



DIRECT SELLING ASSOCIATION

Advisory Memorandum

TO: Government Relations Committee; Lawyers Council

FROM: Jeff Hanscom, Attorney & Government Relations Manager

DATE: February 1, 2013

RE: FTC & State Attorneys General Enforcement Action Against Fortune Hi-Tech Marketing

Background

On January 28, 2013, Kentucky Attorney General Jack Conway (D), along with Steve Baker, Director of the Federal Trade Commission's Midwest Office, announced an enforcement action against Fortune Hi-Tech Marketing ("FHTM") for allegedly operating an illegal pyramid scheme. Joining Kentucky in the suit are the Attorneys General from Illinois and North Carolina. The defendants are Paul C. Orberson, Thomas A. Mills, Fortune Hi-Tech Marketing Inc., FHTM Inc., Alan Clark Holdings LLC, FHTM Canada Inc., and Fortune Network Marketing (UK) Limited. On January 24, 2013, the court halted the deceptive practices, froze the defendants' assets, and appointed a temporary receiver over the corporations pending a trial. In conjunction with the complaint being filed, the Lexington Police Department raided the offices of FHTM and shut down their business office and their warehousing operations in Kentucky.

Recruitment

In its complaint filed in the U.S. District Court for the Northern District of Illinois, Eastern Division on January 24, 2013, the FTC alleges the operation affected more than 100,000 consumers throughout the United States, including Puerto Rico, and Canada. According to the complaint, the defendants falsely claimed consumers would earn significant income for selling the products and services of companies such as Dish Network, Frontpoint Home Security, and various cell phone providers, and for selling FHTM's line of health and beauty products. The complaint further alleges that despite FHTM's claims, nearly all consumers who signed up with the plan lost more money than they ever made. To the extent that consumers could make any income, however, it was mainly for recruiting other consumers, and FHTM's compensation plan ensured that most consumers made little or no money, the complaint alleged.

The complaint goes on to allege any income that was actually made by FHTM distributors was primarily derived from recruiting new consumers to become FHTM distributors and not from the sale of products or services. The complaint details the alleged pyramid structure, including the compensation plan and entry fees associated with joining. Specifically, new consumers wishing to join paid \$250 to join as a "manager" and an additional \$250 annual fee to remain with FHTM. Additionally, the complaint alleges

managers were strongly encouraged to immediately purchase either “starter packs” or “bundles” containing various FHTM health and beauty products, along with other products and services offered by FHTM. Only after the purchase of a “starter pack” or “bundle” were distributors eligible to receive commissions. The “bundles” and “starter packs” were assigned point values and cost between \$130 and \$400 and also enrolled the distributors in an auto-ship program where a distributor was billed monthly for additional products and services. In short, the complaint alleges FHTM encouraged distributors to purchase sufficient products to become and remain eligible for bonuses and focus their efforts on recruiting new members. Including the required entry and annual fees, FHTM distributors were spending more than \$1,500 annually to remain eligible for commissions and bonuses.

Compensation Plan & Income Misrepresentations

The FHTM compensation program had two parts: recruitment bonuses and commissions earned from the sale of products. The complaint alleges the plan provided much larger rewards for recruitment, thereby encouraging distributors to focus on recruiting new members as opposed to selling products. Specifically, the complaint alleges greater than 85% of the total compensation paid to distributors was tied to recruiting new members.

The complaint alleges numerous specific instances of FHTM distributors misrepresenting their incomes and those misrepresentations being posted and promoted by FHTM through various meetings, conferences, websites and social media outlets. Income claims ranged from “double or triple” the amount of money made in previous jobs, such as a registered nurse to “thirty-, forty-, fifty-, sixty-, seventy-thousand a month” as a National or Executive Sales Manager. These claims were posted to distributors’ social media sites, as well as promoted at FHTM meetings.

In order to support the earnings claims, the complaint alleges FHTM represented it had “special relationships” with various “partner” companies such as Dish Network, Frontpoint Home Security, Xoom Energy, Taxbot, DuPont and various cellular telephone companies. However, the complaint alleges FHTM was not a partner with any of these companies, but was instead a “third-party independent contractor” authorized to sell products or services on behalf of these companies. FHTM was not able to offer its consumers prices that were any lower than those otherwise available on the open market.

Specific Counts

The complaint alleges out violations of the following laws:

1. FTC Act, 15 U.S.C. § 45(a), which prohibits “unfair or deceptive acts or practices in or affecting commerce.”
 - a. Promoting an illegal pyramid scheme
 - b. False earnings claims
 - c. Means and instrumentalities
2. Illinois Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505

3. Kentucky Consumer Protection Act, KRS 367.010 *et seq.*; Kentucky Pyramid Sales Act, KRS 367.832 *et seq.*
4. North Carolina Pyramid and Chain Schemes Act, N.C. Gen Stat. § 14-291.2; North Carolina Unfair and Deceptive Practices Act, N.C. Gen Stat. § 75-1.1