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1.	<a href="#">FTC v. Equinox Int'l Corp.</a> CV-S-99-0969-JBR (RLH), UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEVADA, 1999 U.S. Dist. LEXIS 19866; 1999-2 Trade Cas. (CCH) P72,704, September 14, 1999, Decided , September 14, 1999, Filed, Entered and Served

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FEDERAL TRADE COMMISSION, STATE OF HAWAII, MARYLAND  
SECURITIES COMMISSIONER, STATE OF NEVADA, STATE OF NORTH  
CAROLINA, COMMONWEALTH OF PENNSYLVANIA, and STATE OF SOUTH  
CAROLINA, Plaintiffs, v. **EQUINOX** INTERNATIONAL CORP., ADVANCED  
MARKETING SEMINARS, INC. BG MANAGEMENT, INC., and WILLIAM  
GOULDD, Defendants.

CV-S-99-0969-JBR (RLH)

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEVADA

1999 U.S. Dist. LEXIS 19866; 1999-2 Trade Cas. (CCH) P72,704

September 14, 1999, Decided  
September 14, 1999, Filed, Entered and Served

**DISPOSITION:** [\*1] Plaintiffs' Recommendation of Language for the **Preliminary Injunction** (# 75)  
DENIED as moot in light of the Court's **Preliminary Injunction** Order (# 78) entered on September 14, 1999.

**CASE SUMMARY:**

**PROCEDURAL POSTURE:** Plaintiffs moved for a **preliminary injunction**, alleging defendants were involved in a multilevel marketing company operating as a pyramid scheme, which made false and misleading statements constituting deceptive acts or practices in violation of the Federal Trade Commission Act, 15 U.S.C.S. § 45(a). Defendants filed a motion in opposition.

**OVERVIEW:** Plaintiffs sought a **preliminary injunction** preventing defendants from further deceptive practices in violation of the Federal Trade Commission Act (Act), 15 U.S.C.S. § 45(a). Plaintiff Federal Trade Commission (FTC) sought to freeze assets, prevent the destruction of records, permit review of records, and to appoint a temporary receiver. Because defendants satisfied the test of a pyramid scheme and their policies did not effectively promote retail sales while preventing inventory loading, defendants' program would likely be found an unfair or deceptive practice in violation of the Act. Defendants' misrepresentations would also likely constitute an unfair or deceptive practice. The public interest was in preserving the illicit proceeds obtained by deceptive practices in order to provide restitution to the victims. Because the court would tailor the injunction, and would allow the release of money to pay expenses that were actual, ordinary and necessary, the public interest outweighed any private interest of defendants.

**OUTCOME:** Plaintiffs' injunction was partially granted, because defendants satisfied the test of a pyramid scheme. A temporary receiver was appointed, and defendants were enjoined from dispersing assets or

engaging in further deceptive practices.

**CORE TERMS:** distributor, refund, bonuses, rebate, temporary, receiver, manager, deceptive practices, inventory, preliminary injunction, retail sales, downline, recruit, misrepresentation, seminar, advertisement, pyramid scheme, FTC Act, quota, sponsor, monthly, loading, recruitment, recruiting, encouraged, purchasing, telephone, customers, retail, receivership

### LexisNexis(R) Headnotes

***Antitrust & Trade Law > Federal Trade Commission Act > Remedies > Injunctive Relief***  
***Antitrust & Trade Law > U.S. Federal Trade Commission Actions > Remedial Powers > Federal Trade Commission Act***

***Civil Procedure > Remedies > Injunctions > Preliminary & Temporary Injunctions***

[HN1] Section 13(b) of the Federal Trade Commission Act (Act), 15 U.S.C.S. § 539(b), allows a district court to grant the Federal Trade Commission (FTC) a **preliminary injunction** upon a proper showing that, weighing the equities and considering the FTC's likelihood of ultimate success, such action would be in the public interest. Section 13(b), therefore, places a lighter burden on the FTC than that imposed on private litigants by the traditional equity standard; the FTC need not show irreparable harm to obtain a **preliminary injunction**. Under this more lenient standard, a court must 1) determine the likelihood that the FTC will ultimately succeed on the merits and 2) balance the equities. The FTC, however, may only seek a **preliminary injunction** when it believes a person is violating, or is about to violate any law enforced by the FTC. The FTC cannot base its request for injunction relief on evidence of past violations without a showing that those violations are likely to recur.

***Bankruptcy Law > State Insolvency Laws***

***Civil Procedure > Remedies > Injunctions > Preliminary & Temporary Injunctions***

***Civil Procedure > Remedies > Receiverships > Receivers > Powers***

[HN2] The **preliminary injunction** analysis is proper to determining whether a receiver should be appointed or assets should be frozen in Federal Trade Commission cases alleging deceptive practices. A district court's power to supervise an equity receivership and to determine the appropriate action to be taken in the administration of the receivership is extremely broad. The primary purpose of equity receiverships is to promote orderly and efficient administration of the receivership by the district court for the benefit of creditors.

***Antitrust & Trade Law > Federal Trade Commission Act > Coverage***

***Antitrust & Trade Law > Trade Practices & Unfair Competition > Federal Trade Commission Act***

***Banking Law > Federal Acts > Federal Trade Commission Act > Unfair Competition & Practices***

[HN3] Section 5 of the Federal Trade Commission Act, 15 U.S.C.S. § 45(a), prohibits unfair or deceptive acts or practices in or affecting commerce. Deception is found if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances. Pyramid schemes are inherently fraudulent because they must eventually collapse after making money for those at the top of the pyramid, but disappointing those at the bottom who can find no recruits.

***Antitrust & Trade Law > Consumer Protection > Deceptive Acts & Practices > General Overview***

***Antitrust & Trade Law > Federal Trade Commission Act > General Overview***

[HN4] The test for determining what constitutes a pyramid scheme is the payment by participants of money to the company in return for which they receive (1) the right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users. The payment of money element of a pyramid scheme can be met where the participant is required to purchase non returnable inventory in order to receive the full benefits of the program.

***Antitrust & Trade Law > Consumer Protection > Deceptive Acts & Practices > General Overview***

***Antitrust & Trade Law > Consumer Protection > False Advertising > General Overview***

***Antitrust & Trade Law > Federal Trade Commission Act > General Overview***

[HN5] Disclaimers or qualifications in any particular advertisement are not adequate to avoid liability for deceptive advertising unless they are sufficiently prominent and unambiguous to change apparent meaning of claims and to leave accurate impression.

***Antitrust & Trade Law > Consumer Protection > Deceptive Acts & Practices > General Overview  
Antitrust & Trade Law > Federal Trade Commission Act > General Overview***

[HN6] The implementation of policies that would prevent a program from being a pyramid scheme do not insulate the program unless the policies are enforced and actually serve to deter inventory loading, that is, making purchase quotas solely to receive the bonuses and rebates without reselling the product to an end user, and encourage retail sales.

***Antitrust & Trade Law > Consumer Protection > Deceptive Acts & Practices > General Overview  
Antitrust & Trade Law > Federal Trade Commission Act > General Overview***

[HN7] A refund policy is only effective if it can reduce or eliminate the possibility of inventory loading by insuring that program participants do not find themselves saddled with thousands of dollars worth of unsaleable product.

***Antitrust & Trade Law > Federal Trade Commission Act > General Overview***

***Antitrust & Trade Law > U.S. Federal Trade Commission Actions > General Overview***

***Banking Law > Federal Acts > Federal Trade Commission Act > Unfair Competition & Practices***

[HN8] Deception is found if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances, and misrepresenting the amount an investment is likely to return is a deceptive practice.

***Antitrust & Trade Law > Consumer Protection > Deceptive Acts & Practices > General Overview***

***Antitrust & Trade Law > Federal Trade Commission Act > General Overview***

***Business & Corporate Law > Corporations > Directors & Officers > Management Duties & Liabilities > General Overview***

[HN9] Individuals are personally liable for restitution for corporate misconduct if they have knowledge that the corporation or one of its agents engaged in dishonest or fraudulent conduct, that the misrepresentations were the type upon which a reasonable and prudent person would rely, and that consumer injury resulted. The knowledge requirement can be satisfied by showing that the individuals had actual knowledge of material misrepresentations, were recklessly indifferent to the truth or falsity of a misrepresentation, or had an awareness of a high probability of fraud along with an intentional avoidance of the truth. The Federal Trade Commission, however, is not required to show that a defendant intended to defraud consumers in order to hold that individual personally liable.

***Civil Procedure > Remedies > Injunctions > Preliminary & Temporary Injunctions***

[HN10] When a district court balances the hardships of the public interest against a private interest, the public interest should receive greater weight.

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**JUDGES:** Johnnie B. Rawlinson, United States District Judge.

**OPINION BY:** Johnnie B. Rawlinson

## **OPINION**

## **ORDER**

On August 3, 1999, the Federal Trade Commission ("FTC") filed a complaint against Defendants **Equinox** [\*3] International, Advanced Marketing Seminars, BG Management (jointly referred to hereinafter as "**Equinox**") and William Gould (founder and owner of **Equinox**). The complaint alleges that **Equinox** is a "multi level marketing" company operating as a pyramid scheme which makes false and misleading statements that constitute deceptive acts or practices in violation of Section 5(a) of the Federal Trade Commission Act (the "FTC Act," 15 U.S.C. § 45(a)). The FTC also filed an application for an ex-parte temporary restraining order (# 6) preventing Defendants from further deceptive practices, freezing assets, preventing the destruction of records, allowing the FTC to review records, and appointing a temporary receiver.

On August 5, 1999, this Court entered the Temporary Restraining Order (# 17) and scheduled a hearing for a **preliminary injunction**. At the hearing, the parties stipulated to extending the Temporary Restraining Order with modifications until September 1, 1999 when an evidentiary hearing on a **preliminary injunction** could be held. **Equinox** filed an opposition (# 38) to the FTC's motion for a **preliminary injunction**, to which the FTC replied (# 43).

At the evidentiary [\*4] hearing, all parties were represented by counsel. After considering all the pleadings and material on file with the Court, the evidence presented at the hearing and the arguments of counsel, the Court makes its preliminary findings of fact and conclusions of law.

## **PRELIMINARY FINDINGS OF FACT**

**Equinox** is a "multi level marketing" company that sells water filters, air filters, nutritional supplements, and other assorted health care products. Gould is the founder and owner of **Equinox**. **Equinox** distributes products by recruiting distributors, who in turn sponsor other distributors. Recruited distributors are referred to as the "downline" while sponsoring distributors are referred to as the "upline." Distributors achieve different levels in **Equinox** when they, with their downline, purchase a certain volume of product from **Equinox** for a one month period. The following (from lowest to highest) are the six levels achievable: Representative, Manager, Supervisor, Director, Executive Director ("ED") and International Marketing Director ("IMD").

Becoming a Representative requires very little investment. A distributor becomes a Manager when he and certain portions of his downline [\*5] purchase ("Group Purchase") \$ 5000 of **Equinox** product in a one month period. He becomes a Supervisor with Group Purchase of \$ 10,000 in a two-month period. Director status is achieved with a Group Purchase of \$ 20,000 in a one month period. A distributor becomes an ED with a Group Purchase of \$ 100,000 in a one month period. To become an IMD, a distributor must make a Group Purchase of \$ 500,000.

Distributors are also entitled to bonuses and rebates depending on the amount of product they purchase from **Equinox** ("Personal Purchases") from **Equinox** and the purchases of a certain portion of their downline. **Equinox** refers to Personal Purchases as Personal Sales Volume and purchases by certain portions of the downline as Group Sales Volume. The percentage paid in rebates and bonuses, however, does not depend on actual sales by distributors and their downline but only on the amount purchased from **Equinox**. To receive rebates, distributors must personally purchase \$ 100 in product from **Equinox** per month. To receive a bonus, the distributor must be "qualified," i.e. meet a certain minimum purchase quota during the month. Depending on the amount purchased, Representatives receive 0% - 15% rebate [\*6] on Personal Purchases and the products other Representatives they sponsor purchase from **Equinox** ("Group Purchases").

Managers that purchase \$ 100 in product from **Equinox** receive 20% rebate on their Personal Purchases and a rebate calculated as the difference between 20% of the Group Purchases and the rebate percentage that those representatives making up the Group Purchases received. Qualified Managers, Managers with \$ 100 in Personal Purchases and \$ 1000 in Group Purchases per month, also receive 3% bonus on their Personal Purchases, Group Purchases, and three downline generations of the Group and Personal Purchases of the managers sponsored under them.

Supervisors, Directors, EDs, and IMDs also receive the same rebates as managers. When distributors meet the minimum personal and group purchase quota for each of these levels, qualified distributors are entitled to a bonus for that level which is defined as a certain percentage (3 - 10%) of their Personal Purchases and the purchases of a portion of their downline. Also at each level, the distributor is entitled to the bonuses of the lower levels, provided he meets the minimum purchase requirements to be qualified for that level.

[\*7] If a distributor does not meet his Personal and Group purchase quotas, he does not receive the bonus. The bonus is paid to the first qualifying distributor above him in the organization. As the quotas are difficult to meet, only a small percentage of **Equinox** distributors obtain bonuses.

**Equinox** encourages its distributors to recruit other distributors by placing classified advertisements in the help wanted section of the newspaper. The advertisements imply that either a salaried or a commissioned position is being offered. Most advertisements do not indicate that such positions may require a cash investment. Recruits that respond to the advertisements are scheduled for a job interview. Instead of being interviewed, recruits are subject to a sales presentation presenting the "**Equinox** Opportunity." Recruits that seem receptive are pressured to quickly purchase \$ 5,000 worth of product so they can enter as Managers, even if the recruit has to borrow the money. Recruits are told that **Equinox** will provide evidence that the recruit has been given a job with a monthly salary of \$ 3,000 - \$ 4,000 / month to facilitate the loan process.

To become a distributor, recruits are required to sign [\*8] a Representative Application and Agreement. New distributors are usually given little chance to review the agreement because the sponsor explains which spaces are to be filled in before distributors have an opportunity to read the agreement. In the representative agreement, a new distributor certifies that he is bound to the attached terms, conditions, policies and

procedures. Many times, however, the terms, conditions, policies and procedures have been removed from the representative agreement before new distributors sign the representative agreement. Often, new distributors are unaware of the policies and procedures to which they are supposedly agreeing. **Equinox** has no method of verifying that the policies and procedures were included with the representative agreement signed by new distributors.

New distributors are then pressured to lease desk space from **Equinox** for \$ 300 - \$ 500 per month, to subscribe to a phone line, and pay for advertisements so the new distributor can sponsor others. All recruiting is tightly scripted by **Equinox** and Gould due to the extensive seminars promoted by **Equinox** and conducted by Gould or by another person approved by Gould.

Distributors are encouraged [\*9] to attend seminars conducted by Gould or other upper management at a cost to distributors of \$ 300 to \$ 2,500 per seminar. They are told that through **Equinox**, they can achieve fabulous wealth like Gould, the founder of **Equinox**, if they continue to attend seminars. At these seminars and during recruitment, the **Equinox** compensation package is described using hypothetical geometric examples which unrealistically describe the probable amount of compensation to be expected and the number of persons that can be reasonably be recruited.

**Equinox** stresses that money is made by recruiting and not by retail sales. Distributors are told that such wealth can only be achieved if they choose to purchase large amounts of product each month so that they can move up the various levels as quickly as possible. As a result, distributors frequently purchase a large inventory of **Equinox** products that they are unable to sell.

Distributors during seminars are told that the average "qualified" manager makes \$ 600/month, average "qualified" supervisor \$ 1600/month, average "qualified" director \$ 3,800/month, the average "qualified" ED makes \$ 9,700/month and the average "qualified" IMD makes \$ 25,000/month. [\*10] Distributors, however, are not informed in these seminars that "qualified" means those distributors that meet their monthly quotas. Distributors are also not informed that only a small percentage of distributors are "qualified." **Equinox** does not inform distributors that many **Equinox** distributors lose thousands of dollars each month as a result of unsold product that has been purchased, desk leases, phone costs, and other expenses that **Equinox** encourages distributors to incur.

The **Equinox** Manual, which is sold to each new distributor, does indicate that to be qualified the distributor must meet monthly quotas. New distributors, however, are not encouraged to read the **Equinox** Manual but to use it only as a reference if the need arises.

**Equinox** has three policies which were ostensibly implemented to encourage retail sales and prevent distributors from buying product just to meet sales quotas (referred to as "loading"). First, **Equinox's** policies limit the amount of product that a distributor may purchase. **Equinox's** policies provide that distributors must certify that they have sold 70% of the previously ordered product before purchasing additional product (the "70% Rule"). New distributors [\*11] also are limited to purchasing no more than \$ 5000 worth of product per month. Second, to obtain bonuses, distributors are required to certify that they have made sales to six retail customers in the past month (the "Receipt Rule"). **Equinox** conducts random verification checks of the receipts submitted. Third, **Equinox** has a refund policy for distributors that resign. **Equinox** refunds 90% for products that are unopened and have not been certified as sold under the 70% Rule, less bonuses and rebates paid to the distributor on the product returned.

The policies ostensibly adopted by **Equinox** to encourage retail sales are not effective. Distributors may circumvent the \$ 5000 limitation by purchasing product on behalf of their downline, who are often family members. **Equinox**, in fact, encourages such purchases so distributors can achieve the Supervisor level or higher in a one month period. The 70% Rule is at best loosely enforced. Orders are placed by phone without requiring an express certification that 70% of the previously purchased product had been sold. **Equinox** relies on the implication that if a distributor places a new order for product, the distributor is tacitly certifying that 70% [\*12] of the previous product has been sold. There was evidence that in some instances, the 70% certifications were even forged or falsified.

Distributors can satisfy the Receipt Rule by purchasing very inexpensive products which can be bought for less than \$ 10.00, even though the distributor's inventory maybe principally composed of expensive products which can be priced at more than \$ 1000.00. Distributors are told that the bonuses and rebates they receive are worth purchasing six inexpensive products. While **Equinox** randomly reviews certain retail receipts supplied by distributors, **Equinox's** reviews provide little assurance that retail sales are being made and do not verify that the retail sales are typical of the inventory purchased by that distributor.

Distributors can only request refunds by making a toll telephone call. Often, distributors are placed on hold for long periods and are required to make several phone calls before **Equinox** will allow the distributor to return product. Last year **Equinox** provided over \$ 7.5 million in refunds. **Equinox**, however, does not keep records on the number or amount of refunds that were denied.

## ANALYSIS

The FTC seeks a **preliminary [\*13] injunction** preventing Defendants from further deceptive practices in violation of the FTC Act, 15 U.S.C. § 45(a). The FTC also seeks to freeze the assets of **Equinox** and Gould, prevent the destruction of records, permit the FTC to review records, and appoint a temporary receiver over **Equinox**. In *FTC v. Affordable Media*, 179 F.3d 1228, 1233 (9th Cir. 1999), the Ninth Circuit held that "Section [HN1] 13(b) of the [FTC] Act allows a district court to grant the [FTC] a **preliminary injunction** upon a proper showing that, weighing the equities and considering the [FTC's] likelihood of ultimate success, such action would be in the public interest." Citing 15 U.S.C. § 53(b). "Section 13(b), therefore, places a lighter burden on the [FTC] than that imposed on private litigants by the traditional equity standard; the [FTC] need not show irreparable harm to obtain a **preliminary injunction**." *Id.* "Under this more lenient standard, a court must 1) determine the likelihood that the [FTC] will ultimately succeed on the merits and 2) balance the equities." <sup>1</sup> *Id.* The FTC, however, may only seek a **preliminary injunction** when it **[\*14]** believes a person "is violating, or is about to violate" any law enforced by the FTC. *FTC v. Evans Prods. Co.*, 775 F.2d 1084, 1087 (9th Cir.1985). The FTC cannot base its request for injunction relief on evidence of past violations without a showing that those violations are likely to recur. *Id.*

<sup>1</sup> **Equinox** argues that irreparable harm must be shown before a **preliminary injunction** may issue. Even if that were the case, this Court would find that continued deceptive practices by Defendants would constitute irreparable harm.

[HN2] The **preliminary injunction** analysis is also proper to determining whether a receiver should be appointed or assets should be frozen in FTC cases alleging deceptive practices. *See FTC v. American Nat. Cellular*, 810 F.2d 1511, 1512-1514 (1987). A district court's power to supervise an equity receivership and to determine the appropriate action to be taken in the administration of the receivership is extremely broad. *Securities Exch. Comm'n v. Hardy*, 803 F.2d 1034, 1037 (9th Cir.1986). **[\*15]** The primary purpose of equity receiverships is to promote orderly and efficient administration of the receivership by the district court for the benefit of creditors. *Id.* at 1038.

### Likelihood of Success on the Merits

[HN3] Section 5 of the FTC Act prohibits "unfair or deceptive acts or practices in or affecting commerce." 15 U.S.C. § 45(a). Deception is found "if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances." *Southwest Sunsites, Inc. v. FTC*, 785 F.2d 1431, 1435 (9th Cir. 1986) cert. denied, 479 U.S. 828, 93 L. Ed. 2d 58, 107 S. Ct. 109 (1986). In *Webster v. Omnitrition International*, 79 F.3d 776, 781 (9th Cir. 1996), the Ninth Circuit found that pyramid schemes are "inherently fraudulent because they must eventually collapse after making money for those at the top of the pyramid, but disappointing those at the bottom who can find no recruits."

[HN4] The test for determining what constitutes a pyramid scheme is "the payment by participants of money to the company in return for which they receive (1) the right to sell **[\*16]** a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users." *Id.* **Equinox** likely satisfies both elements of this test.

"The 'payment of money' element of a pyramid scheme can be met where the participant is required to purchase 'non returnable' inventory in order to receive the full benefits of the program." <sup>2</sup> *Id.* at 782. In order to participate in rebates, which rewards distributors not only based on their purchases but also on purchases of those they sponsor, Representatives must purchase \$ 100 of product a month. Managers require a significantly greater investment to receive rebates and bonus on their personal purchases and on the purchases of those they recruit. Managers must also personally purchase \$ 100 of product per month to receive their rebates and bonuses. To become a Manager, however, distributors and the Representatives they sponsor must purchase \$ 5,000 of product in a one month period. To continue to receive bonuses, Managers with the Representatives they sponsor must purchase \$ 1000 of product a month. Because **Equinox** pressures new distributors [\*17] to enter at least the Manager level and new distributors have no downline, distributors who enter as Managers personally purchase the initial \$ 5000 in product and the monthly quota in order to receive the rebates and bonuses.

<sup>2</sup> **Equinox** argues that its refund policy makes the product purchased "returnable." This argument will be addressed below in the Court's discussion of **Equinox's** Amway defenses.

**Equinox**, in its recruitment and training seminars, emphasizes the promise of lucrative rewards for recruiting others. Distributors are given unrealistic hypothetical examples that their profits will increase geometrically if distributors focus on recruitment rather than retail sales. **Equinox's** video presentations and certain materials provided by **Equinox** contain disclaimers as to the amount of profits obtainable. These disclaimers, however, 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. *Removatron International Corp. v. FTC*, 884 F.2d 1489, 1497 (1st Cir. 1989) [\*18] (disclaimers [HN5] or qualifications in any particular advertisement are not adequate to avoid liability for deceptive advertising unless they are sufficiently prominent and unambiguous to change apparent meaning of claims and to leave accurate impression). Additionally, Managers are encouraged to sell the product they purchase to new recruits rather than to end users. Rebates and bonuses, the primary compensation emphasized by **Equinox**, are facially unrelated to sales to the ultimate user but are based on purchases made from **Equinox** by the distributor and his downline. In short, distributors rewards are received by purchasing product and recruiting others to do the same.

**Equinox** relies on *In re Amway Corp.*, 93 F.T.C. 618 (1979) to rebut any finding that it is a pyramid scheme. In *Amway*, the FTC found that Amway was not a pyramid scheme because it instituted the following policies: (1) participants must sell at wholesale or retail 70% of the products bought in a given month in order to receive bonuses for that month; (2) participants must submit proof of retail sales made to ten different customers; and (3) participants must buy back from any person they recruit any [\*19] salable, unsold inventory upon the recruit leaving Amway. *Id.* at 716. **Equinox** argues that its formal adoption of policies similar to Amway's was sufficient to prevent a finding that it was a pyramid scheme as a matter of law.

In *Omnitrition*, however, the Ninth Circuit held that [HN6] the implementation of policies that would prevent a program from being a pyramid scheme do not insulate the program unless the policies are enforced and actually serve to deter inventory loading (making purchase quotas solely to receive the bonuses and rebates without reselling the product to an end user) and encourage retail sales. 79 F.3d at 783. The policies adopted by **Equinox** are not adequately enforced and do not have the required effect. Often, distributors are not even aware of **Equinox's** policies. Policies that are attached to representative agreements that distributors are required to sign are removed before the distributor signs the agreement. Distributors are also discouraged from reading the **Equinox** Manual which contain **Equinox's** policies and only use the manual as a reference guide.

**Equinox** requires distributors to certify that 70% of the previously purchased product [\*20] has been sold or consumed before allowing distributors to purchase more product. **Equinox**, however, does not enforce this rule. Evidence presented at the hearing indicated that distributors are allowed to make orders by phone directly from **Equinox** without any mention of certification. When a distributor orders additional product, **Equinox** merely infers that the distributor is certifying that 70% previous product purchased had been sold.

Evidence also indicted that **Equinox**, despite its written policies to the contrary, allowed and/or encouraged distributors to falsify or forge at least some of the written certifications that were made. Because **Equinox's** 70% Rule is not effectively enforced, it does not actually serve to prevent inventory loading.

Additionally, distributors can satisfy the 70% Rule by consuming the product themselves or by selling the product to their own downline.<sup>3</sup> **Equinox** does not require certification in order to receive rebates and bonuses. Amway's 70% Rule provides that bonuses may be withheld for product not certified as sold. Rebates and bonuses paid by **Equinox** are therefore less likely to be tied to sales to the retail customers.

<sup>3</sup> **Equinox**, in its policies, acknowledges that such sales do not constitute retail sales because products opened by the distributor are not entitled to any refund, whereas retail customers are entitled to 30 day money back guaranty if not satisfied.

[\*21] **Equinox's** policies do require that distributors make retail sales to six customers per month and send copies of the retail receipts to **Equinox** in order to obtain bonuses. **Equinox** also produced evidence that it randomly checks to verify that the receipts are genuine. In *Omnitrition*, however, the Ninth Circuit found that requiring evidence of sale to ten retail customers did not clearly serve to tie the amount of bonuses to retail sales. 79 F.3d at 783. Here, **Equinox** only requires retail sales to six customers instead of ten. Additionally, distributors can satisfy the Receipt Rule by purchasing very inexpensive products, even though the distributor's inventory may be principally composed of expensive products. **Equinox** Receipt Rule is therefore less likely than the rule in *Omnitrition* to tie the amount of bonuses to retail sales. Further, this Court is not convinced that **Equinox's** audit procedures effectively deter forged or falsified receipts.

**Equinox** does have a refund policy. **Equinox**, however, only refunds 90% of the price of the product which is less than Amway refunded in the case considered by the Ninth Circuit. See *Omnitrition*, 79 F.3d at 783. [\*22] Distributors that enter as Managers and purchase \$ 5000 in product are effectively paying \$ 500 for the right to participate in the **Equinox** opportunity.

**Equinox's** refund policy also does not effectively prevent the evil of inventory loading. In *Omnitrition*, the Ninth Circuit found that [HN7] a refund policy "is only effective if it can reduce or eliminate the possibility of inventory loading by insuring that program participants do not find themselves saddled with thousands of dollars worth of unsaleable product." 79 F.3d at 784. Distributors that want to resign are saddled with the majority of their inventory because **Equinox** refuses to allow the return of product that was certified as sold under the 70% Rule. **Equinox** infers that distributors certify that 70% of previous product purchased had been sold when distributors order additional product. Consequently, when a distributor orders any additional product, 70% of his previous order becomes automatically unreturnable. As written and applied, the 70% Rule becomes a sword for **Equinox** to deny refunds, instead of a shield to protect distributors from inventory loading. If a distributor entered as a Manager, placed a \$ 100 order [\*23] the next month to remain active but decided to resign in the third month, the resigning Manager would be saddled with \$ 3,500 worth of unrefundable product. While **Equinox** issued \$ 7.5 million in refunds last year, **Equinox** does not keep records on refunds denied due to the 70% Rule or for other reasons. **Equinox** therefore cannot show the actual extent to which it repurchased product from disappointed distributors. The facts before the Court, therefore, provide an inference that a majority of product sold to **Equinox** distributors is unrefundable.

**Equinox** argues that its refund policy is superior to the Amway policy discussed in *Omnitrition* because **Equinox** provides the refunds directly whereas Amway requires the departing distributor to seek a refund from his upline before Amway will issue a refund. Under Amway's refund policy, the downline of the departing distributor is given to the upline distributor, who provides a refund. Additionally, if Amway issues a refund, Amway charges the account of the first Direct Distributor (one of the levels in Amway). By requiring the upline to provide the refund, sponsoring distributors are deterred from pushing unrealistically large amounts of inventory [\*24] onto the sponsored distributor in order to increase bonuses. **Equinox**, however, has no effective check to prevent sponsors from pushing huge inventories on their downline so as to increase their rebates and bonuses.

Because **Equinox** satisfies the test of a pyramid scheme and its policies do not effectively promote retail

sales while preventing inventory loading, the **Equinox** program will likely be found an unfair or deceptive practice in violation of the FTC Act, 15 U.S.C. § 45(a), using the *Omnitrition* analysis.

**Equinox** misrepresented distributorships as salaried or commissioned positions without disclosing that the "positions" require a financial investment. **Equinox** also misrepresented the amount of potential earning an **Equinox** distributor can expect and failed to disclose that the vast majority of **Equinox** distributors do not qualify for rebates and bonuses. Such misrepresentations will also likely constitute an unfair or deceptive practice in violation of the FTC Act, 15 U.S.C. § 45(a). *Southwest Sunsites*, 785 F.2d at 1435 (deception [HN8] is found if there is a representation, omission or practice that is likely to mislead [\*25] the consumer acting reasonably in the circumstances); *Affordable Media*, 179 F.3d at 1234-36 (misrepresenting the amount an investment is likely to return is a deceptive practice).

**Equinox** asserts that it can no longer be subject to a **preliminary injunction** based on the aforementioned misrepresentations because **Equinox** no longer makes such misrepresentations. **Equinox** argues the evidence provided by the FTC was over two years old and that any misrepresentations in recruiting or in amounts earned were made by independent distributors, contrary to **Equinox's** current policies. Even if that were true, **Equinox** previously taught its distributors to use such misrepresentation, now profits from the use of those misrepresentations, knows that its distributors continue to make such misrepresentations, and has done little to prevent distributors from currently making the misrepresentations. **Equinox** cannot therefore shield itself from liability merely by arguing that current misrepresentations are made by independent contractors. See *Affordable Media*, 179 F.3d at 1235-36 (reckless indifference to deceptive practices by independent sales office supported granting [\*26] a **preliminary injunction** for a violation of Section 5(a) of the FTC Act); *Consumer Sales Corp. v. FTC*, 198 F.2d 404, 406-07 (2nd Cir. 1952) (by furnishing independent salesman with deceptive information, defendants actively encouraged and participated in a deceptive practice in violation of Section 5(a) of the FTC Act regardless of the salesman's status as independent contractors).

Mr. Gould will also likely be found subject to liability for the aforementioned deceptive practices. In *Affordable Media*, the Ninth Circuit held that "individuals [HN9] are personally liable for restitution for corporate misconduct if they had knowledge that the corporation or one of its agents engaged in dishonest or fraudulent conduct, that the misrepresentations were the type upon which a reasonable and prudent person would rely, and that consumer injury resulted." 179 F.3d at 1234 (citation and quotation omitted). "The knowledge requirement can be satisfied by showing that the individuals had actual knowledge of material misrepresentations, were recklessly indifferent to the truth or falsity of a misrepresentation, or had an awareness of a high probability of fraud along [\*27] with an intentional avoidance of the truth." *Id.* The FTC, however, "is not required to show that a defendant intended to defraud consumers in order to hold that individual personally liable." *Id.* Mr. Gould, as the founder of **Equinox**, was intimately connected with the creation of **Equinox's** compensation plan and was aware that the program encouraged inventory loading at the expense of retail sales. Mr. Gould was also well aware that the return policy was designed to burden unwary distributors with unreturnable product. Mr. Gould, who scripted most of the **Equinox** training and was a model for other **Equinox** distributors, encouraged distributors to overstate the average earnings of **Equinox** distributors and had approved use of recruitment advertisements designed to mislead potential recruits. The FTC will therefore likely succeed in holding Mr. Gould liable for **Equinox's** deceptive practices.

### **Balance of the Equities**

In *Affordable Media*, the Ninth Circuit held that "when [HN10] a district court balances the hardships of the public interest against a private interest, the public interest should receive greater weight." 179 F.3d at 1236. The public interest [\*28] is in preserving the illicit proceeds obtained by deceptive practices in order to provide restitution to the victims. As the Court has found that **Equinox** and Gould have likely engaged in deceptive practices, asset preservation is a prime concern. The public also has an interest in preventing further deceptive practices by **Equinox** and Gould. Because this Court will tailor the injunction to address the harms **Equinox** may have caused and will allow the release of money to pay expenses that are actual, ordinary and necessary, the public interest outweighs any private interest of **Equinox**. Accordingly,

IT IS ORDERED that the FTC's motion for a **Preliminary Injunction** is **PARTIALLY GRANTED**.

IT IS FURTHER ORDERED that Defendants **Equinox** International, Advanced Marketing Seminars, BG Management and William Gould, each of them and their successors, assigns, officers, agents, servants, and employees and those persons in active concert or participation with them whether acting directly or through any corporation, subsidiary, division or other device, are preliminarily enjoined from operating a pyramid scheme or in any other way violating Section 5(a) of the FTC Act, 15 U.S.C. § 45 [\*29] (a). Specifically, that Defendants shall cease and desist from:

- A. any and all representations as to income levels of **Equinox** distributors, except as provided for in this order, including but not limited to any hypothetical income levels from the purchase of product and services by a distributor's downline or recruits, the income levels that distributors, potential distributors, or any person may achieve as an **Equinox** distributor, or the income level of current or past **Equinox** distributors.
- B. any and all representations that distributors or potential distributors of **Equinox** may or will receive compensation related to recruitment.
- C. any and all representations of a high likelihood of success in selling **Equinox's** products.
- D. failing to disclose, in a clear and conspicuous manner, before accepting a representative application or fulfilling an initial order the monetary commitment required to run an **Equinox** distributorship and other typical expenses made by **Equinox** distributors including but not limited to monthly desk rental, monthly telephone costs, monthly advertising costs, and training seminar costs.
- E. failing to disclose, in a clear and conspicuous manner, before accepting [\*30] a representative application or fulfilling an initial order the number of Active **Equinox** Distributors (those that have made purchases in the last twelve months) in the distributor's geographic area and the percentage of Active **Equinox** Distributors that are presently qualified to receive rebates and bonuses from **Equinox**.
- F. failing to require **Equinox** distributors to refrain from representations found in the above paragraphs A - C and to provide the disclosures found in the above paragraphs D - E.
- G. failing to provide to a distributor terminating his **Equinox** distributorship a 100% refund, less rebates and bonuses paid to the distributor based on the product being returned, for all undamaged products with the tamper proof seals intact purchased from **Equinox** and received by the distributor within the proceeding twelve month period without regard to any previous representations, express or implied, that the product had been previously sold by the distributor.
- H. failing to provide a toll-free telephone number for the purpose of arranging and processing distributor refunds.

IT IS FURTHER ORDERED Defendants shall develop recruitment advertisements that are not deceptive or misleading, [\*31] approved by the Temporary Receiver hereinafter appointed, which Defendants shall require as the only advertisements that **Equinox** distributors may use.

IT IS FURTHER ORDERED Defendants shall amend the Terms and Conditions and Supplemental Terms and Conditions attached to **Equinox's** current Representative Application and Agreement to reflect the changes to **Equinox's** policies ordered by the Court in a form approved by the Temporary Receiver hereinafter appointed. Each term and condition shall be initialed by all new distributors before **Equinox** will process any orders from that distributor.

IT IS FURTHER ORDERED Defendants shall use its best efforts to notify **Equinox** distributors about the changes to **Equinox's** policies ordered by this Court including posting such information on **Equinox's** world wide web page, and informing distributors through **Equinox's** meetings, conference calls, seminars and newsletters.

IT IS FURTHER ORDERED, to insure that funds are available to provide restitution to the victims of any deceptive practices that may have resulted from Defendants acts or practices, the Court appoints Rob Evans as temporary receiver (the "Temporary Receiver") for Defendants and of all [\*32] the funds, properties, premises, accounts and other assets directly or indirectly owned, beneficially or otherwise by Defendants, with direction and authority to prevent the dissipation of assets. The Temporary Receiver is to specifically,

- A. Collect, marshal, take custody, control and possession of all funds property, premises, accounts and other assets, owned beneficially or otherwise, in possession or under the control of Defendants wherever situated that are not, in the judgment of the Temporary Receiver or as directed by this Court, actual, ordinary, and necessary business or living expenses that Defendants will reasonably incur.

B. Perform all acts necessary to protect, conserve, preserve and prevent from waste or dissipation the funds, property, premises, accounts and other assets of Defendants in order to insure that funds are available to provide restitution to the victims of any deceptive practices that may have resulted from Defendants acts or practices.

C. Approve all contracts, obligations and expenditures that are not actual, ordinary and necessary business or living expenses or are valued over \$ 50,000.00 (other than those expenses to purchase inventory at a cost [\*33] per unit no greater than that before the court entered this order and in a quantity no greater than necessary to fulfill orders from distributors) prior to entering those contracts or incurring those expenditures or obligations.

D. Perform all act necessary to ensure that Defendants are in compliance with the provisions of this Order including approving advertisements that **Equinox** and its distributors will be permitted to use, requiring Defendants to generate reports, documents and other records, and ensuring that Defendants cease any and all representations as to income levels of **Equinox** distributors, any and all representations that distributors or potential distributors of **Equinox** may or will receive compensation related to recruitment, any and all representations of a high likelihood of success in selling **Equinox's** products, failing to disclose all material information required by this Order, and failing to provide the refund policy provided for in this Order.

E. Perform all acts necessary to determine the extent, nature and amount of all funds, property, premises, accounts and other assets, beneficially or otherwise, of or in possession or under the control of Defendants, wherever [\*34] situated, including without limitation to inspect and inventory all property and assets of Defendants, and to audit, review, inspect and copy all books and records of accounts, all financial and accounting records, balance sheets, income statements, bank records (including monthly statements, canceled checks, records of wire transfers, and check registers), client lists, title documents, leases, computer maintained information, contracts, receipts, refund records, membership records and other papers and documents of Defendants.

F. Prepare and submit periodic reports, as necessary, to this Court and the parties describing Defendants business activities, income, expenditures, transactions and any deceptive practices by Defendants. Reports should include recommendations of any additional action required by this Court to ensure that the funds, property, premises, accounts and other assets of Defendants are preserved in order to provide restitution to the victims of any deceptive practices that may have resulted from Defendants' acts or practices.

G. To employ such managers, agents, employees, servants, accountants, attorneys and other professionals as may be advisable or necessary for [\*35] the Temporary Receiver to perform his duties and otherwise to assist generally in the receivership. The Temporary Receiver and those he employs are entitled to reasonable compensation for the performance of duties pursuant to this Order and for the costs of actual out-of-pocket expenses incurred by them, from the assets now held by or in the possession or control, or which may be received by Defendants.

H. The bond in the amount of \$ 50,000.00 filed with the Clerk of the Court by the Temporary Receiver shall continue to insure that the Temporary Receiver will well and truly perform the duties of the office and abide by and perform all acts the Court directs.

IT IS FURTHER ORDERED Defendants shall cooperate with and assist the Temporary Receiver, and shall take no action, directly or indirectly, to hinder, obstruct, or otherwise interfere with the Temporary Receiver in the conduct of his duties as set forth in this order.

IT IS FURTHER ORDERED that Defendants are preliminarily enjoined from destroying, erasing, mutilating, concealing, altering, transferring, or otherwise disposing of, in any manner, directly or indirectly, any contracts, accounting data, correspondence, advertisements, [\*36] computer tapes, discs, or other computerized records, books, written or printed records, handwritten notes, telephone logs, telephone scripts, receipt books, written or printed records, handwritten notes, telephone logs, telephone scripts, receipt books, ledgers, personal and business canceled checks and check registers, bank statements, appointment books and other documents or records of any kind which relate to their business practices or business or personal finances.

IT IS FURTHER ORDERED that Defendants are preliminarily enjoined from directly or indirectly selling, transferring, alienating, liquidating, encumbering, pledging, loaning, assigning, concealing, dissipating, converting, withdrawing, or making any other disposition of any funds, credit instruments, real or personal property, or other assets, or any interest therein, wherever located, owned or controlled by, or held for the benefit of, in whole or in part, or in the possession of Defendants, other than those approved by the Temporary Receiver or those that are actual, ordinary, and necessary business or living expenses that Defendants will reasonably incur.

IT IS FURTHER ORDERED Defendants shall provide the Temporary [\*37] Receiver with books, records, and accounts which are created and maintained in reasonable detail and accurately, fairly, and completely

reflect the amount of refunds granted and denied, incomes, disbursements, transactions, use, and location of monies and assets by Defendants.

IT IS FURTHER ORDERED that the Court reserves the right to make and enter such further orders or decrees, upon application of the Temporary Receiver or otherwise, that may be necessary for the guidance of the Temporary Receiver in his administration of the receivership herein established.

IT IS FURTHER ORDERED that the Court retains jurisdiction of this matter for purposes of construction, modification and enforcement of this Order.

DATED this 14th day of September 1999.

Johnnie B. Rawlinson

United States District Judge

**ORDER**

This matter is before the Court on Plaintiffs' Recommendation of Language for the **Preliminary Injunction** (# 75). Defendants filed an 'Opposition to Plaintiffs' Recommendation of Language for the **Preliminary Injunction** (# 76).

IT IS **ORDERED** that Plaintiffs' Recommendation of Language for the **Preliminary Injunction** (# 75) <sup>1</sup> is **DENIED** as moot in light of the Court's [\*38] **Preliminary Injunction** Order (# 78) entered on September 14, 1999.

<sup>1</sup> The Court did not solicit nor consider Plaintiffs' recommended language.

DATED this 14th day of September 1999.

Johnnie B. Rawlinson

United States District Judge