compensation plan.

8 **IX. LEGAL**

9 There are two new legal matters to report. As noted above, the FTC opened a
10 separate investigation into Vemma to review its compliance with the 1999 Consent Order
11 dated March 3, 1999, in *In re New Vision International*. The company is complying with
12 the request. In addition, the Internal Revenue Service has informed Vemma that it intends
13 to audit the company for tax years ending 2012 and 2013.

14 **X. THE FUTURE**

15 Vemma believes that it is successfully working through the backlog of issues
16 created by the Receiver's shutdown of the business, and will be able to operate in a
17 profitable manner. Although few companies have recovered from an *ex parte* asset freeze
18 and the appointment of a Receiver, Vemma is proving to be the exception based on
19 customer loyalty and demand for its innovative nutritional products.

20 Since Vemma resumed operations on October 8, 2015, the company has had
21 product orders of almost \$2,000,000. This is remarkable given that the company: (i) did
22 not take any orders for the 46 day period between August 24, 2015 and October 8, 2015;
23 (ii) reduced its prices; (iii) has been unable to properly process credit cards due to the
24 merchant account issues discussed above; (iv) has not been able to run its Auto Deliveries;
25 (v) paid out only \$30,000 in commissions since August 24, 2015; and (vi) is engaged in
26 significant litigation with the FTC, coupled with the attendant negative publicity. Most

1 importantly, even though the vast majority of Vemma's Affiliates understand they will be
2 unlikely to earn commissions under the company's new compensation plan, they continue
3 to order product.

4 DATED this 18th day of December, 2015.

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CERTIFICATE OF SERVICE

I hereby certify that on December 18, 2015, I electronically transmitted the attached document to the Clerk’s Office using the CM/ECF System for filing and a copy was electronically submitted to counsel at the e-mail addresses below:

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s/ Kelly Thwaites