
IN THE MATTER OF

KOSCOT INTERPLANETARY, INC., ET AL.

ORDER, OPINION ETC., IN REGARD TO ALLEGED VIOLATION OF
THE FEDERAL TRADE COMMISSION ACT AND SEC. 2 OF THE
CLAYTON ACT

Docket 8888. Complaint, May 24, 1972-Final Order, Nov. 18, 1975

Order requiring an Orlando, Fla., seller and distributor, of cosmetics and cosmetic distributorships, among other things to cease using its open-ended, multilevel marketing plan; engaging in illegal price fixing and price discrimination and imposing selling and purchasing restrictions on its distributors; and to cease making exaggerated earnings claims and other misrepresentations in an effort to recruit distributors.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act and the Clayton Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission, having reason to believe that Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, and Glenn W. Turner, Terrell Jones, Malcolm Julian, Ben

Bunting, Michael Delaney, Hobart Wilder, and Raleigh P. Mann, individually and as former officers, officers, or directors of said corporations, hereinafter referred to as respondents, have violated the provisions of said Acts, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., are corporations organized, existing and doing business under and by virtue of the laws of the State of Florida, with their principal office and place of business located at 4805 Sand Lake Rd., Orlando, Fla.

Respondent Glenn W. Turner is chairman of the board of directors of Koscot Interplanetary, Inc., and is the sole stockholder of Glenn W. Turner Enterprises, Inc. Mr. Turner was the founder of Koscot Interplanetary, Inc., and instituted the marketing plan and distribution policies. He, with others named herein, has been and is responsible for establishing, supervising, directing and controlling the business activities and practices of corporate respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., including the acts and practices hereinafter set forth. Mr. Turner's address is the same as that of the corporate respondents.

Respondents Terrell Jones, Malcolm Julian, Ben Bunting, Michael Delaney, Hobart Wilder, and Raleigh P. Mann are officers, or directors of said corporate respondents. Together with others, said respondents have been and are responsible for the formulation, control and direction of the acts and practices hereinafter set forth. Their address is the same as that of the corporate respondents.

The aforementioned respondents cooperate and act together in carrying out the acts and practices hereinafter set forth.

PAR. 2. In the conduct of their business, at all times mentioned herein, respondents have been in substantial competition in commerce with corporations, firms and individuals in the sale of cosmetics, toiletries and associated items of the same general kind and nature as those sold by respondents.

PAR. 3. Respondents are now, and for some time last past have, engaged in the advertising, offering for sale, sale and distribution of cosmetics, toiletries and associated items and distributorships and franchises to the public, and are inducing, and have induced, persons to invest substantial sums of money in respondents' multilevel marketing program as hereinafter more fully described.

PAR. 4. In the course and conduct of their business, respondents now cause, and for some time last past have caused, their products, when

sold, to be shipped from their places of business in various States to purchasers thereof located in various States of the United States other than the State of origination, and maintain, and at all times mentioned herein have maintained, a substantial course of trade in said products in commerce, as "commerce" is defined in the Federal Trade Commission Act and the Clayton Act.

PAR. 5. In the course and conduct of their business, respondents have used a multilevel marketing program having four levels of distributors and are presently using a multilevel marketing program which allows the potential participant to enter at any one of three levels, *i.e.*, beauty advisor, supervisor or director. All participants are designated as independent contractors and except for the beauty advisors who sell primarily at retail through party plans and door-to-door methods, are permitted to, and do, sell or attempt to sell at both wholesale and retail. A description of these levels, in order of ascendancy, follows:

1. Beauty advisor (retailer)—The beauty advisor purchases products from her sponsor (who may be a supervisor or director) at a 40 percent discount, for sale to the consuming public. The beauty advisor receives a refund bonus from her sponsor each month, based on the total retail volume ordered during the month. Entrant qualifies by investing \$10 for a starter kit.

2. Supervisor (sub-distributor)—The supervisor purchases products from the company at a 55 percent discount for distribution to his beauty advisors and direct sales to the consuming public. The supervisor receives a special commission for each new supervisor order he creates, \$500 or 25 percent of the \$2000 paid for the initial order. An entrant qualifies as a supervisor in any one of these ways:

- a. By investing \$2000 immediately;
- b. By purchasing \$5400 in Koscot cosmetics (at retail value) from his sponsor;
- c. By selling a portion of the required \$5400 volume through his organization and purchasing the balance in one lump sum.

3. Director (distributor)—The director purchases products from the company at a 65 percent discount for distribution to his direct distributors (supervisors and beauty advisors) and for direct sales to the consuming public. The director is entitled to a 10 percent special commission on all of his supervisor's purchases. He receives \$500 for each supervisor order that he sells. The director sponsoring a new director is also entitled to a 65 percent commission (\$1,950) on the \$3,000 additional inventory which the new director is required to purchase. An entrant qualifies as a director by: a) becoming a supervisor, purchasing the additional \$3000 director inventory and selling a new supervisor order in order to replace himself in his

sponsoring director's organization; or b) by initially investing \$5000 and becoming known as an apprentice director until he fulfills all the necessary aforementioned requirements.

These positions are described more fully to the prospective investors at "Opportunity Meetings" held weekly in various locations across the country. At such a meeting, a movie is shown and speeches are made which concentrate upon the unlimited potential to earn large sums of money in a relatively short time by recruiting others into the Koscot program. In most instances, the opportunity meeting will closely follow the script provided by respondents as found in the distributor's training manual. This meeting is run in such a manner as to excite those attending and to induce them into making an emotional decision to invest in the program.

PAR. 6. In the course and conduct of their business as aforesaid, respondents have done and performed and are doing and performing the following:

1. Respondent Koscot Interplanetary, Inc. has entered into contracts, agreements, combinations, or understandings with its distributors whereby said distributors agree to maintain the resale prices established and set forth by respondent corporation, notwithstanding that some of such distributors are located in States which do not have Fair Trade laws.

2. Respondent Koscot Interplanetary, Inc. has entered into contracts, agreements, combinations, or understandings with its distributors whereby said distributors agree to maintain the discounts, overrides, rebates, bonus schedules, finder's fees and release fees, between and among all other distributors, as established and set forth by respondent corporation.

3. Respondent Koscot Interplanetary, Inc. has entered into contracts, agreements, combinations, or understandings with its distributors whereby said distributors understand that a violation of any company rule or regulation is reason for immediate termination of their status as distributors by the company board of directors.

4. Respondent Koscot Interplanetary, Inc. has instituted certain rules and regulations, among which are those set out below, whereby its distributors:

- (a) Agree to purchase merchandise only from respondent or his sponsor in accordance with Koscot's marketing program,
- (b) agree that all purchases of merchandise from respondent corporation or his sponsor constitutes a nonrefundable sale,
- (c) agree not to engage in the sale of a competitive line of products or individual products which would be considered competitive to respondent corporation,

(d) agree never to make any consignment of merchandise to anyone without receiving written notice of approval by Koscot Interplanetary, Inc.,

(e) agree to restrict retail sales and display of cosmetics to home service routes and beauty forums, and to certain categories of retail outlets specified by respondent but only with Koscot's approval,

(f) agree to obtain prior written approval from Koscot for any promotion or advertising of Koscot products or his distributorship,

(g) agree to maintain a record of the names and addresses of all his customers and to provide Koscot with such information through his supervisor or director,

(h) agree not to transfer to another organization without prior written consent of all distributors above him in his organization, including respondent corporation,

(i) agree to have a financial interest in only one Koscot distributorship at a time and that he cannot be part of two separate distributorships,

(j) agree not to enter into any agreement with a distributor in another Koscot organization to make a division of profits, assets, or new recruits in violation of the "Koscot Marketing Konzept."

5. Respondent Koscot Interplanetary, Inc. has entered into contracts, agreements, combinations or understandings with its distributors whereby respondent:

(a) Prohibits a corporation from becoming a Koscot distributor,

(b) requires that the organization of a distributor, who quits or loses his status as a distributor, becomes a part of the organization of the distributor immediately preceding him on Koscot's organizational chart.

6. Respondent Koscot Interplanetary, Inc. discriminates in price, directly or indirectly, between different purchasers of its products of like grade and quality by selling said products at lower prices to some purchasers than to other purchasers, many of whom have been and now are in competition with the purchasers paying the higher price. For example, director-distributor purchases his products directly from respondent corporation at approximately: (a) 22.2 percent discount as compared with the cost to a supervisor-distributor, (b) 41.7 percent discount as compared with the cost to a beauty advisor.

There are approximately 7,988 director-distributors and approximately 10,726 supervisor-distributors in the program.

The supervisor-distributor who purchases his products directly or indirectly from respondent corporation, purchases at approximately a 25 percent discount as compared with the cost to a beauty advisor.

In addition, respondent corporation has agreed to pay the director-distributor a 2 percent override on the purchases of the entire

organization of each supervisor-distributor recruited by said director-distributor when such supervisor-distributor works up or buys in and becomes a director himself. Thereafter, although both director-distributors buy from respondent corporation, only the first will receive the 2 percent override from respondent corporation.

COUNT I

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One through Six hereof are incorporated by reference in Count I with respect to respondents, as if fully set forth herein.

PAR. 7. Respondents make various oral and written statements to prospective investors regarding the sale of their cosmetics, toiletries and associated items and the recruitment of additional participants in their marketing program. Typical and illustrative of said statements and representations, but not all inclusive thereof, are the following:

1. To become a Director a Supervisor * * * must go out, create a new Supervisor's initial order, and bring this order to *you*, the Director, before you *release* this Supervisor to become a Director * * *. When this new Supervisor entered the program, he ordered \$2000 in retail products. This Supervisor created the order, so he receives the 25% commission on products. But *you* are the Director, so *you* earn the 10% Director's commission of \$200.

As soon as this Supervisor's initial order is received by the company, the company sends *you* the 65% commission on this \$3000 additional inventory. This is \$1,950! You now have earned a total of \$2,850!

Create this volume once a month and at the end of the year you will have earned over \$34,000.

2. As a Director with one Supervisor in your organization, your job is to help this Supervisor become successful. See that he and his retail manager are thoroughly trained and make certain he fully understands the program. When he is ready to enjoy additional benefits, help him create a new Supervisor's initial order for cosmetics and he will become a Director.

Continue to help the one Supervisor you will always have. Help him sell only one Supervisor's order per month for your organization and you will earn over \$26,000 per year! But work with your Supervisor full-time to make him a success! Do this twice a month and your income will exceed \$52,000 per year!

3. Let's assume you decide to recruit girls to be trained as Beauty Advisors * * *. Let's look at your third month in the business. Again sponsor only eight girls who produce the part-time volume of only \$300 a month. This new group will produce \$2,400 their first 30 days. The last group you sponsored has learned the benefits of our incentive plan. They have learned that by increasing their efforts and continuing to service their customers they can produce a monthly volume of \$900 each. When this occurs, this group will give you an additional \$7,200 in volume.

Your first group of girls may have increased their volume even *more*, but suppose they are producing only \$900 each per month or \$7,200 for the group. Then your total monthly volume is \$16,800!

At this point you will *certainly* want to become a Director and enjoy the benefits of a 65% discount! You continue to sponsor eight girls a month and train them to produce the

necessary volume, and you will be giving yourself an \$1,800 a month *raise* in income every month.

PAR. 8. Respondents' multilevel marketing program, as represented by the above-quoted statements, contemplates an endless recruiting of participants since each person entering the program must bring in other distributors to achieve the represented earnings. The demand for prospective participants thus increases in geometric progression whereas the number of potential investors available in a given community or geographical area remains relatively constant. Consequently, a person coming into the program at a later stage will be unable, in a substantial number of instances, to find additional investors because the recruiting of participants into the program at an earlier stage by others has exhausted the number of prospective participants. It is self-evident that respondents' marketing program must of necessity fail when the market for potential distributors has become saturated.

Although some participants in respondents' multilevel merchandising program may realize a profit, all participants do not have the income potentiality represented by respondents, such as described in Paragraph Seven through recruiting other participants and the resultant finder's fees, commissions, overrides, rebates and other compensation arising out of the sale of respondents' products. In reality, some participants in the program will receive little or no return on their investment.

Respondents' multilevel merchandising program is organized and operated in such a manner that the realization of profit by any participant is predicated upon the exploitation of others who have virtually no chance of receiving a return on their investment and who had been induced to participate by misrepresentations as to potential earnings. Therefore, the use by respondents of the aforesaid program in connection with the sale of their merchandise was and is an unfair act and practice, and was and is false, misleading and deceptive.

PAR. 9. In the course and conduct of their business as aforesaid, and for the purpose of inducing the purchase of their products, and the purchase of distributorships and participation in their multilevel marketing program, the respondents have made, and are now making numerous statements and representations in certain promotional materials, including, but not limited to, film strips, newsletters, information manuals, marketing plan booklets, meeting scripts, and other materials.

Typical and illustrative of said statements and representations, but not all inclusive thereof, are those set out below, as well as those in the distributor's training manual.

1. The world's largest cosmetic company sponsors over 200,000 girls a year. Knowing

this, with a full-time effort in our program, don't you believe you can sponsor 2 girls a week?

2. There are ordinary men and women in KOSCOT like you and me who are earning five and even ten thousand dollars per month!

3. Ladies and gentlemen, this is over \$50,000 a year and now *we are* talking about a great deal of money aren't we? Do you know what excites me about this figure? Many KOSCOT Distributors are presently earning this kind of money and more! The point you should consider is this: When we can do so much, surely you can do as well or even better when you exert the necessary effort.

PAR. 10. By and through the use of the above-quoted statements and representations, as well as the exposition of the "Koscot Marketing Konzept," as found in the distributor's business manual, and other statements and representations of similar import and meaning, but not expressly set out herein, respondents and their agents and representatives, represent, and have represented, directly or by implication, to prospective participants, that:

1. It is not difficult for participants in the Koscot program to recruit and retain distributors and sales personnel to work home routes and sell respondents' products door-to-door enabling said participants to recoup their investment and to earn the represented profits set forth herein.

2. Participants in the Koscot marketing program have the potentiality and reasonable expectancy of receiving large profits or earnings.

3. The Koscot marketing program is commercially feasible for all participants and the supply of available entrants and investors is virtually inexhaustible.

PAR. 11. In truth and in fact:

1. It is difficult for participants in the Koscot program to recruit and retain distributors and sales personnel to work home routes and sell respondents' products door-to-door, hence, many participants cannot even recoup their investment, much less earn the represented profits set forth herein.

2. Participants in respondents' marketing program do not have the potentiality and reasonable expectancy of receiving large profits or earnings (for the reasons hereinbefore set forth).

3. The Koscot marketing program is not commercially feasible for all participants and its operation exhausts the supply of available entrants and investors as hereinbefore explained.

Therefore, the statements and representations as set forth in Paragraphs Nine and Ten have been and are, false, misleading and deceptive.

PAR. 12. Respondents' merchandising program is in the nature of a lottery in that participants are induced to invest substantial sums of money on the possibility that by the activities and efforts of others, over whom they exercise no control or direction, they will receive the

profits described in Paragraphs Seven and Nine herein. The realization of such financial gain is not dependent on the skill and effort of the individual participant, but is the result of elements of chance including the number of prior participants and the degree of saturation of the market which exists when the participant is induced to make his investment.

The use by respondents of a multilevel marketing program, which is in the nature of a lottery, is contrary to the public policy of the United States and is an unfair act and practice and an act of unfair competition within the intent and meaning of Section 5 of the Federal Trade Commission Act.

PAR. 13. The use by the respondents of the aforesaid false, misleading and deceptive statements, representations and practices has had, and now has, the capacity and tendency to mislead members of the public into the erroneous and mistaken belief that said statements and representations were and are true and into the investment of substantial sums of money to participate in the respondents' multilevel marketing program and the purchase of substantial quantities of respondents' products by reason of said erroneous and mistaken belief.

PAR. 14. The aforesaid acts and practices of the respondents, as herein alleged; were and are all to the prejudice and injury of the public and of respondents' competitors in commerce and unfair methods and deceptive acts and practices in commerce, in violation of Section 5 of the Federal Trade Commission Act.

COUNT II

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One through Fourteen hereof are incorporated by reference in Count II as if fully set forth herein.

PAR. 15. The acts and practices, courses of conduct and methods of competition engaged in, followed, pursued or adopted by respondents, as alleged hereinabove, have had and continue to have the purpose and effect of substantially lessening, restraining, preventing and excluding free and open competition by, between, and among respondents' distributors in the marketing, sale and distribution of respondents' products throughout the United States in the following manner:

- a. By fixing, maintaining and otherwise controlling the prices at which respondents' products are resold in both the wholesale and retail markets.

- b. By fixing, maintaining or otherwise controlling the various fees, bonuses, rebates, or overrides required to be paid by one distributor or class of distributors.

- c. By restricting the sellers from whom respondents' distributors

may purchase their products and the customers to whom they may sell their products.

d. By restricting their distributors to reselling respondent corporation's products only in certain categories of retail outlets.

e. By unreasonably restricting the freedom of respondents' distributors to market their products in the manner of their own choosing.

Said acts, practices, courses of conduct and methods of competition are prejudicial and injurious to the public; have a tendency to hinder and prevent competition and have actually hindered and restrained competition, and constitute unfair acts or practices and unfair methods of competition in commerce within the meaning and intent of Section 5 of the Federal Trade Commission Act.

COUNT III

Alleging violation of Section 2(a) of the Clayton Act, the allegations of Paragraphs One through Five and subparagraph (6) of Paragraph Six hereof are incorporated by reference in Count III as if fully set forth herein.

PAR. 16. The difference in net cost among the various distributors of respondents' products, each of whom is in competition with other distributors of respondents' products, results in substantial discrimination in the net prices for products sold to the nonfavored customers, who are both direct purchasers and indirect purchasers of respondents' products.

In addition, the various fees, overrides, or other payments result in discriminations among the direct and indirect purchasing distributors who are in competition with one another. These monies are direct and indirect payments by respondent Koscot Interplanetary, Inc. and are in effect discriminations in the net price of products to the various distributors.

The effect of respondent Koscot Interplanetary, Inc.'s discrimination in net price as alleged herein may be substantially to lessen competition or tend to create a monopoly in the line of commerce in which its favored purchaser is engaged, or to injure, destroy, or prevent competition between the favored and nonfavored purchasers or with the customers of either of them, except to the extent that competition has been lessened by the acts and practices alleged in Counts I and II hereof.

The aforesaid acts and practices of respondents constitute violations of the provisions of Section 2(a) of the Clayton Act as amended.

COUNT IV

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One through Fourteen hereof are incorporated by reference in Count IV with respect to respondents, as if fully set forth herein:

PAR. 17. In the course and conduct of their business as aforesaid, respondents' multilevel merchandising program is organized and operated in a manner that results in the recruitment of many participants who have virtually no chance to recover their investments of substantial sums of money in respondents' program and who have been induced to participate by misrepresentations as to potential earnings. Respondents have received the said sums and have failed to offer to refund and refused to refund such money to participants that were unable to recover their investment.

The use by the respondents of the aforesaid program and their continued retention of the said sums, as aforesaid, is an unfair act and practice and an act of unfair competition within the intent and meaning of Section 5 of the Federal Trade Commission Act.

PAR. 18. The aforesaid acts and practices of the respondents, as herein alleged, were and are all to the prejudice and injury of the public and of respondents' competitors in commerce and are unfair acts and practices and unfair methods of competition in commerce, in violation of Section 5 of the Federal Trade Commission Act.

Appearances

For the Commission: *Quentin P. McColgin* and *David C. Keehn*.

For the respondents: *Jerris Leonard* and *Kenneth Michael Robinson*, *Leonard, Cohen & Gettings*, Wash., D. C. for Koscot Interplanetary, Inc., *Glenn W. Turner Enterprises, Inc.*, *Glenn W. Turner*, *Malcolm Julian*, *Ben Bunting* and *Hobart Wilder*.¹

INITIAL DECISION BY DONALD R. MOORE, ADMINISTRATIVE
LAW JUDGE

MARCH 20, 1975

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¹ A supplemental memorandum of law was submitted on behalf of Koscot Interplanetary, Inc., by Levy, Levy & Ruback, New York, N. Y., as special bankruptcy counsel. Various other counsel participated at earlier stages of the proceeding but subsequently withdrew. Regarding respondents Terrell Jones, Michael Delaney, and Raleigh P. Mann, see *infra*, pp. 3-4, 15 [pp. 1119, 1127, herein].

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PRELIMINARY STATEMENT

The complaint in this proceeding, charging violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, and of Section 2(a) of the Clayton Act, 15 U.S.C. § 13, was issued on May 24, 1972, and was thereafter duly served on all respondents except Terrell Jones (see *infra*). The complaint, containing four counts, charges as unlawful certain of respondents' practices in connection with the sale and distribution of toiletries and cosmetics and the recruitment of distributor-investors.

Count I of the complaint charges that respondents' "multi-level marketing program" was not only inherently deceptive and unfair but also involved numerous misrepresentations. Count II alleges that agreements between respondent Koscot and its distributors were in unlawful restraint of trade. Count III alleges that respondents discriminated in price among various classes of customers, in violation of the Clayton Act as amended. Count IV charges in effect that

respondents' retention of funds obtained through misrepresentation constituted an unfair practice.

Respondents filed answers on Aug. 22, 1972, and on Sept. 7, 1972, which put in issue most of the material allegations of the complaint.²

After extensive prehearing procedures, including several prehearing conferences, hearings were held between July 30, 1973, and Oct. 18, 1974, in Washington, D.C., New York City, Kansas City, Mo., and Orlando, Fla. At these hearings, testimony and other evidence were offered in support of and in opposition to the allegations of the complaint. The testimony and evidence presented—aggregating 5224 pages of transcript and thousands of pages of documentary exhibits—have been duly recorded and filed.

Forty-one witnesses were called to testify in support of the allegations of the complaint, including the seven individual respondents, one additional former officer of respondent Koscot, two officials of Avon Products, Inc., three expert witnesses (marketing and economics), and 28 distributors or former distributors of respondent Koscot.

Four of the individual respondents—Glenn W. Turner, Malcolm Julian, Ben Bunting, and Hobart Wilder—were excused from testifying after each pleaded his constitutional right to remain silent on the ground that answers to questions propounded or proposed on the subject matter of this proceeding might tend to incriminate him. These Fifth Amendment pleas were made in the light of a pending criminal proceeding in the United States District Court for the Middle District of Florida (*Koscot Interplanetary Incorporated, et al.*, Criminal No. 73-71). (See Tr. 912-91).

Respondents called no witnesses in defense but offered some documentary evidence, primarily relating to the status of respondent Koscot as a result of its petition for an arrangement under Chapter 11 of the Federal Bankruptcy Act.

Hearings were in recess from October 1973 until August 1974, because certain witnesses whose testimony was required to complete the case-in-chief in support of the complaint were prohibited from testifying by protective orders issued on Oct. 17, 1973, by the Honorable Gerald B. Tjoflat, United States District Judge for the Middle District of Florida, in connection with the criminal case styled *United States v. Koscot Interplanetary, Inc., et al.*, No. 73-71-Orl-Cr. On Aug. 1, 1974, such protective orders were modified so as to permit the testimony in question, and hearings in support of the complaint were resumed on Aug. 19, 1974, and concluded on Aug. 22, 1974. After

² The answer filed on Aug. 22, 1972, on behalf of the corporate respondents and respondents Turner, Julian, and Wilder was later amended to reflect that it was also the answer of respondent Michael Delaney (order granting motion to amend answer, Sept. 11, 1972).

further proceedings, including the submission of documentary exhibits on behalf of respondents, the evidentiary record was closed on Oct. 18, 1974.

The parties were represented by counsel and were afforded full opportunity to be heard, to examine and to cross-examine witnesses, and to introduce evidence bearing on the issues.³ Also, although respondent Raleigh P. Mann was afforded a full opportunity to participate in the trial, he was not represented by counsel during the hearings and did not participate other than to appear as a witness subpoenaed by complaint counsel and to make a statement under oath on his own behalf at the conclusion of his testimony (Tr. 4814-15). He filed no exceptions or other response to the proposed findings, etc., submitted by complaint counsel. However, on Sept. 26, 1974, he filed *pro se* a motion to dismiss the case as to him on grounds that there had been failure of proof. The motion was taken under advisement for determination as part of the initial decision herein.

After the presentation of evidence, proposed findings of fact and conclusions of law and a proposed form of order were filed by counsel supporting the complaint, together with a supporting brief. (Certain errors in complaint counsel's proposed findings of fact, etc., as originally filed, were corrected by a "Notice of Corrections" filed on Jan. 2, 1975.)

Counsel for respondents filed a brief in opposition to the submittals of complaint counsel, and complaint counsel filed a reply brief.

In their brief, all respondents except Mann have consented to the issuance of the order proposed by complaint counsel except that part (Section V) which requires that restitution be made by the corporate respondents and by three of the individual respondents. As to the proposed findings of fact submitted by complaint counsel, respondents' exceptions are directed only to those that are intended to provide a factual predicate for the restitution order. Their brief states:

Counsel strongly disagrees with the opening language used in complaint counsel's brief whereby *Koscot, et al.* are described as inherently deceptive and fraudulent. However, in view of the recognized fact that none of these respondents are presently participating in such illegal marketing deceptions and frauds we do not take issue with the proposed order except for the proposed findings which deal with restitution. [Footnote omitted.]

* * * * *

* * * [W]e do not intend to respond or object to the proposed findings of fact and conclusions of law except for those parts regarding restitution. In not objecting to the language of the proposed order which deals with "pyramiding" and fraudulent practices,

³ Terrell Jones, although cited in the complaint, was not a party since he was not served with a copy of the complaint (Tr. 4835-37). (He was later located and was called as a witness by complaint counsel.)

we do not wish for anyone to interpret our silence as a stipulation that such did occur. We simply reaffirm our proffer that the interests of justice can best be served in this case by the issuance of an order which enjoins that conduct which complaint counsel argues existed. If such conduct and practice did exist in the context as complaint counsel argues them then respondents are the first to agree that such activity should be forever stopped.

* * * * *

* * * [I]t is respectfully submitted that the remedies requested by complaint counsel as regards restitution be denied and that all other injunctive relief be ordered and noted as not objected to by respondents. (RB, pp. 1, 8, 19; see also pp. 17-18).

In view of these concessions by the principal respondents, most of the essential facts are virtually undisputed, and most of the provisions of the proposed order may be entered as "not objected to." Accordingly, despite the size of the record and the volume of counsel's submittals, the administrative law judge has made relatively brief findings of ultimate facts. The proposed findings of complaint counsel are meticulously detailed, with extensive citations to the record. Since, for the most part, respondents have not challenged these proposed findings, they are incorporated by reference as subsidiary findings that support the findings of ultimate fact constituting this initial decision.⁴ Respondents' exceptions are essentially limited to those proposed findings that underlie complaint counsel's plea for a restitution order. These exceptions have been carefully considered and are discussed in greater detail than those matters that respondents have not specifically contested. As requested (RB, p. 8), the undersigned has carefully reviewed the testimony, particularly the cross-examination, of Messrs. Delaney, Edwards, Mann, and Jones.

FINDINGS OF FACT

I. *Respondents and Their Business*

A. The Corporate Respondents

1. Koscot Interplanetary, Inc. ("Koscot")⁵ is a corporation existing and doing business under and by virtue of the laws of the State of Florida, with its principal office and place of business located at 4805

⁴ Where references are made to proposed findings submitted by the parties, such references are intended to include their citations to the record unless otherwise indicated. Citations to the record, as well as to the proposed findings, are intended to serve as convenient guides to the testimony and to the exhibits supporting the findings of fact, but they do not necessarily represent complete summaries of the evidence considered in arriving at such findings. The proposed findings of the parties not adopted, either in the form proposed or in substance, have been rejected as lacking support in the record or as involving immaterial matters.

⁵ The name "Koscot" is an acronym for the term "Kosmetics for the Communities of Tomorrow." Spelling cosmetics with a "k" was designed to call attention to the product (CX 11, p. 3). Later, Turner spelled the word "cash" with a "k" in a company called "Kash Is Best," which involved a discount for cash payments (Jones 4896).

Sand Lake Rd., Orlando, Fla. It was organized on or about Aug. 21, 1967 (complaint, ¶ 1; answer of Koscot, et al., ¶ 2; CX 29 C).

2. Glenn W. Turner Enterprises, Inc. ("Turner Enterprises") is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Florida, with its principal office and place of business located at 4805 Sand Lake Rd., Orlando, Fla. It was originally organized prior to October 1970 under the name of Dare To Be Big, Inc. (complaint, ¶ 1; answer of Koscot, et al., ¶ 2; CX 30 B).

3. Koscot was founded by respondent Glenn W. Turner, who, directly or indirectly owned the controlling interest in Koscot until August 1973. He was its sole stockholder from December 1970 until August 1971, when Koscot became a wholly-owned subsidiary of Glenn W. Turner Enterprises, Inc., which had previously been a subsidiary of Koscot. Turner was the sole stockholder in Turner Enterprises. Turner Enterprises held 100 percent of the voting stock of Koscot until August 1973, when all of the outstanding capital stock of Koscot was sold by Turner Enterprises to Max Morris for the sum of \$15,000 (complaint, ¶ 1; answer of Koscot, et al., ¶¶ 2-3; CX 1 A-C; CX 13 A; CX 27 F; CXs 29-30; CX 190 C-D; CX 357 H, CX 358 H; CX 362 G; CX 759 A; Tr. 5210-11). This stock sale took place about a month after Koscot filed a petition for an "arrangement" with its creditors under Chapter XI of the Federal Bankruptcy Act. A plan of arrangement has been submitted by Koscot, and further proceedings were scheduled in early 1975 (RXs 12 A-Z-102, 16, 17 A).

In this decision, references to the record are made in parentheses, and certain abbreviations are used as follows:

CPF - Complaint counsel's proposed findings—"Proposed Findings of Fact, Conclusions of Law, and Order."

CB - Complaint counsel's "Brief in Support of Proposed Findings of Fact, Conclusions of Law and Order."

CRB - "Complaint Counsel's Reply Brief and Other Submissions."

CX - Commission exhibit.

RB - Respondents' brief—"Brief in Opposition to Commission's Brief in Support of Proposed Findings of Fact and Conclusions of Law, and Order."

RPF - Respondents' proposed findings, as contained in RB (pp. 1-7).

RX - Respondents' exhibit.

Tr. - Transcript. (References to testimony sometimes cite the name of the witness and the transcript page number without the abbreviation "Tr."—for example, Jones 4868.)

References to the proposed findings of counsel are to paragraph numbers, while citations to the briefs are to page numbers.

Having heard and observed the witnesses and having careful

reviewed the entire record in this proceeding, together with the proposed findings and briefs filed by the parties, the administrative law judge makes the following findings of fact, enters his resulting conclusions, and issues an appropriate order.

4. For most of the period 1971 until August 1973, Turner Enterprises controlled and directed the affairs of Koscot (CXs 358 H, 362 G; CXs 271-73, 275 A, 279 A-B, 291 A, 568 B; Mann 4403-06, 4494) and derived most of its income from Koscot. From September 1971 to August 1973, Koscot was required to make weekly transfers of funds to Turner Enterprises amounting to 10 percent of all revenues, net of commissions paid out (CXs 291 A, 358 Q, 362 Q). For the 11-month period ending June 30, 1972, more than one-half of the total income of Turner Enterprises came from Koscot (CXs 179 E, 330 C). Money was transferred regularly between Turner Enterprises and Koscot, as well as between other subsidiaries and affiliates, foreign and domestic, of Turner Enterprises (CX 758 A-B; Jones 4899). As of July 1972, Turner Enterprises had investments in and advances to foreign corporations in excess of \$2 million. These foreign corporations included the following:

- Koscot of Australia Pty. Ltd.
- Fashcot of Australia Pty. Ltd.
- Dare To Be Great of Australia Pty. Ltd.
- Koscot Interplanetary of Canada (1971) Limited
- Koscot GmbH
- Dare To Be Great GmbH
- Koscot Hellas L.L.C.
- Koscot Italia S.R.L.
- Koscot Interplanetaria De Mexico, S.A.
- Koscot A.G.
- Koscot Interplanetary (U.K.) Ltd.
- Koscot De Venezuela S.A.

5. During January 1973, all of the outstanding capital stock of one or more of the companies listed in ¶ 4, *supra*, was sold by Turner Enterprises to Ariarnes, a corporation (not otherwise identified), for an amount ranging between \$10,000 and \$100,000 (CXs 758 A, 759 B-C; Tr. 210-11).

6. As of July 31, 1972, Koscot had total assets of \$22.5 million, but as of July 1973, its total assets had dwindled to \$11.7 million (CX 758 A; X 12 Z-70-71, 76-77, 91).

B. The Individual Respondents

7. *Glenn W. Turner*—Glenn W. Turner was the founder of Koscot⁶ and instituted its marketing plan and its distribution policies. He owned a controlling interest, directly or indirectly, in each of the corporate respondents. He was president of Koscot from August 1967 to January 1968 and chairman of its board of directors from January 1968 until at least March 1972. He was also chairman of the board of directors of Turner Enterprises from February 1971 until March 1972 (see ¶3, *supra*).

8. Each of the two corporate respondents was, in essence, the alter ego of Turner. He was primarily responsible for establishing, supervising, directing, and controlling the policies, business activities, and practices of each of the corporate respondents. Despite ostensible changes in corporate officers, as well as the establishment of a voting trust for Koscot, both corporations operated under his ultimate control and domination. He appointed and removed corporate officers and directors. The two corporations had many officers and directors in common and, with other Turner-controlled companies, essentially operated as a single enterprise. Turner controlled the corporate funds and used them for such purposes as he saw fit, borrowing and otherwise using corporate funds as his own.

9. Although there is evidence that Turner resigned as a corporate officer of Turner Enterprises in March 1972,⁷ a document submitted by respondents as Appendix I of their brief shows that in October 1974, he signed a stipulation of settlement in a class action suit pending in the United States District Court for the Western District of Pennsylvania as president of Turner Enterprises, as president of Dare To Be Great, Inc., and also on behalf of Koscot (capacity not designated).

(Record references: Complaint, ¶ 1; answer of Koscot et al., ¶¶ 2, 3; Edwards 1129-32; Mann 4375-85, 4391-92, 4399-4403, 4488, 4494, 4592-4612, 4660-64, 4699-4709, 4719; Jones 4880-83, 4888-89, 4899, 5000-01; CXs 1 A-C, 5, 13 A, 27 F, 29-30, 43-49, 190 D, 192, 195 A, 221, 223, 226, 229, 244, 292, 357 H & J, 358 H & L, 362 G & K, 490 A-C, 568 A-B, 618-19, 759 A; Tr. 5210-11; RX 12 Z-98.)

10. Although Turner retained ultimate veto power over corporate operations, he necessarily delegated authority to others. Those who shared with him the responsibility for the formulation, control, and

⁶ Turner established Koscot in August 1967 with \$5,000 in borrowed money. He supposedly had no other capital despite the fact that he claimed to have earned \$30,000 to \$35,000 a month as a "General" in Holiday Magic, with which he had been associated since late 1966. (Jones 4847-48, 4853), and Koscot literature portrayed him as having earned \$250,000 in cosmetics in "twelve short months" (CX 11, pp. 19, 34) before he founded Koscot.

⁷ Turner resigned as chairman of the board of Turner Enterprises on Mar. 13, 1972, but announced he would serve as a consultant. He requested \$250,000 a month for such consulting services, and other financial considerations were to be negotiated (CX 292).

direction of the acts and practices of the corporate respondents included the following respondents:

Ben Bunting
Hobart Wilder
Malcolm Julian
Raleigh P. Mann

The role of each may be outlined as follows:

11. *Ben Bunting*—Respondent Ben U. Bunting played a key role in Koscot operations from 1969 until mid-1971 and was a well-paid "consultant" thereafter. As the "right hand man for Turner" during most of this period, he virtually had total control of Koscot operations. Beginning as a Koscot distributor, he later held the following corporate offices in Koscot:

National director—November 1968–January 1969;
president—January–June 1969;
corporate president⁸—June 1969–July 1970;
member and chairman of voting trust—April–December 1970; and
international corporate president—July 1970–July 1971.

In addition, Bunting was involved in Turner Enterprises, as assistant to the chairman of the board (July 1970–February 1971) and as vice chairman of the board (February–July 1971). Thereafter, he became a consultant to Turner Enterprises while apparently continuing to serve as a director of Turner Enterprises (Mann 4387-88, 4391-92, 4488; Jones 4904-06, 4970, 4991; CXs 2 D-U, 3 A, 5, 13 J, 46 F, 211, 223, 245, 252 A, 253, 279, 490 A, 568 A, 574 A-B, 614 C).

12. On July 8, 1971, Bunting resigned from the boards of directors of all companies except Turner Enterprises and was designated to be in charge of all monies for that corporation (CX 574 A-B). About this same time, Bunting and Turner entered into a contract providing that 3 percent of the gross receipts of Turner Enterprises and its subsidiaries, including Koscot, were to be paid to Bunting for consulting services (Mann 4577-78). Meanwhile, using a loan of \$250,000 from Turner, Bunting acquired a foreign "shell corporation," Candida Holdings, NV ("Candida") (Mann 4574-4577, 4580; CX 611 A). In November 1971, Candida became a publicly-held company, but Bunting continued to hold in excess of 50 percent of its stock (CX 611 A; Mann 4577, 4584). Shortly thereafter, Bunting assigned his consulting contract to Candida (CX 611 A; Mann 4578).

13. Bunting continued to meet regularly with Turner and often attended the board meetings of Turner Enterprises in 1971-72 (CX 279 -B; CX 285; CX 291 A; Mann 4571).

⁸ The distinction between "President" and "Corporate President" is not altogether clear, but it appears that, at least in theory, the corporate president was superior to the president of the corporation (CX 13 J).

14. In a contract dated Aug. 25, 1971 (CX 279 C), Turner and Turner Enterprises retained Candida for management and sales consultation services.⁹ Turner Enterprises agreed to pay Candida 3 percent of its gross sales, and Turner individually agreed to cause other corporations that he controlled to pay the same amount. In addition, all expenses for services to Turner corporations were to be reimbursed, and office facilities were to be made available to Candida on request. Although adjustments might be made in the percentage fee, the minimum fee was stated to be 3 percent plus expenses. The arrangement was to continue for five years. The contract was signed by Turner as chairman of the board of Turner Enterprises and as an individual and was accepted by Bunting as managing director of Candida. Candida was to provide "complete management and sales consultation services" (CX 279 C) and "to structure and develop new sales and marketing plans and programs * * *" (CX 611 B).

15. As of Apr. 1, 1972, the contract between Turner Enterprises and Candida was terminated (CX 612 B; Mann 4571, 4581). As a result of the operation of the contract and the agreed settlement for its premature termination, Candida received nearly \$2 million, comprising the following:

(a) \$475,020, representing 3 percent of the gross sales of Turner Enterprises and its subsidiaries for the months of September, October and November 1971 (CX 611 A).

(b) \$666,503, representing 3 percent of the gross sales of Turner Enterprises from Dec. 1, 1971, until the original contract was terminated (CX 612 A).

(c) \$270,912, representing one percent of the gross sales of Turner Enterprises from Apr. 1, 1972, until Aug. 31, 1972 (CX 612 A).¹⁰

(d) \$183,375, representing a lump sum payment for the termination of the original contract with Turner Enterprises (CX 612 A-B).

(e) Approximately \$400,000 representing notes from F. Lee Bailey and Enstrom Helicopter Corporation transferred from Turner Enterprises upon termination of the original contract between Turner Enterprises and Candida (Mann 4579).¹¹

16. *Hobart Wilder*—Respondent Hobart Wilder likewise played a significant role in the operations of Koscot and Turner Enterprises. Beginning as a distributor and advancing to the position of state director, he then held the following offices in Koscot: National director

⁹ A report to Candida's shareholders dated Feb. 4, 1972, shows the contract date as Dec. 1, 1971 (CX 611 A).

¹⁰ Whether Candida has continued to collect one percent of the gross sales of Turner Enterprises is not clear from the record. A report to Candida shareholders states that "Candida has received a lump sum settlement of \$183,375, and a fee of 1 percent of Turner Enterprises' gross sales for the remainder of the original contract period which ends Dec. 1, 1976" (CX 612 B).

¹¹ The directors placed a value of \$40,000 on the notes receivable assigned to Candida (CX 612 B).

of field operations—July–October 1970; president—October 1970–February 1971; and corporate president—February–July 1971.

Wilder was also active in Turner Enterprises, serving as international corporate president from July 1971 until March 1972, when he became chairman of the board. He ultimately replaced Bunting as the No. 2 man in the Turner operation. He apparently left the Turner organization between July 1972 and July 1973 (Delaney 874-75; Mann 4390-93, 4403-04, 4488, 4554-55, 4562-64; Jones 4906-07; CXs 234 A, 237 A, 270 A, 279 A, 292, 490 A, 560, 567 A, 568 A, 574 A, 605, 606, 614 D).

17. Wilder received a salary many times greater than Bunting, Julian, and Mann—\$102,300 in 1972 (CX 322), compared to a range of \$16,000 to \$37,000 for such other officials (CXs 297, 299, 300, 307, 309, 324, 326). In May 1973, he also received a loan from Koscot of \$161,000, which had not been repaid as of July 1973 (RX 12 Z-74).

18. *Malcolm Julian*—Respondent Malcolm Julian was another top official of Koscot. He served twice as president of Koscot (June 1969–July 1970 and September–December 1971). He was also a member of the voting trust (April–August 1970) and served as international corporate vice-president from July 1970 to September 1971. He was also a member of the board of directors of Turner Enterprises, resigning in December 1972. He subsequently became a consultant to Koscot (Delaney 1044; Mann 4442; CXs 2 D, 5, 13 J, 223, 235, 245 A, 262 A, 271, 279 A, 286, 287, 490, 502 C).

19. *Raleigh P. Mann*—Respondent Raleigh P. Mann also held important positions in Koscot. After joining Koscot as a distributor in June 1968, he later moved to Canada and in early 1969 became president of Koscot's Canadian affiliate. He then served as president of Koscot (July–October 1970), a member of the voting trust (August–December 1970), and international president (October 1970–July 1971). He resigned all offices and directorships in all Turner corporations in July 1971 but was retained as a Koscot consultant until October 1971 (Mann 4347-52, 4358-60, 4386, 4397-4400; CXs 5, 6, 85, 258, 262 A, 490 A, 559, 560, 566, 568 A, 573).

20. As a consultant, Mann initially prepared a memorandum recommending to Turner in effect that Koscot get out of the "wholesale promotion business" and become a real cosmetics marketing company independent of Turner Enterprises (CX 575 A-C; Tr. 4556-57, 4563-65). His later consulting work was unrelated to Koscot (Tr. 4567-70). Meanwhile, Mann had become associated with Bunting as a stockholder and as a consultant in Candida (*supra*) and engaged in consulting work unrelated to Turner Enterprises until August 1972 (Tr. 4570).

21. Mann testified that his salary from Koscot in the course of approximately two and one-half years (including his consulting fees)

amounted to approximately \$90,000, while his income from Candida was approximately \$60,000 (Tr. 4614-16). Koscot had advanced him \$51,000 for a downpayment on his home, but this note was paid off when the house was sold (Tr. 4614-15). Mann initially had 10,000 shares of Candida stock (at \$1 a share), which later increased to 100,000 shares as a result of a stock split. He later sold 82,475 shares for approximately \$23,000 and retained 17,525 shares, which he characterized as worthless (Tr. 4582-83).

22. Although he was unemployed for most of 1973 because of the "Turner stigma," he was then employed by a drapery and carpet company owned by his wife (Tr. 4617-20). As of August 1974, Mann described his financial condition as "broke." He was living in a rented house, owned one car, and had a minimal bank balance. He concluded: "We have our personal belongings; we have our furnishings; we have our clothing. We have no trust funds, trust accounts, hidden assets or anything else." (Tr. 4619; see also Tr. 4814-15).

23. In November 1974, Mann's address was Route 3, Box 281 (Jacaranda), Orlando, Fla. (attachment to motion to correct the official transcript, filed Nov. 22, 1974).

24. The business address of all the individual respondents was the same as that of the corporate respondents.

25. Respondents Bunting, Wilder, Julian and Mann were responsible, along with Turner and others, for the formulation, direction, and control of the acts and practices of Koscot and Turner Enterprises. They participated actively and knowingly in such acts and practices, as outlined more fully *infra*, ¶¶ 132-39.

26. In summary, respondents Koscot, Turner Enterprises, Turner, Julian, Bunting, Wilder, and Mann cooperated and acted together in carrying out the acts and practices herein found.

27. On the basis of the foregoing facts, as well as those developed *infra* on the record as a whole, the motions to dismiss for failure of proof that were entered by respondent Mann (*pro se* on Sept. 26, 1974) and by counsel for Julian (Tr. 5054-57) are hereby denied.

28. Two other individuals were cited in the complaint but are being dismissed as respondents:

(a) *Terrell Jones*—Although Terrell Jones, whose address in August 1974 was in Indian Hills, Colo., was named as a respondent in the complaint and played a significant part in Koscot's operations, he was never served with a copy of the complaint and thus is not a party to this proceeding. As proposed by complaint counsel (CPF 25), the complaint is being dismissed as to Jones, without prejudice, however, to the right of the Commission to bring further proceedings against him if the public interest so warrants. (See Tr. 4835-37.)

(b) *Michael Delaney*—Respondent Michael Delaney is an individual who was residing in August 1974 at 241 Timberlane Trace, Longwood, Fla. He was associated with Koscot from September 1969 to February 1971 in the following capacities: Assistant director of manufacturing—September–December 1969; director of manufacturing—December 1969–September 1970; voting trust member—April–December 1970; and executive vice-president—December 1970–February 1971.

Thereafter he engaged in various administrative duties until he resigned in July 1973. Since then he has been a Koscot consultant (Delaney 792-98; CXs 2 D-U, 245 A, 269 A, 273 B).

At the conclusion of the hearings, counsel for Delaney (Kenneth Michael Robinson) renewed a previous motion that the complaint be dismissed as to Delaney for failure of proof. Complaint counsel joined in the motion, and it was accordingly granted by the administrative law judge. (Tr. 5041-54) The reasons for this action are essentially summarized in the argument of defense counsel (Tr. 5041-52) and on the basis of the following record references: Delaney 792-910, 994-1120; Mann 4624, 4651-60, 4683, 4709-16, 4720-21, 4753, 4764-65; Jones 4929, 4957, 4962, 4964, 4974.

(Unless otherwise indicated, the term “respondents” as used herein is not intended to refer to Jones or Delaney. The term “Koscot” may sometimes be used to refer to all respondents collectively.)

C. Jurisdictional Findings

29. For several years the respondents have been engaged in the advertising, offering for sale, and sale of distributorships and franchises and of various products and services, including a line of cosmetics, toiletries, and associated items sold and distributed under the trade name Koscot. In so doing, respondents have caused their products to be shipped from their places of business in various States to purchasers located in various States other than the State of origination and have maintained a substantial course of trade in such products in commerce, as “commerce” is defined in the Federal Trade Commission Act and in the Clayton Act (complaint, ¶¶ 3-4; answer of Koscot, et al., ¶¶ 7-9; RPF 9; CXs 29 F, 69 A-S, 72 A-D, 103 A-F, 105 A-J, 110 A-113 V, 120 A-123 K).

30. Respondents have been in substantial competition in commerce with corporations, firms, and individuals in the sale of cosmetics, toiletries, and associated items of the same general kind and nature as those sold by respondents (complaint, ¶ 2; answer of Koscot, et al., ¶ 6; RPF 9).

II. *Unfair and Deceptive Practices*

A. Introduction

31. Glenn Turner had an "impossible dream" (Tr. 5003). And, for a time, the dream became a sort of reality for him, for some of his associates, and for those relatively few who got in on the ground floor. But for thousands of others, it remained an impossible dream and a virtual financial nightmare. The impossible dream was the creation of a distribution network for the sale of cosmetics that was represented as offering an opportunity for untold riches for those who became involved in an "endless chain" of recruiting distributors for this business and in selling Koscot products. The Koscot plan is somewhat complicated to explain, but it was made to appear deceptively simple at "golden opportunity" meetings.

32. Koscot offered a plan that was ostensibly designed to sell cosmetics but that actually operated as a scheme to defraud the gullible—and even the not-so-gullible. To those who were victimized, the description of Turner as a "share-cropper on his way to harvest the world" (CX 11, preface) has an ironic twist.

33. Koscot's distribution method has come to be known as multileveling or pyramid selling (Westing 1197; Darling 1444; Nelson 2057). Such a system has been condemned as unlawful by the Commission, as well as by numerous courts.¹²

34. Cosmetics were to be sold, not through shops, but by direct selling, that is, by sales effected by individuals in the homes of the purchasers. There was a hierarchy of individuals involved, and those at the higher levels had to pay Koscot substantial sums for their so-called franchises (although the term "franchise" does not seem to have been used). The attraction was that the higher level participants received substantial commissions if they or those under them recruited new members to such upper levels. Through this method, a sales force in something of the shape of a pyramid was built up, with Koscot at the top and with two or more levels of individuals beneath, with the bottom level supposedly being the most numerous, and each level being connected with the others by a system of commissions whereby the higher levels profited from the activities of the lower levels.

35. The primary vice under attack in this proceeding is that this system of paying commissions on recruitment has the same appeal and the same ultimate result as a "chain letter."

36. Although, initially, Koscot had no cosmetics to sell, it began an operation ostensibly designed to sell cosmetics in the manner described

¹² *Holiday Magic, Inc.*, Dkt. 8834, Final Order, Oct. 15, 1974, (slip opinion pp. 11-14 [84 F.T.C. 748, at pp. 1036-1039]); *Ger-O-Mar, Inc.*, Dkt. 8872, Final Order, July 23, 1974 (slip opinion, pp. 8-12 [84 F.T.C. 95, at pp. 145-149]).

in ¶ 34, *supra*. Koscot set up a hierarchy of individuals through whom sales were to be made. At the lowest level, there were beauty advisors, who were to sell Koscot products directly to members of the public through door-to-door selling or through "party plans", involving group selling. These beauty advisors were appointed by supervisors or subdistributors, who were the next rung on the Koscot distribution ladder. The supervisors, in turn, were appointed by the top rung (other than Koscot), who were called distributors or directors. The rights that went with the position of a distributor or supervisor might be analogized to a franchise. Koscot products were to be sold through distributors at a discount of 65 percent off retail price; supervisors in turn were to enjoy a 55 percent discount; and beauty advisors were to have a 40 percent discount.

37. However, product sales were by no means to be the only source of revenue, either for Koscot or for the distributors and supervisors. Each distributor was required to pay to Koscot a stated amount, ranging up to \$5,000, for his position, for his initial inventory, and for the right to recruit supervisors and other distributors. If he had been introduced by another distributor, that other distributor received a commission of \$2,650, with Koscot keeping the balance of \$2,350. A supervisor had to pay Koscot \$2,000 for his position. If he had been introduced by a distributor, the distributor got a commission of \$700, the balance of \$1,300 remaining with Koscot. If the new supervisor had been recruited by another supervisor, the same commission of \$700 was payable, but the supervisor who found the new recruit got only \$500, with the remaining \$200 going to that supervisor's distributor. If a supervisor advanced to distributor, he was required to pay Koscot an additional \$3,000, of which \$1,950 was paid to the distributor who had sponsored him. He was also required to recruit another supervisor to replace himself, a transaction on which both he and his sponsoring distributor received the fees listed *supra*.

38. This was Koscot's basic "dual level" program, as outlined essentially in CXs 11 and 13. There were earlier and later variations, with different commission and discount figures, including a "single level" plan in which there was no supervisor or subdistributor (CXs 8 A-Z-23, 9, 10, 14, 15, 98 A-J). Many of the changes were made to meet legal objections raised in particular States. The variations are set forth in detail in CPF 116-62.

39. In their literature, and in their presentations in opportunity meetings and on GO-Tours, respondents held out the promise of big profits for all in an "endless chain" of recruiting, supplemented by fat commissions on subsequent sales of cosmetics.

40. A cardinal feature of the Koscot plan was that, irrespective of

any sales of cosmetics to consumers, a distributor or supervisor who had paid his entry fee could supposedly get it back, and more, by means of recruiting further distributors or supervisors, each of whom paid similar sums to Koscot. The one certainty was that Koscot received substantial sums on each appointment. Whether those who recruited the new distributors or the new supervisors got some or all of their money back, or made any profit, depended on the number of new appointments.

41. The beauty advisors, on the bottom rung, were outside these commission arrangements, and their compensation was based on the 40 percent spread between their acquisition cost of product and the retail price at which they sold.

42. It is readily apparent that there existed a strong financial incentive for distributors and supervisors to recruit others to these positions. Whereas the recruitment of beauty advisers merely facilitated increased earnings on sales, the recruitment of other distributors or supervisors, brought immediate and substantial commissions. A distributor who paid \$5,000 for his position would get his money back, and more, if he recruited two distributors or eight supervisors, while a supervisor got his money back if he recruited four supervisors. For so-called franchise holders, the commissions on any recruitment above these numbers were all profit. Additionally, apart from any commissions earned by a distributor by his own efforts, there was always a possibility that one of his supervisors would recruit another supervisor and thus bring the distributor \$200 without any effort on his part.

43. Stated another way, the system had financial attractions in that both in the franchise structure and in the sales structure, there were rewards not only for work done by the participant himself but also for work done by others, through a system of overriding commissions on sales made by others.

44. This does not purport to describe the system in all its details, nor all of the variations that Koscot instituted. However, this sufficiently describes the essentials of the plan to indicate its nature.

45. The record supports findings that for approximately a year following the establishment of Koscot and the institution of its marketing plan, respondents were engaged solely in the marketing of distributorships; that, thereafter, the sale of cosmetics was merely incidental to the marketing of distributorships; that except for a relatively few distributorships in the early stages of the program, the distributorships conferred few, if any, effective legal rights upon the holders and were virtually worthless; that members of the public were induced to purchase distributorships by a variety of misrepresentations as to their value and as to the income likely to be realized; and that

distributors were encouraged to recoup their losses and to make profits by recruiting others by deceptive means. There follows a more detailed examination of the massive deception involved in the Koscot operation.

B. "Endless Chain"

46. The Koscot marketing program clearly contemplated an "endless chain" in that it involved the continual recruitment of additional participants, since each person entering the program had to bring in other distributors to achieve the specified earnings. The demand for prospective participants thus increased in geometric progression while the number of potential investors available in a given community or geographical area remained relatively constant (Westing 1271-72, 1278; Nelson 1718-19; Darling 1445).

47. The fallacy in the "endless chain" aspect of the Koscot marketing program, with each distributor supposedly recruiting successively two other distributors a month, is that it involves a geometric progression which, carried through to its ultimate result, would mean that in 18 months the entire United States population (203 million in 1970) would be involved in the plan (CX 536; Westing 1273; Darling 1445-48).

48. Aside from the mathematical fallacy inherent in the Koscot plan, an endless chain scheme must, in any event, ultimately fail to provide returns to all participants. Such a scheme must cease when it exhausts the number of people willing to invest in it. The exhaustion of prospects results from over-saturation, leading potential purchasers to realize that their chance for success is limited in view of the numbers already recruited; lack of funds on the part of otherwise potential purchasers; or a negative reaction on the part of potential purchasers for any number of other reasons. Recruiting must always cease, and those recruited into the program at or near its conclusion must lose (Westing 1271, 1273; Nelson 1729-30). And the fact is that most Koscot distributors lost by relying on the endless chain aspect of the Koscot marketing program (CPF 225).

49. Respondents' defense to the endless chain charge (complaint, ¶ 8) is that because of "self-imposed" quotas on the number of distributorships, sales of distributorships "would not be like a chain letter, hence not deceptive or unfair to the investor," so that "Turner believed that if the quota was followed then there could be no misrepresentations involved about it." Respondents state that Turner's original quota of one distributor per 4,000 population was changed in 1969 to one per 7,000 upon the advice of counsel and a marketing consultant. On the basis that the population in 1972 was 207 million, they contend that Koscot complied with its self-imposed quota when it

stopped selling franchises in mid-1972 with just under 30,000 distributorships (RPF 12, 25).

50. This defense is rejected. First, the facts are contrary to the defense claims. Actually, the purported quota of one per 7,000, which had been instituted in February 1970 (CX 233 A), was discontinued in September 1971 in favor of the earlier quota of one per 4,000 population (CX 239), so that the so-called quota nationally was 51,000 distributors. Second, the purported quotas were on a State basis rather than on a national basis (Mann 4623). Third, the quotas were not always "self-imposed;" in several States, a quota was imposed as the result of legal action by State authorities (Westing 1278-79; Jones 4892-93). Fourth, the quotas were deliberately ignored and circumvented by respondents. Among other things, Koscot classified numerous distributors as "inactive" and thus not chargeable against the quota. Other devices were encouraged and permitted to evade the so-called quota. (CPF 173, 178-89) Fifth, distributors were either not told of the quota or of its specific impact (CPF 172), or, if they were, it was "used as a high pressure tactic" to enroll the prospect before it was too late (Jones 4893).

51. In addition, even where there was ostensible compliance with the quota as far as Koscot sales were concerned, respondents established additional companies operating on a similar basis and allowed Koscot distributors to participate in them and thus continue the chain of recruitment (CPF 191-216). The fact that respondents deliberately provided distributors with the opportunity to continue recruiting when enforcement of the so-called quota might otherwise have stopped such activity is sufficient to show their intent to operate an endless chain recruitment scheme.

52. Finally, even if the quota had been adhered to, the theory that this would defeat any chain letter aspect and prevent the Koscot program from being deceptive or unfair will not withstand scrutiny. First, even with the purported limitations of one Koscot distributor for each 7,000 people, this would involve the recruitment of 29,000 distributors within ten months; and if the limitation were one distributor for each 4,000 people, this would involve the recruitment of nearly 51,000 distributors, or a saturation point likewise reached within ten months (CX 536; Westing 1273; Darling 1445-48). Second, the imposition of an inappropriate statewide quota did not negate the endless chain representation, nor did it prevent the chain from soon reaching the saturation point in numerous local areas. This was largely because, with rare exceptions, distributors naturally tended to recruit in their own circumscribed local areas, and the chain soon ended in such an area before a statewide quota was breached (CPF 174-77).

53. In summary, the imposition of quotas that ostensibly limited the number of distributors within each State did not really affect the endless chain aspect of the Koscot program. Respondents continued to recruit distributors by portraying the program as an endless chain; they devised numerous means to circumvent the quotas; and they established and promoted numerous other companies whose distributorships could be sold by Koscot distributors (CPF 172-216). Meanwhile, distributors learned to their sorrow that the chain was not endless but that all too soon it reached its inevitable end in their communities.

C. Other Misrepresentations

Distributor Earnings

54. The deception inherent in the endless chain aspect of Koscot's marketing plan is but one of numerous misrepresentations made by respondents. This basic deception necessarily involved, of course, gross misrepresentations of the income to be made through recruitment.

55. The earnings claims varied with the various programs. Again using CX 11 as typical, we find Koscot claiming that a distributor could readily sell a minimum of 12 distributorships a year or, with a little more effort, 24 distributorships a year. Depending on how many were directly recruited as distributors and how many were "promoted" from the supervisor level, the annual income was represented as ranging from \$26,000 to \$52,000 (CX 11, pp. 12-13; CXs 531, 532; Darling 1309-13). These claims were scaled down from those in an earlier manual, which had portrayed earnings ranging from \$33,000 to \$175,000 (CX 15, pp. 21-22). The falsity of such representations as applied to virtually all of Koscot's distributors has already been demonstrated *supra* (§§ 47-53). None of the typical distributors who testified even approached such figures.

56. In addition to gross misrepresentation of the earnings from recruitment, respondents also made numerous misrepresentations concerning the status of Koscot and the opportunities for success and wealth in selling Koscot cosmetics.

57. To begin with, respondents misrepresented the ease with which beauty advisors could be recruited and retained; the volume of initial orders that could be realized; and the extent of repeat business. Contrary to respondents' representations, it was difficult to recruit beauty advisors and, for the relatively few recruited by most distributors or subdistributors, it was even more difficult to keep them working (CPF 242-47).

58. Then, using a gross misstatement of the retail market for

cosmetics—average family purchases of \$17.82 per month (CX 11, p. 3), when the correct figure was \$8.33 (Nelson 1581)—respondents persisted in presenting a totally false and misleading picture of the volume of sales and the profits that could be made by beauty advisors, by subdistributors, and by distributors (CPF 247-71).

59. The falsity of respondents' representations concerning anticipated retail sales is demonstrated not only by mathematical analysis of the market in the light of the representations made but also by Koscot's records and by the actual experience of those who testified in this proceeding.

60. Koscot painted a picture of 400,000 beauty advisors (CX 13 B), each earning over \$8,000 a year in commissions on an annual volume (at retail prices) of \$21,600 (CX 11, p. 4; Darling 1299-1300). This multiplies out to annual retail sales for Koscot of \$8.6 billion, when total retail sales by all companies of the type of products sold by Koscot amounted to only \$5.1 billion in 1970 (CX 21; Nelson 1573-79). Similarly, Koscot represented earnings of \$50,000 a year by a distributor through sales made by his beauty advisors (CX 11, p. 9). This would necessitate retail sales of over \$200,000 for each distributor. With 40,000 distributors (CX 13 B), Koscot's total retail sales would have to be \$8.1 billion—again, far in excess of the total market for Koscot-type products. Even if we were to cut in half the represented sales of a distributor's retail organization, this would contemplate an 80 percent saturation of the market by Koscot.

61. However, it is not necessary to rely on mathematical theory. Analysis of Koscot's records shows that in Illinois, Kansas, and New Jersey, average or mean sales per distributor were only a fraction of the figures represented by Koscot. Whereas Koscot depicted a distributor's annual product sales as ranging from \$50,000 to more than \$200,000 (CX 11, pp. 8-9; Darling 1302-06), the actual annual average or mean sales of distributors in those States in 1971 were reported in hundreds of dollars, not thousands. The national distributor averages were \$1125 in 1970, \$1733 in 1971, and \$938 in 1972. (CPF 270; see also CPF 267-69)

62. Distributors and subdistributors having the greatest volume of sales in New Jersey had retail sales ranging only from \$8,507 to \$24,384, while in Illinois, the range was from \$8,160 to \$22,760 (CPF 271).

63. In summary, the average distributor found it difficult to recruit beauty advisors and even more difficult to retain them. Contrary to Koscot's claims, he wound up with just a few, and even fewer stayed on the job for more than three months. For the most part, their sales were minimal, and most distributors wound up trying to sell directly themselves or relying on their wives or other family members (CX 609

A; CPF 246). The claimed volume of sales simply did not materialize, and, of course, neither did the promised profits (Jones 4979-81). Thus, Koscot's representations concerning the earnings of distributors, supervisors, and beauty advisors were vastly overstated, contrary to what might reasonably be expected, and without basis in fact (CPF 239-71).

64. The lack of success at retail by Koscot's distributors was amply demonstrated by Koscot's own books and records, but that did not deter respondents from continuing to make their grossly deceptive claims of huge retail sales with resulting huge profits for distributors, supervisors, and beauty advisers. As a matter of fact, at a meeting attended by Turner, Bunting, and Julian, the suggestion that Koscot literature be revised to reflect the actual retail sales experience of Koscot distributors was rejected by Turner because "the figures weren't high enough to arouse the enthusiasm that he wanted" (Jones 4892).

Status of Koscot

65. Koscot made grandiose claims concerning its status as a seller of cosmetics and its prospects of surpassing within a year or two Avon Products, Inc., as the leading seller of cosmetics—of becoming "Number One in '71" (CX 11, pp. 3, 20, 34-35; CX 3 A; Mann 4450; CPF 272-79).

66. Illustrative of misrepresentations concerning the status of Koscot and its operations is the following:

KOSCOT was begun with an investment of \$5,000. During its first month in operation, it sold \$67,000 in retail cosmetics. One year later, its sales were exceeding one million dollars per month, and seven months after that the retail sales were in excess of four million dollars per month (CX 11, p. 20).

67. Contrary to such representations, there was no product for many months after Koscot was launched in August 1967, and total product revenues in 1968 totalled only \$255,000 (CX 29 E). During the first year of its operations, Koscot was engaged almost exclusively in the sale of distributorships and devoted almost no effort to providing a basis for future retail sales. Koscot had a minuscule share of the market throughout its history—considerably less than one percent (Mann 4450-51, 4740; CPF 282), and it could not reasonably be expected to become the leading seller of cosmetics for at least ten years (Delaney 1057; Mann 4451, CPF 282-97).

Opportunity Meetings and GO-Tours

68. Distributorship sales were generally accomplished by high-

pressure sales methods applied at golden opportunity meetings and on golden opportunity tours (GO-Tours). The opportunity meetings were carefully contrived and scripted to create a highly-charged emotional atmosphere in which prospects were persuaded that Koscot offered a fantastic opportunity to "achieve financial success beyond [their] greatest expectations" (CX 11, p. 1). Koscot was presented as an opportunity for "ordinary men and women" to earn from \$5,000 to \$20,000 a month (CX 15, p. 13; CX 11, p. 5; CPF 70, 76, 82). Scripts were generally followed, but even the exaggerated figures that they contained would sometimes be further exaggerated by overly enthusiastic distributors (CPF 71-72).

69. Koscot literature outlined in detail various techniques designed to "close" the prospect (CX 15, pp. 40-51, 55-58, CPF 58, 80-81). Success stories of named individuals were frequently grossly exaggerated or almost entirely fabricated (CPF 83).

70. To create an impression that affiliation with Koscot was the pathway to success and wealth, hundred dollar bills and thousand dollar bills, as well as Koscot checks for large sums of money—some of them fakes—were ostentatiously displayed (Jones 4856, 4861-62; CPF 84).

71. Through its literature, and particularly through its opportunity meetings and GO-Tours, Koscot represented that there was a virtually unlimited potential to earn large sums of money in a relatively short time by affiliating with Koscot (CPF 67-70, 80). None of the witnesses could fully articulate the atmosphere of the opportunity meetings, but it is apparent that they were generally conducted in such a manner as to excite most of those attending and to induce them to make an emotional decision to invest in the program (CPF 62, 66). Opportunity meetings took on the charged atmosphere of an old-fashioned revival meeting, except that the god was Mammon. For example, there "was a 'money hum,' where the crowd would hum 'money' and then shout it loudly" (Jones 4909). Another widely-favored chant was "Get that check; get that check" (*ibid.*).

72. Anyone who had or could get the amount of the enrollment fee was a prospect (CPF 59). Under the extreme psychological and emotional pressures established at opportunity meetings and on GO-Tours, individuals were sold on the idea that anyone could succeed in the Koscot program. For those who had reservations about their qualifications, Koscot promised to provide the necessary training.¹³

73. One former Koscot official described the "extremely high pressure" tactics used by respondent Hobart Wilder to "get that check" from a prospect:

¹³ See *infra*, p. 35 [p. 1145, herein].

things like grabbing people's lapels, pulling their ties off, hitting them on the back, yelling in their ear, * * * any bizarre, odd things that could change a person's state of consciousness so much that he would just unthinkingly invest in the company, on the spot sometimes (Jones 4908-09).

74. Opportunity meetings were supplemented periodically with GO-Tours. A GO-Tour was a trip by bus or plane to a Koscot facility, climaxed by an opportunity meeting. With a captive audience of distributors and prospective distributors, the GO-Tour presented an extended opportunity for Koscot to use all its high-pressure recruitment techniques. The technique was to "keep everyone enthused, vibrating. You had to keep them excited until you got the money * * *. This was the whole thing, constant sing, shout, holler, go, go, go." (Tell 3887-88; CPF 85-96)

One GO-Tour participant reported:

When I got back home I didn't sleep for five nights after this, neither did my wife.

The guy got us so jacked up, in thousands, I was ready to sell the Brooklyn Bridge to Eisenhower. (Vaz 2476)

Company Support of Retail Sales

75. The failure of distributors and their so-called sales organizations (subdistributors and beauty advisors) to achieve any substantial consumer sales was due in major part to Koscot's failure to make good on its representations as to company support of retail sales.¹⁴ Respondents concede that the "promises attached to the sale of Koscot distributorships" included commitments (1) to provide product availability—initial inventory and a distribution system for the delivery of products; (2) to provide free training with respect to both recruitment and retail selling; and (3) to provide advertising (RPF 26). Respondents have put in issue the question whether or not Koscot lived up to those commitments. They have proposed numerous findings that purportedly "rebut much of the evidence complaint counsel sought to adduce" respecting product, training, and advertising, as well as other subjects (RB, p. 8). Respondents claim too much. Many of their proposed findings lack record support or are actually contrary to the record, and others are irrelevant to the issues presented. Each of these aspects of the Koscot operation will be examined in turn.

Product Availability

76. It is undisputed that ready availability of product is necessary for a successful retail operation. In recognition of this truism, Koscot promised ready availability of product to its distributors and their

¹⁴ See *infra*, p. 41 [pp. 1149-50, herein].

retail sales organizations. Respondents argue that they met their commitments with regard to provision of product and that therefore no fraud occurred with respect to this aspect of the Koscot marketing program. Respondents' proposed findings regarding product may be summarized as follows:

1. Koscot did better in providing product than did Holiday Magic (RPF 14, 16, 18, 31).
2. Events beyond the control of Koscot or Turner caused whatever shortages occurred (RPF 19, 21, 32, 34, 40).
3. Koscot and Turner actually desired to have product (RPF 23, 33, 39).
4. Koscot took actions to obtain product (RPF 27, 35-38).
5. Koscot provided an effective product distribution system (RPF 30).
6. Koscot provided adequate product availability from late 1968 on (RPF 40).

77. A comparison of the foregoing summary with complaint counsel's contentions (CRB, pp. 4-5) shows that the principal dispute relates to the question of product availability and distribution methods after 1968, with subsidiary questions relating to the reasons for the lack of product in 1967-1968 and Turner's intent respecting retail operations.

78. Respondents concede that product "was not readily available in 1967 and most of 1968" but they blame this situation on factors "beyond Koscot's control" and contend that by the end of 1968 "product was beginning to pour into Koscot and thereafter product was always plentiful" (RPF 40). Thus, the acknowledged fact is that for more than a year after Koscot was organized and began recruiting and making claims of product availability, neither Koscot nor any of its distributors had any product available for immediate sale (Edwards 1132-36, 1163; Mann 4349, 4639, 4648; Jones 4921-24, 4928-29, 4952-54; CXs 196 A, 198). It is by no means clear that this initial lack of product was due to factors beyond Koscot's control. And, in any event, such a circumstance does not justify the continuing misrepresentations as to product availability.

79. It is true that cosmetics worth millions of dollars were produced or purchased by Koscot thereafter (Jones 4952). The record establishes, however, that even after the first year, Koscot was consistently unable to fill immediately its distributors' orders with the products desired, particularly the most popular products. There were significant lags in obtaining product necessary to fill completely the orders of distributors. (CXs 275 A, 277 A, 609 A; Jones 4876-77, 4989; CPF 334-35).

80. Some of the production and distribution problems encountered

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by Koscot, particularly in the first year or so, might be rationalized as simply the growing pains of a new company, complicated by mismanagement due to the lack of qualified personnel, as well as certain other factors. Actually, the factors allegedly beyond Koscot's control which respondents cite to excuse their initial failure to deliver product apply only to the first year of Koscot's operation. Respondents blame the incompetence of the personnel assigned to get product (RPF 19, 21, 32, 34).

81. This excuse must be assessed against the fact that no one with any experience in cosmetics was brought into the company in its early days and that officials were selected on the basis of their ability to sell distributorships rather than skill in managing a cosmetics sales operation (Delaney 1084-86, 1090, 4452, 4468; Mann 4792; Jones 4902-03, 4962). Thus, by selecting personnel unqualified to successfully obtain product, Koscot and Turner took actions whose predictable consequence was the shortages of product they experienced, particularly in the early history of Koscot.

82. Respondents also refer to a glass industry strike in 1968 (RPF 34), but the record fails to establish sufficient details concerning the date or the duration of the strike or its actual impact on Koscot operations (Delaney 1051-53; Edwards 1163; Mann 4639).

83. It is true, moreover, that efforts were ultimately made to develop good products and to employ some personnel knowledgeable in the field of cosmetics production and marketing. Nevertheless, this record establishes that product sales were constantly subordinated to recruitment. Koscot and its distributors were primarily in the business of selling distributorships (Westing 1214-16; Nelson 1726). The extent and nature of Koscot's product inventories demonstrated its expectation of limited product sales (Westing 1237-39).

84. That the principal activity of Koscot was the sale of distributorships is shown by financial records reflecting that during the period 1967-1972 distributorship sales accounted for the bulk of its revenues. The breakdown is as follows:

Period	Total Revenues*	Recruitment Revenues*	% of Total	Product Revenues*	% of Total
1967	143	143	100%	255	8.7%
1968	2,932	2,676	91.3%	1,474	10.8%
1969	13,658	11,400	83.5%	9,516	42%
1970	22,716	13,200	58%	19,504	35%
1971	56,204	36,700	65%	8,772	19%
1971**	46,135	37,363	81%	7,677	39.4%
1972	19,485	11,807	60.6%		

* In thousands of dollars. Figures have been rounded.
 ** For 11 months ended June 30, 1971; see *infra*.

Notes: The figures are drawn primarily from CPF 464 and the sources there listed (by "Notice of Corrections"), except that the figures for the fiscal years 1970 and 1971 have been inserted from CXs 357 G-H and 358 F, I. Although the Koscot financial records from which this analysis was drawn are not models of clarity, and there are a few discrepancies, they appear to be the best information available. Some explanation is required as to methodology.

CX 29 E, a Koscot report to the Commission, is the source for the 1967 and 1968 figures. For the fiscal year ended July 31, 1969, the total revenues figure is found at CX 26 F; the recruitment figure at CX 26 G. For fiscal 1969, product revenues were derived by subtracting the recruitment revenues from total revenues and then adjusting that figure by subtracting revenues for sales aides, newspaper income, and trucking, as shown on CX 26 Q. Here there are two discrepancies: (1) CX 26 G cites distributor revenues of \$11.4 million, "of which \$9,816,000 is included in revenue;" and (2) CX 26 Q shows "Cosmetic sales" of \$9.7 million. If the \$9.8 million figure were used instead of \$11.4 million, the percentage figures would be 71 percent and 29 percent respectively. As a further complication, CX 29 E presents another set of figures, showing "gross sales" of \$13.03 million, distributorship revenues of \$8.9 million, and product revenues of \$4 million. These figures would result in percentages of 69 percent and 31 percent respectively.

The 1970 figures, shown in CPF 464 as not available, were derived from CX 357 G-H for the fiscal year ended July 31, 1970. Product revenues were obtained by subtracting the recruitment revenues from total revenues.

The first set of 1971 figures (for the fiscal year ended July 31, 1971) was similarly derived from CX 358 I (but see 358 F). The second set of 1971 figures, taken from CPF 464, is for the eleven months ended June 30, 1971. The total revenues figure was arrived at by adding "Receipts from New Contracts" (CX 168 B) to "Receipts—Product Sales" (CX 168 B), except that this product figure has been adjusted to reflect net prices by subtracting the "Territory Override." (Since the year-to-date override entry on CX 168 B is illegible, it was arrived at by using the year-to-date figure on CX 167 D and adding to it the June 1971 figure shown on CX 168 B.) The substantial variance between the 1971 figures has not been explained. Presumably, complaint counsel considered CX 168 more reliable than CX 358.

The figures for the fiscal year ended July 31, 1972, were derived from CX 180 D. Recruitment revenues represent the sum of the "New contracts" figure plus "GO Tour" revenue. The product revenue figures represents the "Product sales" figure from which the "Territory override" was subtracted to reflect net prices. (See also Westing 1214-16 and Nelson 1727-38.)

85. Whatever the shortcomings of the data in ¶ 84, there nevertheless is no doubt that during the period covered, distributorship sales accounted for most of Koscot's revenues (Edwards 1173; Westing 1216; Nelson 1728).^{14a}

86. Respondents also plead good intentions on the part of Turner and his associates (RPF 23, 33, 39). The evidence tends to show that Turner initially wanted to establish a successful company to sell cosmetics at retail, but there are also indications that this desire may have changed in the face of the constant need of the Turner empire for more cash, which could be more quickly realized through recruiting activities than through cosmetic sales (Delaney 1057, 1089-91; Edwards 1152-56, 1160-61, 1173; Mann 4564-65, 4589-91, 4650-55, 4670-75, 4695-99, 4794-95, 4802-05; Jones 4875, 4926-36, 4949-50, 4990-94, 4998, 5001-03).

87. Regardless of respondents' intentions, the fact remains that from the inception of Koscot, there were serious misrepresentations regarding retail operations—(1) the availability of product; (2) the extent and nature of supporting advertising; (3) the training offered with respect to retail operations; as well as (4) the likelihood of success and the amount of income to be realized through retailing of Koscot products (*supra*). And these were knowing misrepresentations.

88. Until early 1969, the only method used by Koscot to distribute its products was by direct factory shipment to distributors. All initial inventories, less out-of-stock items, were shipped direct to the distributors. These initial inventories consisted of an assortment of products chosen by Koscot. All reorders for product had to be made in case lots direct from Koscot (CPF 315).

89. Beginning in March 1969, distributors, with Koscot's advice and assistance, began establishing local cooperative warehouses ("co-ops") in which their inventories were stored. The idea was that such co-ops would provide immediate product availability on a local basis by establishing a larger inventory assortment than would have been available to a distributor under the direct factory shipment method. Although distributors could continue to get direct factory shipment, they were strongly discouraged from doing so and encouraged, instead, to join in the co-op warehouse (CPF 316-17).

90. To establish a co-op, existing distributors put in the inventory which they already possessed, while new distributors either received their initial inventory direct from Koscot and placed it in the co-op or Koscot simply credited the co-op account with the amount of product due a new distributor (CPF 318).

91. Distributors were required to maintain a minimum inventory account at the co-op. A distributor could withdraw products without

^{14a} From August 1967 until July 1972, Koscot netted \$14.1 million after paying recruiting fees (CPF 226-228).

additional charge only so long as his inventory value exceeded this minimum. The co-ops soon encountered difficulties in re-stocking (CPF 319-20).

92. Within a few months, Koscot acquired control of the co-ops and their inventory and converted them to "satellite warehouses" and also opened additional satellites. By June 1970, there were 350 satellite warehouses in operation (CPF 321) Koscot obtained control of existing inventories of the co-ops and assumed their liability to distributors for their inventory accounts. As new distributors were recruited, Koscot established for them an inventory account at the nearest satellite. There were restrictions on withdrawal of inventory. Distributors had to maintain a minimum inventory value at the satellite and paid immediately for all product withdrawn once this minimum was reached (CPF 322-23).

93. In 1971, Koscot began closing down the local satellites and replaced them with five regional mail-order satellites. These mail-order satellites assumed the obligations of the local satellites and were operated in the same manner as the local satellites with respect to the crediting of distributor inventory and the withdrawal of product by distributors or their sales organization. (CPF 325-27). The mail-order satellites disadvantaged, rather than helped, retail sales (CPF 344). There are indications that the mail-order satellites were later closed and that all orders thereafter were shipped from Orlando, Fla. (Bennett 3709).

94. Thus, Koscot's successive modifications of its distribution system, so that a distributor's initial inventory was not physically delivered to him, meant that Koscot was receiving payment for product that it did not actually deliver. As a matter of fact, between July 1969 and July 1973, Koscot had less finished goods inventory on hand than the amount for which it already had been paid by its distributors. During this period, Koscot steadily reduced the amount of finished goods that it had on hand, in comparison to the initial inventories for which it had been paid by distributors but had not furnished. The table prepared by complaint counsel from respondents' own records tells the story as follows:

<i>Fiscal Year</i>	<i>Koscot's Finished Goods Inventory</i>	<i>Cost of Product Due Distributors</i>	<i>Percentage Relationship*</i>
1969	\$995,000	\$1,155,000	86
1970	2,579,000	4,291,000	60
1971	5,557,000	10,362,000	54
1972	4,793,592	9,693,000	49
1973	1,400,000	9,693,000**	14.4

* Finished inventory as a percentage of product due distributors.

** Assuming no change from 1972.

Sources: CXs 26 E, H; 357 F, I; 358 E, K; 758 A-B; RX 12 Z-71; Nelson 1713-15; CPF 336-37.

95. Such a practice allowed funds paid for product to be diverted to other uses (Westing 1237-39; Darling 1459-60).

96. The weakness in respondents' defense is pointed up by the fact that they are driven to claim that Koscot did better in providing product than did Turner's "alma mater," Holiday Magic (RPF 14, 16, 18, 31). Complaint counsel concede that Koscot supplied a better and more extensive line of cosmetics than did Holiday Magic. But this is irrelevant, as is the disputed claim of respondents that Koscot provided its distributors a greater availability of product than Holiday Magic. Even if we accept respondents' contention that Holiday Magic had "little product" and was "not interested in the retail cosmetics business" (RPF 31), this would merely show that Koscot, in its failure to provide what it promised, may not have been as derelict as another firm that the Commission has found to have engaged in a fraudulent operation (*Holiday Magic, Inc., supra*).

97. As a matter of fact, the Koscot plan was adopted from the Holiday Magic plan. Turner quit Holiday Magic and established Koscot when Holiday Magic curtailed the opportunity to earn large commissions on recruiting by imposing certain requirements for retail sales. Koscot's manuals were based on those of Holiday Magic, and Turner's instructions were to out-magic Holiday Magic by raising the ante on the earnings claims (Jones 4851-53, 4860-61). Although there is some testimony that does tend to introduce some ameliorating factors and to suggest some "honorable parts of Koscot's history" different from the Holiday Magic scheme" (RB, p. 8), the undersigned has not made a detailed comparative study of the two plans, and he sees no occasion to do so. To predicate a defense on the theory that Koscot's offenses were not as bad as those of a similar operation (Holiday Magic) already found to have been fraudulent is to confess the bankruptcy of the defense. Degrees of fraud are somewhat akin to degrees of pregnancy.

98. However anomalous it may seem for Koscot to operate in a manner apparently designed to discourage consumer sales of its products, that was the effect of its supply and distribution policies and practices (CPF 338-41, 344; see *infra*, p. 41 [p.1149, herein]). Whatever the cause of its failure to provide ready availability of product for resale, Koscot plainly did not make good on its representations in that regard.

Training

99. Because of the lure of the money to be made through

recruitment, many Koscot distributors sold distributorships to others whom they knew or believed to be unqualified (Hatcher 3115; Brown 3390-91; Tell 3883-86; Fletcher 3977). So long as it was possible to "get that check," anybody with a "pulse and two legs" (Vaz 2465) or "anyone that was breathing" (Tell 3883) was a prospect by Koscot standards (Mann 4475-76; CPF 97-98, 100, 104).

100. Many persons who purchased Koscot distributorships were unqualified to operate a cosmetics selling business by reason of their age, lack of education and training, or lack of business, administrative, or sales experience. Koscot's recruitment methods tended to result in the enrollment of persons without any special qualifications, including frequently the credulous, who in turn tended to recruit others with similar profiles. By reason of their limited education and modest backgrounds, such persons tended to have a limited degree of sophistication in financial and business matters. (CPF 100, 103, 106-09, 111, 304-06, 310-11) They were particularly vulnerable to the misrepresentations and the high-pressure enrollment techniques used at opportunity meetings and on GO-Tours (*supra*, p. 26 [p.1137, herein]).

101. Consistent with the Turner philosophy, respondents represented that anyone could achieve success by becoming a seller of Koscot cosmetics—that no special qualifications or experience were necessary (CX 11, pp. 5, 34; CPF 100, 305-06. To those who expressed doubts on this score, Koscot promised to provide training that would overcome any such shortcomings (CPF 307, 345-47, 349). This record demonstrates that Koscot's representations of this nature were false and misleading (CPF 310-11, 350-354a).

102. Koscot deliberately chose a method of recruitment that enrolled distributors who, for the most part, did not know how to set up and manage a wholesale or retail business and then, to compound the offense, used the promise of its training program to overcome objections by potential distributors that they were not qualified (CPF 104-11, 348-49).

103. Because of certain terminology used in the findings that follow, it is important to understand that in the operation of the Koscot plan, the sale of distributorships for compensation was known as "wholesale," while the sale of cosmetics, whether at wholesale or at retail, was known as "retail." In theory, and to a very limited extent in practice, a Koscot distributor performed a traditional wholesale function in supplying products to others (supervisors (or subdistributors) and beauty advisors) for eventual sale at retail to consumers. To avoid the possible confusion that may result in referring to the sale of distributorships as "wholesale," the undersigned has usually referred to the sale of distributorships in those words or by the use of the terms

"recruitment" or "recruiting" (see CPF 128). However, in this section, "wholesale training" refers to salesmanship and motivation training designed to teach distributors to recruit others into the Koscot program. As used by counsel and witnesses, "retail training" primarily means business training respecting the establishment and operation of a distributorship for the sale of cosmetics, etc., although the term was also loosely used sometimes to include the training of beauty advisors for retail selling. To avoid confusion, the term "business training" will be used herein except when quoting.

104. Respondents do not dispute that Koscot promised its distributors "free training—both wholesale and retail"¹⁵ (RPF 26). In contending that respondents met this commitment, defense counsel have proposed the following findings:

Glenn Turner created Koscot with the idea that he would get better product and training to his distributors than Ben Patrick gave his with Holiday Magic. * * * The training was superior. (RPF 14)

Glenn Turner gave Miss Jeri Jacobus 5 percent of Koscot to be in charge of retail training. She was knowledgeable and her judgment was valued. * * * Miss Jacobus did provide training programs for the beauty advisors. In excess of \$20,000 per month was spent on such training alone as early as 1968. (RPF 15) Jeri Jacobus provided free, expert training in the early days for Koscot retailers * * * and thereafter, Jerry McLaughlin headed a substantial (perhaps a 100) husband and wife retail training teams. * * * In excess of \$35,000 per month was spent by Koscot on salaries and travel expenses for the retail training teams while Mann was president of Koscot. * * * In 1968, Koscot had spent in excess of \$20,000 per month for training while Mr. Edwards was president. (RPF 28)

105. The difficulty with such proposed findings is that they fail to meet the issues posed by complaint counsel's proposed findings (CPF 345-354a). And, although the record citations tend to support respondents' proposed findings on the general subject of training, the testimony relied on is principally concerned with "wholesale" training and training of beauty advisors. Complaint counsel concede that respondents provided free training, both "wholesale and retail," and that such training was superior to that offered by Holiday Magic (CRB, pp. 14-15). Complaint counsel also concede that respondents spent considerable sums on training Koscot distributors how to recruit and that this phase of the training was effective (*ibid.*). However, the allegation is that Koscot falsely promised business training—to teach its distributors and subdistributors how to set up and manage a cosmetics business—a wholesale-retail operation. Respondents' proposed findings simply fail to meet the record evidence in support of this allegation. The testimony relied on by respondents relates almost exclusively to "wholesale" training and to the training of beauty

¹⁵ See ¶ 103, *supra*.

advisors. At most, the cited testimony (Edwards 1157; Mann 4631-34; Jones 4918-19) simply demonstrates that there was some "retail" training and that this involved the expenditure of Koscot funds (see Mann 4452, 4470, 4473-74, 4773-80; Jones 4952-53, 4982, 4997). The figures cited by respondents in RPF 15 and 28 are not figures for business training but cover wholesale training and beauty advisor training (Edwards 1157; Mann 4635, 4684, 4773-77). As a matter of fact, although Koscot represented that \$300 of each distributorship fee went for training, company records indicate that out of \$2 million earmarked for training in the fiscal year ended July 31, 1969, Koscot spent only \$1.4 million (CXs 13 D-E, 26 Q).

106. The business training that was provided did not qualify distributors to operate a cosmetics business (CPF 353). No training in record-keeping or cost accounting was provided (CPF 353a), although such subject matter was necessary to enable distributors to operate any business successfully (CPF 348).

107. Although Koscot recognized the need for business training and promised to provide it, it actually discouraged distributors from taking it, so that they could be trained instead in recruitment (CPF 353). Frequently, Koscot's so-called business training sessions were devoted in large part to "wholesale" and to motivational aspects or to product description and application and the recruitment, control, and maintenance of beauty advisors (CPF 350, 353b).

108. The former Koscot officials who, according to respondents (RB, p. 17), were "highly complimentary" of the retail training program failed to support the claim of effective business training for distributors as each testified that he was unfamiliar with the nature of such training (Edwards 1174; Mann 4780; Jones 4982, 4997). Even so, one of them, a former president of Koscot, testified that in 1971, the retail training program for distributors "needed a tremendous amount of improvement" (Mann 4473).

109. In summary, Koscot promised to teach its distributors how to set up and manage a business, and it did not do so, regardless of how much money it may have spent.

Advertising

110. Respondents have offered a simplistic defense to the proposed findings of complaint counsel on the subject of advertising. They contend that Koscot promised to spend \$75 per distributor for advertising and that Koscot spent from 1968 to 1972, an amount greater than that commitment (RPF 26, 29). These proposed findings of respondents must be rejected as irrelevant and as contrary to the record. First, although there was apparently a contractual commitment

in Koscot's early days to spend \$75 per distributor on advertising (Edwards 1143, 1159; Mann 4635-37), Koscot's representations as to advertising were far broader than that narrow commitment. The issue is not whether the contractual commitment was met, but whether Koscot provided the advertising it promised in its manuals, in opportunity meetings, and otherwise. But, second, even if we were to adopt respondents' test, the record fails to support the claim that Koscot spent on advertising \$2.25 million between 1968 and 1972. Respondents arrived at this figure by multiplying the supposed number of Koscot distributors (30,000) by the \$75 figure and then asking a former president of Koscot whether that amount was indeed spent on advertising. It is true that an affirmative answer was given (Mann 4636), but it is entitled to scant weight when considered in the light of the whole record, including Koscot's own records.

111. Mann's testimony does not demonstrate any basis for his knowing Koscot's advertising expenditures for the period 1968-72, or even having an informed opinion. Moreover, some of his other answers materially detract from his estimate (Tr. 4452-67, 4628-30, 4664-68, and 4672-73). Mann testified that advertising expenditures while he was international president of Koscot totalled \$450,000 for October 1970-February 1971 and that he knew of no other period where such an amount was spent for advertising (Tr. 4460-61). He contrasted it with an advertising budget of \$60,000 for the last six months of 1971 (Tr. 4461; CXs 570-72).

112. Above and beyond its contractual commitment to spend on advertising \$75 per distributor, Koscot promised that it would be spending millions of dollars on advertising within a year or two to create a consumer demand and to make Koscot the leading firm in the cosmetics industry ("No. 1 in '71"). Koscot promised to place effective advertising on network television and radio and in magazines and newspapers (CPF 355-56, 369).

113. Koscot's promises concerning advertising demonstrated recognition by its officials, as well as by its distributors, that extensive advertising would be necessary for a new firm selling cosmetics door-to-door in competition with one or more firms already firmly entrenched in the industry (Mann 4451-52, 4751-52; CPF 355e, 357-59). Yet Koscot's advertising effort was far overshadowed by that of the industry leader, Avon Products, Inc. (CPF 364).

114. Koscot announced its intention "to reach the greatest heights in product recognition—to become the *one* product everyone thinks of when cosmetics are mentioned!" This was said to be a "fantastic idea" but "one that is fast becoming a reality!" (CX 11, p. 3).

115. The "reality" was that more than once Turner disapproved of

advertising expenditures to reach such a goal (Edwards 1141-42; Jones 4875). Jeri Jacobus favored "massive advertising to get product recognition" (Jones 4929-30), but Turner "always said that most of the money was coming out of the wholesale¹⁶ side, and he thought that most of the money should be devoted to that end" (Jones 4875).

116. Thus, the substantial advertising promised by Koscot did not materialize. Advertising was "minimal" in 1968 (Edwards 1140). Later, there were periods when nothing was spent on advertising and other periods when a "good bit" was spent (Edwards 1143-44, 1159-60; Jones 4929-30, 4953-54). Such advertising as Koscot did sponsor was too little and too late, and the glowing promises regarding product recognition were never fulfilled (CPF 369, 371-72). There were some limited local TV commercials, many in other than prime time, and a few magazine and newspaper advertisements (CPF 365, 367).

117. Contrary to respondents' dubious estimate that at least \$2.2 million was spent for advertising¹⁷ between 1968 and 1972 (RPF 29), the fact is that only about half of this amount was spent for advertising. As developed from Koscot's own records, its advertising expenditures were as follows:

<i>Year</i>	<i>Total Amount</i>	<i>Media</i>	<i>Production</i>
1967-			
1968	\$ 24,446*		
1969	\$110,512	\$ 99,871	\$10,641
1970	\$311,302	\$287,511	\$23,791
1971	\$317,263	\$273,246	\$44,017
1972	\$370,459	\$332,993	\$37,466
Total	\$1,133,982	\$993,621	\$115,915

* Includes some expenditures made through 3/14/69.

From CPF 360. Sources: CXs 625, 651, 652, 699 A-B, 743 A-B, 756 A-K (see Tr. 4339-41).

118. Some of these advertising expenditures were forced upon Koscot in the light of legal proceedings instituted or threatened. For example, as a result of negotiations with the attorney general of New York, \$100,000 was spent in a single campaign in that State (Mann 4465). Although Koscot designated certain funds for advertising in its financial records, actual advertising expenditures were substantially below the funds so earmarked (Edwards 1143, 1159-60; CPF 362). As a matter of fact, as of July 31, 1972, Koscot had a book entry reflecting \$1,876,989 designated for advertising expenses but unspent (CX 758 B).

119. Despite the conceded quality of Koscot cosmetics, they remained largely unknown to the consuming public, and lack of

¹⁶ See ¶ 103, *supra*.

¹⁷ "Sales aids" were included in respondents' estimate, but Koscot sold these items to its distributors at a profit (CPF 378).

advertising was a significant factor leading to this negative result. Koscot failed to make good on its representations concerning the nature and scope of its advertising.

D. "Wholesale v. Retail"¹⁸

120. Koscot's emphasis on the "get-rich-quick" aspect of its endless chain recruitment had predictable results. Koscot raked in millions of dollars, and a few early birds also realized huge profits before the bubble burst. Meanwhile, the sale of "kosmetics" to the public languished, and Koscot's representations about this phase of its business turned out to be just as false and misleading as those concerning recruiting. Koscot's initial glowing promises about the retailing of cosmetics were at best highly dubious. But the preoccupation of Turner and his cohorts with the "big money" to be made through recruitment virtually ensured the failure of the retail operation.

121. That is one of the saddest and most ironical aspects of this case. There is evidence indicating that Koscot did indeed have a potential for success as a seller of cosmetics. As a matter of fact, now that it is out of the business of selling distributorships, Koscot may yet emerge as a viable cosmetics company. According to most of the distributors and subdistributors who testified, the Koscot products had merit and might have achieved considerable consumer acceptance with proper promotion and advertising. Some of the company officials saw this potential, particularly Delaney, Mann and Julian, and many distributors made prodigious efforts to succeed in the retail sale of the product. However, the steps necessary for success in the sale of cosmetics were almost invariably subordinated to the promotion of the sale of distributorships. Company officials who tried to change the emphasis to retailing either quit in disgust or were forced out of the company or into subordinate positions.

122. The Koscot marketing program was structured so as to maximize recruitment earnings even at the expense of retail earnings. Distributors were encouraged to devote their energies to recruiting by virtue of the apparent opportunity to make big money fast. No real effort was made to obtain distributors interested in or qualified for the operation of a retail business. The incentives in the Koscot marketing program were so structured that recruitment provided the possibility of large immediate rewards. In contrast, the work of building a retail sales organization was very difficult, initial rewards were small, and it took time to develop and build a retail sales organization. Koscot's former president recognized the difficulty of getting distributors to

¹⁸ See ¶ 103, *supra*.

concentrate their efforts on retail when it appeared that the rewards from recruiting were faster and more substantial (Mann 4473).

123. By encouraging the recruitment of any person who had or who could get sufficient money to buy into the program, regardless of their qualifications or their location in reference to other distributors, the Koscot program virtually foredoomed the retail effort to failure.

124. The result was an inadequate and unbalanced distribution network, with too many distributors serving certain areas and too few serving other areas. Distributors were not evenly distributed in any State in proportion to the relative population of the various marketing areas. Instead, distributors were concentrated in certain marketing areas in numbers greatly disproportionate to the population of those marketing areas. (CXs 537-39)

125. One of complaint counsel's expert witnesses expressed it this way:

If a manufacturer selects his own distributors, he will look at them very hard headedly in terms of how knowledgeable they are, how financially secure they are, how experienced they are, and so on. He also will strive to put together an organization that covers the territory of the country that he wants to cultivate in an even and balanced manner.

If an organization is put together by other distributors whose primary inducement is the profit they can make from recruiting, they are likely to pay primary attention to whether the prospect can pay the investment. That would be the primary concern because that is going to be the source of their profit.

Secondly, they will tend to recruit from among the people who[m] they have access to, which means that the proximity will be an important consideration and the consequences of this is likely to be an over-development of an organization in certain territories and a scarcity of distributors in other territories. (Westing 1210-11.)

126. The rationalization that the emphasis on recruitment was designed to establish a distribution network as quickly as possible (Mann 4802-05; Jones 4936; CX 13 B) will not withstand analysis. Whether the quota was 30,000 distributors or 40,000 distributors, this was an excessive number for the amount of retail business that was being done or that could reasonably be expected (CPF 385-87, 389-92). Although perhaps not conclusive, a comparison with Avon as a successful company in the field tends to show that there was no necessity for the number of distributors being sought by Koscot other than as a means of realizing a rapid and substantial cash intake. In 1969, Avon had 1,566 district managers to recruit and supervise its retail sales representatives. By 1971, this number had increased to 1,841 district managers, pursuant to the Avon formula of one district manager to 100,000 population (Speer 2121-22).

127. The compensation of Koscot's State directors and their assistants was "based on receipts from new contracts" (CX 164 E).

Understandably, this method of compensation provided an incentive for such officials to favor recruitment over retail. And the record demonstrates their natural reaction to such an incentive: The Illinois State director told a scheduled "business meeting" of distributors: "I don't care about retail. I am here to sell wholesale."¹⁹ (Gittings 3286; CPF 417).

128. Despite his ostensible interest in building a cosmetics company, Turner devoted most of his time to recruitment activity and problems; he promoted officials and employees who emphasized the recruitment aspect of Koscot, to the detriment of those who tried to build up the cosmetics-selling end of the business (CPF 419-26, 431-34, 438-447). At a time when recruiting had to be halted in several States because of legal restrictions or because the so-called quota had been reached, Turner was urged to make a tour designed to encourage retail activity, but he rejected this proposal and elected to devote his time to the promotion of Dare-To-Be-Great as a substitute pyramid plan (CPF 435-37).

129. To the extent that the application of quota limitations or the institution or threat of legal action by State authorities raised questions about the continued sale of Koscot distributorships, distributors were constantly reassured that "there will always be wholesale"²⁰ —that Turner would create new companies in which distributorships could be sold (CPF 192-193). For example, Turner established in 1969, a corporation called Dare To Be Great, Inc. ("DTBG") which used a marketing plan similar to that of Koscot except that the "product" comprised texts and manuals presenting an attitude course. Koscot distributors were authorized to sell distributorships in DTBG. The purpose was made clear:

Glenn Turner said they will try to stop me with Koscot but we will just go on with Dare to be Great (Palamara 2572).

Turner "decided that we could start many, many pyramid companies and we could start them faster than the Government could shut us down. And, he stated that he * * * intended to be the pyramid king of the world." (Jones 4896). Several other companies using the same type of marketing program were also established by Turner (CPF 192-216).

130. Dissension developed within Koscot, not only in its Orlando headquarters, but also in the field, between those who wanted to continue to reap the harvest of distributorship sales through "wholesaling" (see ¶ 103, *supra*) and those who wanted Koscot to sell cosmetics. It is not necessary for the purposes of this proceeding to

¹⁹ See ¶ 103, *supra*.

²⁰ See § 103, *supra*.

detail the infighting that ensued. It is sufficient to note that in mid-1971 the "wholesalers," led by Wilder, prevailed with Turner's blessing, and "retailing" was further deemphasized (CPF 433-447, 454-61). However, Glenn Turner's "impossible dream" ended in July 1972, when Koscot petitioned for reorganization under the Federal Bankruptcy Act (RX 12). Koscot finally became a marketer of cosmetics instead of the promoter of a fraudulent scheme.

E. Liability of Individual Respondents

131. Although the previous findings (§§ 7-26) are sufficient to demonstrate the need for a cease-and-desist order against the individual respondents (except Delaney and Jones), brief additional findings may be desirable with respect to the order of restitution being entered against Turner, Bunting and Wilder. (Obviously, any restitution order should be directed to the corporate respondents.)

132. Turner was the alter ego of the corporate respondents and the "architect and prime mover"²¹ of Koscot's marketing scheme. He bears primary responsibility for the unlawful practices herein found. Additionally, he was the primary beneficiary of the income realized from Koscot's operations, manipulating and using corporate funds as his own. (§§ 7-9, *supra*)

133. It is possible, though almost incredible, that at the outset, Turner may have been sincere in his intentions and may have believed the representations made by him and by Koscot. Although he may have been shielded, or may have shielded himself, from some of the harsh realities of what was happening to Koscot's distributors, subdistributors, and beauty advisors (Jones 4903-04, 4968-70, 4986, 4989-94, 5002-03) he is nevertheless chargeable with knowledge that the Koscot operation was based on deception and fraud. If he did not know—and the finding here is to the contrary—he should have known. Although defense counsel pleads that Koscot's operation was superior to that of Holiday Magic, the fact is that there exists a deadly parallel between the two (§ 97, *supra*). Turner professed to want to establish a successful cosmetics operation, but when there had to be a choice between "retailing" of cosmetics and "wholesaling" ("head-hunting" for a profit), he opted to invest time, effort, and funds in the latter. This he did with full knowledge of the fraud and deceit involved.

134. Despite exhortations that "honesty" was necessary for success in Koscot (CX 10, p. 2; CX 88), Turner operated on the theory that "it was okay to lie as long as it was for the benefit of the person that you were lying to" (Jones 4858). Turner's idea of benefitting people was for

²¹ *Holiday Magic, Inc., supra*, at 24.

them "to give up everything they had and go * * * deeply in debt, because he felt like if they had everything to lose they would make it" (Jones 4914).

135. The record is replete with stories of the adverse impact on the finances and the careers of those who took that advice and invested in Koscot. Many borrowed the money,²² and others quit their jobs to work full time as Koscot distributors. In many instances, net losses were substantial, and some distributors wound up in debt even to the point of bankruptcy or in financial circumstances requiring them to sell their homes (CPF 381-83).

136. Bunting and Wilder each occupied the position of Koscot's chief operations officer for a significant period of time (§§ 11, 16, *supra*). Although Bunting's salary was less than one-third of Wilder's (CXs 307, 309, 322), he continued to reap rich financial rewards from Koscot's operations even after he resigned (§§ 12-15, *supra*). Wilder not only was high-salaried but also received a substantial loan from Koscot (§ 17, *supra*). The full extent of their enrichment is not shown by this record, but enough is known to warrant a restitution order against them.

137. There is no question that Bunting and Wilder knowingly and actively directed and participated in the corporate activities. They were familiar with the nature of Koscot's marketing plan, the representations made, and the falsity of such representations. Each had operated as a Koscot distributor, and each had been engaged in field operations (primarily the sale of distributorships) as paid employees before becoming corporate officers. As corporate officers, each participated in opportunity meetings and GO-Tours. Each was aware of the failure of Koscot to deliver the goods (literally and figuratively) to its distributors. Each was actively engaged in day-to-day operations and had available to them computer print-outs showing the facts that contradicted the misrepresentations being made (CPF 538).

138. Under their leadership, high-pressure recruitment methods were intensified through the increasing use of GO-Tours; the method of product distribution was successively modified for the benefit of Koscot and to the detriment of the retail operation; and advertising was not delivered as promised. In addition, plans were made and carried out to avoid the so-called quota restrictions on the continued recruitment of distributors (CPF 539).

139. Wilder occupied a special niche. Next to Turner, he was the chief promoter of recruitment activities. He was ruthless in seeking to "get that check;" he "would do anything to get money" (Jones 4993). He

²² Koscot encouraged prospective distributors to borrow the money if necessary and furnished a blueprint that in effect encouraged prospects to mislead a bank in applying for such a loan (CX 96 A-D; CPF 105).

and Turner were the prime movers in subordinating cosmetic sales to recruitment activities. (CPF 552-57)

140. In recommending that Julian and Mann be excepted from the restitution order, complaint counsel state:

"These two individuals occupied lesser positions of authority in the direction and implementation of the Koscot marketing plan and received no large financial rewards as a result of their position[s] as officers" of Koscot and Turner Enterprises (CB, p. 62).

The undersigned concurs. Despite the identity of some of the corporate positions held by Bunting, Wilder, Julian, and Mann, the record supports a finding that Bunting and Wilder were more dominant figures and played more significant roles in the operations of the corporate respondents. Moreover, the efforts of Mann and Julian to convert Koscot into a legitimate seller of cosmetics may have been among the factors that led complaint counsel to recommend that these respondents be omitted from that part of the order requiring restitution. Finally, Mann's uncontradicted testimony was that, despite a good income from Koscot, he was now "broke" and without hidden assets (§ 22, *supra*).

III. Restraints of Trade

A. Price Fixing and Other Restrictive Practices

141. In addition to its deceptive nature, the Koscot marketing plan also involved unlawful restraints of trade and unlawful price discriminations. As to these matters, the undersigned finds as follows:

142. Koscot distributors entered into contracts with Koscot whereby they agreed to abide by certain published rules and regulations, including provisions that the distributors would sell only at Koscot's suggested retail prices. These agreements, as reinforced by various written and oral representations made by Koscot, constituted contracts, agreements, combinations, and understandings to fix prices. (CPF 482-87) It is so well established that such fixing of prices is illegal per se²³ that the customary case citations are omitted (but see CB, pp. 21-22).

143. Through other provisions in its rules and regulations which were similarly agreed to by Koscot distributors, Koscot established and maintained contracts, agreements, combinations and understandings which (1) provided for exclusive dealing in that a distributor might purchase merchandise only from Koscot or from his sponsor; (2) limited the customers or categories of customers to whom distributors might sell Koscot products; and (3) required Koscot's approval for consign-

²³ Although respondents did not rely on any exemption provided by so-called Fair Trade laws in certain States, the order provides recognition for any such exemptions.

ment selling. As a means of enforcing these provisions, Koscot required distributors to maintain a record of customers and to make it available to Koscot (CPF 482-83, 488-93; CB, pp. 23-26).

144. On the authority of *Holiday Magic, Inc.*, (slip opinion, pp. 32-35 [*supra*, at pp. 1052-1055]), it is found that these restrictions are unreasonable and anti-competitive.²⁴ Restraints on the right of a distributor to resell products he has purchased are illegal per se, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 382 (1967).

B. Price Discrimination

145. The facts as to the price discrimination charge (complaint, Count III) may be briefly stated.

(a) Koscot discriminated in price between competing purchasers of its products. To distributors Koscot sold at 65 percent off the retail price, while to supervisors or subdistributors (hereinafter "subdistributors") it sold at 55 percent off retail price.²⁵ (§ 36, *supra*) Since both distributors and subdistributors sold to beauty advisors at 40 percent off the retail price, the distributor's gross margin on such sales was 25 percent, while that of a subdistributor on such sales was 15 percent. On direct sales to consumers, distributors enjoyed a gross margin 10 percentage points above that of subdistributors.

(b) The products involved were of like grade and quality.

(c) Distributors and subdistributors performed the same function in the sale and distribution of Koscot products. Both classes of customers purchased directly from Koscot and resold to consumers, either directly or through beauty advisors.

(d) There was competition between distributors and subdistributors, not only in direct sales to consumers, but also in the recruitment of beauty advisors and in sales to beauty advisors.

(e) There is evidence of actual or potential injury to competition as a result of the discriminations. Irrespective of such evidence, however, the magnitude of the discrimination was such as to warrant an inference that the effect may be to substantially lessen competition.

(f) There was no showing by Koscot that the price discriminations were justified on any of the grounds specified by the applicable statute (CPF 494-508).

146. Accordingly, such discriminations in price were in violation of Section 2(a) of the Clayton Act, as amended.

²⁴ Unlike the respondents in *Holiday Magic*, respondents here have not sought to offer any business justification for these restrictions.

²⁵ The fact that during part of the relevant time period, these discounts were actually reduced by virtue of the imposition of a 5 percent bookkeeping fee applicable to both classes of customers is immaterial (CPF 503-505).

CONCLUSIONS

1. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of all the respondents except Terrell Jones.

2. The complaint states a cause of action, and this proceeding is in the public interest.

3. The Koscot program was organized and operated in such a manner that the realization of profit by any participant was predicated upon the exploitation of others, most of whom had virtually no chance of receiving a return on their investment and all of whom had been induced to participate by inherent misrepresentations as to potential earnings. Therefore, the Koscot marketing plan was false, misleading, and deceptive, and its use by respondents constituted an unfair and deceptive act and practice and an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act.

4. In the course of promoting, selling, and offering for sale distributorships, respondents made and caused to be made various statements and representations which were false, misleading, and deceptive, and which respondents knew to be false, misleading, and deceptive. Many persons, in reliance upon such statements and representations, purchased respondents' distributorships, together with cosmetics and related products, and suffered substantial injury thereby. Therefore, the acts and practices of respondents constituted false, misleading and deceptive acts and practices in violation of Section 5 of the Federal Trade Commission Act. In addition, such acts and practices by respondents constituted fraud.

5. The use by respondents of such false, misleading and deceptive statements, representations, and practices, as herein found, has had the capacity and tendency to mislead members of the public into the erroneous and mistaken belief that such statements and representations were true and into the investment of substantial sums of money to participate in respondents' marketing program and the purchase of substantial quantities of respondents' products by reason of such erroneous and mistaken belief.

6. Such acts and practices of the respondents, as herein found, were all to the prejudice and injury of the public and of respondents' competitors and constituted unfair methods of competition and unfair and deceptive acts and practices in commerce in violation of Section 5 of the Federal Trade Commission Act.

7. The failure of the corporate respondents, Glenn W. Turner Enterprises, Inc., and Koscot Interplanetary, Inc., and the individual respondents, Glenn W. Turner, Ben Bunting, and Hobart Wilder to

refund to persons who acted in reliance upon the statements and misrepresentations, as herein found, all monies paid to Koscot Interplanetary, Inc., by such persons was and is inherently and unconscionably unfair and deceptive. The retention of funds obtained pursuant to the unlawful and fraudulent acts and practices disclosed by this record constitutes a violation of Section 5 of the Federal Trade Commission Act.

8. The acts, practices, and methods of competition engaged in, followed, pursued, or adopted by respondents, and the combinations, conspiracies, agreements, or common understandings entered into or reached between and among the respondents and others not parties hereto were unfair methods of competition and were to the prejudice of the public because of their dangerous tendency toward, and the actual practice of, fixing, maintaining, or otherwise controlling the prices at which Koscot's products were resold, in both the wholesale and retail markets, and fixing, maintaining, or otherwise controlling the various fees, bonuses, rebates, or overrides required to be paid by one distributor or class of distributors to another distributor or class of distributors. Such acts, practices, and methods of competition constituted an unreasonable restraint of trade and an unfair method of competition in commerce in violation of Section 5 of the Federal Trade Commission Act.

9. The acts, practices, and methods of competition engaged in, followed, pursued, or adopted by respondents, and the combinations, conspiracies, agreements, or common understandings entered into or reached between and among the respondents and their distributors constituted unfair methods of competition in that they resulted in, or had a dangerous tendency, toward restricting the customers to whom Koscot's distributors might resell their products; restricting the source of supply from which distributors might purchase their products; and restricting their distributors to reselling their products through specified channels. Such acts, practices, and methods of competition constituted an unreasonable restraint of trade and an unfair method of competition in commerce within the intent and meaning of Section 5 of the Federal Trade Commission Act.

10. The effect of the price discriminations found herein has been and may be substantially to lessen competition or to tend to create a monopoly in the line of commerce in which the favored purchaser is engaged or to injure, destroy, or prevent competition between the favored and nonfavored customers or with the customers of either of them. Such discriminations constituted violations of the provisions of Section 2(a) of the Clayton Act as amended.

11. It is in the public interest to issue a cease and desist order

against the respondents Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, respectively, in their individual capacities, as well as against the corporate respondents, Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc.

12. It is in the public interest to issue an order of restitution against the corporate respondents, Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., and against respondents Glenn W. Turner, Ben Bunting, and Hobart Wilder.

13. The complaint must be dismissed as to Terrell Jones for want of jurisdiction and as to Michael Delaney for failure of proof.

Rationale of the Order

Introduction

Although respondents do not concede that they engaged in "pyramiding" or other "fraudulent practices" (RB, p. 8), they do not challenge, for the most part, the proposed findings of complaint counsel, and they also do not object to the entry of the proposed order except for that part dealing with restitution. They do, however, take exception to the description of the Koscot operation as "inherently deceptive and fraudulent" (RB, p. 1) and seek to overcome the cited evidence underlying complaint counsel's proposed findings in that regard.

Thus, the only controverted issues are (1) whether an order of restitution should be issued against the corporate respondents and three of the individual respondents (Turner, Bunting, and Wilder) and (2) whether an order of any kind should be issued against respondent Raleigh P. Mann. The restitution issue may be further subdivided into issues of law and fact as follows: (1) whether the Federal Trade Commission is empowered to issue such an order and (2) whether, assuming such power, the facts and circumstances disclosed by this record warrant the issuance of a restitution order. As reflected in the conclusions, *supra*, all these questions have been answered in the affirmative.

In this state of the record, there remains only the necessity to articulate the basis for such rulings. However, there is no occasion for any lengthy discussion respecting either the basic violations found or the controlling law, except as they may relate to restitution. The findings of fact essentially speak for themselves, and there is no need to rehash them here.

Before dealing with the restitution issue, it may be desirable to comment briefly on the other sections of the order.

The order contained in this initial decision is essentially adapted from that proposed by complaint counsel. Some changes were made,

primarily of an editorial nature. It should be noted that the order differs in many respects from the notice order contained in the complaint, although reflecting the substance and intent thereof. It appears that complaint counsel revised the notice order so as to conform, where applicable, to the order entered in the *Holiday Magic* case, *supra*. Almost without exception, the corresponding order provisions herein are either identical or substantially similar to the *Holiday Magic* provisions.

Although Paragraph Twelve of the complaint challenged respondents' merchandising program as "in the nature of a lottery" and thus an unfair practice in violation of Section 5, complaint counsel have not proposed any findings or conclusions with respect to this allegation, and it is being dismissed pursuant to the Commission's rulings in the *Holiday Magic* case, *supra*, at 14 [p. 1039], and in *Ger-Ro-Mar, Inc.*, [*supra*, (slip opinion, pp. 17-21 [*supra*, at pp. 153-155])].

Restitution Provisions

Respondents have presented a three-pronged objection to the entry of any order of restitution:

First, they challenge the authority of the Commission to enter such an order, relying on the case of *Heater v. FTC*, 503 F.2d 321 (9th Cir. 1974);

Second, assuming *arguendo* that the Commission has such authority, they contend that complaint counsel have failed to prove fraud or any other factual basis to support a restitution order; and

Third, they deny that there has been a sufficient showing of the retention by these respondents, particularly the individual respondents, of any fraudulently obtained funds or any funds that are properly the subject of a restitution order.

These questions will be considered *seriatim*.

It should be noted first, however, that additionally, respondents offered several affirmative defenses against restitution: (1) That the illegal practices have been discontinued; (2) that the corporate respondents have either ceased to exist or have become inactive; (3) that the individual respondents have severed their relationship with the corporate respondents; and (4) that the issue of restitution in this proceeding has become moot by virtue of actions in progress in other forums. These defenses will be considered after the basic questions stated above are disposed of.

At this level the question of the Commission's authority to issue a restitution order must be answered in the affirmative. The Commission has ruled that it has such authority: *Holiday Magic, Inc.*, (slip opinion, p. 23 [*supra*, at p. 1046]); *Universal Credit Acceptance Corp.*, 82 F.T.C.

570 (1973), *rev'd in part sub nom Heater v. F.T.C.* (refund provisions set aside), 503 F.2d 321 (9th Cir. 1974); *Curtis Publishing Co.*, 78 F.T.C. 1472 (1971); *cf. Windsor Distributing Co.*, 77 F.T.C. 204, 222-23 (1969), *aff'd*, 437 F.2d 443, 444 (3rd Cir. 1971).

In ordering restitution in *Holiday Magic*, *supra*, the Commission said it was "fully aware of the decision by the Ninth Circuit Court of Appeals declaring that it may not order restitution of retained monies obtained as a result of violations of the FTC Act occurring prior to the entry of a cease-and-desist order." However, "[w]ith all due respect for the court," the Commission expressed its belief that the *Heater* decision is "incorrect" and announced its intention to seek Supreme Court review (slip opinion, p. 23, n. 11 [p. 1046]). Subsequently, the Commission determined not to seek Supreme Court review of the *Heater* decision and, in recognition of the pendency of the *Holiday Magic* appeal in the Ninth Circuit, reopened the *Holiday Magic* case and vacated the restitution order. In so doing, the Commission stated that "this determination should not be construed to signify a change in the view of the Commission regarding the correctness of the *Heater* decision" (order reopening proceeding and modifying final order (Jan. 21, 1975), p. 2 [85 F.T.C. at 89]).

Since the Commission has maintained its position that it has restitution authority despite the *Heater* case, the undersigned considers himself bound by this determination.

Accordingly, on the basis that the Commission does have such authority, the undersigned has determined to enter the restitution order proposed by complaint counsel. However, it should be noted that it is possible that, like *Holiday Magic*, these respondents may seek review of such an order in the Ninth Circuit. Whether this circumstance calls for a disposition of the restitution issue in this case similar to that ordered in *Holiday Magic* is for the Commission to determine.

In any event, and in recognition that the Commission might want to utilize in this case the restitution provisions of the recently approved amendments to the Federal Trade Commission Act, the undersigned has made findings relevant to the issue of restitution and has considered the opposing contentions of counsel with respect thereto. In that connection, it should be noted that although the notice order* in the complaint contained no restitution provisions, the Commission was careful to reserve its right to enter such an order if the record so warranted. It stated (complaint, p. 16):

If * * * the Commission should conclude from record facts developed in any adjudicative proceeding in this matter that the proposed order provisions may be inadequate to protect the consuming public and respondents' competitors, the Commis-

* Notice order not reported herein.

sion may order such other relief as it finds necessary or appropriate, including, but not limited to, an order of restitution for the losses suffered by past and present participants.

Moreover, Count IV of the complaint alleged as follows:

* * * [R]espondents' multi-level-merchandising program is organized and operated in a manner that results in the recruitment of many participants who have virtually no chance to recover their investments of substantial sums of money in respondents' program and who have been induced to participate by misrepresentations as to potential earnings. Respondents have received the said sums and have failed to offer to refund and refused to refund such money to participants that were unable to recover their investment.

The use by the respondents of the aforesaid program and their continued retention of the said sums, as aforesaid, is an unfair act and practice and an act of unfair competition within the intent and meaning of Section 5 of the Federal Trade Commission Act.

On the basis of this record, and the *Holiday Magic* decision, *supra*, the undersigned has concluded that the allegations of Count IV have been established and that an order of restitution should be issued. The facts here meet the standards for restitution established in *Holiday Magic* and the other cases cited *supra*.

As to the substantiality of the evidence supporting the findings, respondents contend that the testimony of 28 "victim" witnesses²⁶ "should have the impact of a fly in a hurricane when one considers that 30,000 people invested in Koscot" (RB, pp. 14-15). This contention must be discounted in light of the fact that the number of so-called victim witnesses was limited by the administrative law judge in response to respondents' motion urging that additional witnesses would be merely cumulative (Tr. 2918-52). In a battle of metaphors, complaint counsel argue that the consumer testimony should be regarded "as the tip of an iceberg rather than as 'a fly in a hurricane' " (CRB, p. 39).

Relying on a dictum in the *Heater* case suggesting that salaries and loans from a corporation were not properly subject to a restitutionary order, respondents argue that restitution is inappropriate here as to the three individual respondents (Turner, Wilder, and Bunting) because the evidence indicates that they received nothing other than salaries and loans from the corporate respondents.

The undersigned agrees with complaint counsel that on the basis of the evidence now in this record, and in light of the refusal of Turner, Wilder, and Bunting to testify, the burden has shifted to the individual respondents to show that they did not receive or that they do not now retain funds or other assets from the corporate respondents.

As the record stands, it has been proved that the corporate

²⁶ Counsel for both sides have overstated the number of consumer witnesses. Complaint counsel referred to 39 distributors or former distributors of Koscot (CPF, p. 2), and respondents' counsel rounded this figure to 40 (RB, p. 14). Actually, there were 28 such witnesses.

respondents received funds from the victims of an illegal and fraudulent scheme; that a significant portion of such funds are no longer in the possession of the corporate respondents; and that the individual respondents were in such a position of control as to permit them to withdraw funds or other assets from the corporate respondents. In this state of the record, the burden of proof is properly shifted to the individual respondents to show that they did not obtain or do not now possess any fruits of the illegal activities engaged in by the corporate and individual respondents. The facts with regard to this issue lie peculiarly within the knowledge of each individual respondent, and it is well established that in these circumstances, the burden of proof may be properly shifted.

The evidence shows that from August 1967 until July 1972, Koscot retained more than \$44 million from the initial fees paid by distributors who enrolled in its marketing program, over and above any recruiting fees remitted to the participants (p. 31, *supra*, n. 14a [p. 1142, herein]); that as of July 1972, Koscot's total assets were only \$22.5 million and by July 1973 had been further diminished to only \$11.7 million (§ 6²⁷); that Turner Enterprises received millions of dollars directly from Koscot during this period (§§ 4-5); and that Turner, Bunting, and Wilder were each in control of those corporate respondents and in a position to withdraw funds from them during a significant portion of this period (§§ 7-16).

On June 28, 1974, respondents filed a series of motions designed to settle this case on the basis of a consent order as to all issues except that of restitution; and, as to the question of restitution, to provide a factual record on the question of the existence of assets in the hands of respondents available for any restitution that might be ordered (motion to recess proceedings, etc., and motion for an order withdrawing this case from the adjudication process).

Thereafter, in a conference on July 8, 1974, defense counsel proffered to produce as witnesses on the question of assets respondents Turner, Wilder, Bunting, and others (Tr. 4252, 4280-81).

The administrative law judge then entered an order on July 10, 1974 providing, among other things, that "following the completion of the case-in-chief in support of the complaint, defense hearings shall be held for the purpose of determining respondents' assets available for restitution * * *." See also notice of hearing filed on Aug. 1, 1974.

However, on Aug. 21, 1974, in Orlando, Fla., defense counsel announced that, with the exception of Delaney, none of the respondents or other individuals previously listed would testify on the subject

²⁷ Paragraph numbers refer to the findings of fact, *supra*.

matter of respondents' assets (Tr. 4818-27). At that time, defense counsel made the following statement:

* * * [W]e recognize that since we were the ones that initiated having these hearings, if we don't come forward now, then that rests the matter on assets. We don't have another day to try to prove it. We recognize that, and I've explained it to the Respondents and they understand. And so, it's now or never. We understand that. (Tr. 4825-26; see also Tr. 4525-38 and Tr. 5062-65)

As to respondents' affirmative defenses, their brief summarizes them this way:

There has been no substantial public harm done by these respondents since the filing of the FTC complaint and any public harm which may have [preceded] the instant complaint has been provided for [by] the class action stipulated settlement and the Chapter 11 proceedings (RB, p. 12).

However, this defense will not withstand scrutiny.

The fact that the record contains no evidence that these respondents have engaged since mid-1972 in any of the practices challenged by the complaint (RPF 1-6) does not negate the need for an order to cease and desist or for an order of restitution. It is well settled that discontinuance of an unlawful practice does not preclude the entry of an order against its resumption, particularly when, as here, the discontinuance was after issuance of the complaint. In any event, the burden was on respondents to show affirmative discontinuance, and this burden they have not met. Respondents have cited no record evidence in support of their claim that they discontinued the challenged practices about June 1972 or shortly thereafter, and the undersigned is aware of none.

For example, respondents state that "no distributorship has been sold by Koscot since mid-1972" (RPF 8), but the sole record citation (Delaney Tr. 880) fails to support this claim. Moreover, it was not until August 1974 that the referee in bankruptcy specifically prohibited Koscot from selling any franchises or distributorships (RB, Appendix II). As to the contention that there is no evidence that Turner Enterprises is even in existence (RPF 8; see also RPF 2), Turner Enterprises was a signatory to a stipulation of settlement in a class action suit (RB, Appendix I). And, although Turner resigned from Turner Enterprises in March 1972 (RPF 3; CX 292), he stayed on as a consultant. Moreover, Turner signed the stipulation as president of Turner Enterprises and also on behalf of Koscot.

Having established that violations occurred, complaint counsel is not required to show them continuing after the issuance of the complaint. Moreover, it is fairly apparent that any such discontinuance that may have occurred was not necessarily voluntary. Whatever the facts may be as to discontinuance, this record demonstrates the necessity for an

order designed to prevent as fully as possible any likelihood that respondents will resume the activities complained of.

The collateral litigation that, according to respondents, obviates the need for a restitutionary order in this case is as follows:

1. Proceedings for an arrangement under Chapter XI of the Federal Bankruptcy Act filed by Koscot on June 3, 1973, in the United States District Court for the Middle District of Florida (No. 73-179-Orl-P). See RXs 12 and 13.

2. A Stipulation of Settlement proffered on Oct. 7, 1974, in the consolidated class action proceeding *Glenn W. Turner Enterprises Litigation*, MDL Docket No. 109, in the United States District Court for Pennsylvania (No. Misc. 5670) (see Appendix I attached to respondents' brief).

3. A criminal proceeding against Koscot and others, pending in the United States District Court for the Middle District of Florida (Criminal No. 73-71), which resulted in a mistrial (jury unable to agree on a verdict) on May 30, 1974, and which is now scheduled for a new trial.

The reference to the criminal proceeding may be summarily dismissed as irrelevant to the issue of restitution.

As for the stipulation of settlement and the bankruptcy proceeding, both are still in a pending status and thus offer no assurance that they will achieve to any degree the purpose of the proposed restitution order.

Moreover, neither proceeding appears to satisfy the Commission's standards for omission of a restitution order in a case of this kind. In rejecting a pretrial offer of settlement that would have involved the entry of the notice order in the complaint but that would have precluded any provision for restitution, the Commission, in language still applicable to respondents' present arguments, stated:

The proposed settlements in the pending litigation do not purport to require all of the respondents to disburse to their customers all funds retained by them as a result of alleged violations of Section 5 of the Federal Trade Commission Act. Until there is a clear showing that respondents have accomplished disbursement of all such funds, it is premature at this time to determine that no provision for restitution should be included in any Commission order. (82 F.T.C. 1464, 1466 (1973))

Additional language in that same opinion also effectively refutes respondents' present contentions. The Commission pointed out:

The violation for which restitution in some instances is an appropriate corrective action occurs when the seller's retention of its customers' money or property is an unfair trade practice, in and of itself, in violation of the Federal Trade Commission Act. [citations omitted] If the private parties involved agree to an approved settlement, they will be bound by its terms, but this does not bar a restitution provision in a cease and

desist order by the Commission if one is issued. An effective remedy may require complete disbursement of such funds to the victims of the unlawful practices up to the amount of their actual payments, and the possibility that this may result in some parties receiving funds in addition to amounts they have received in settlement of their claims does not prevent such restitution. The public policy expressed in the Federal Trade Commission Act is, of course, paramount. (*id.*, at 1466-67)

Thus, there "is no conflict between the Court litigation and the proceeding before the Commission. The Court action is to vindicate private individual rights; the Commission proceeding is to enforce the Federal Trade Commission Act." (*id.*, at 1466).

So here, once the class action suit is disposed of the Commission will have an opportunity to determine whether such disposition would provide for "effective disgorgement" by the respondents of "all unlawfully retained monies" (*Holiday Magic, supra*, at 26 [p. 1048]).

As matters now stand, neither the class action suit nor the bankruptcy proceeding provides for complete disbursement. Moreover, neither proceeding appears to contemplate any definitive determination as to assets held by the respondents proposed to be covered by a restitution order. The proposal is for a maximum payment of \$3 million to distributor-claimants (RX 17 A; RB, Appendix I, pp. 8-9). This amount is to be contrasted with some \$44 million in enrollment fees unlawfully received and retained by respondents (p. 31, *supra*, n. 14a).

The pending plan of settlement in the bankruptcy proceeding does not make moot the question of restitution in this proceeding. First, the plan of arrangement may or may not be approved, and, second, the Commission's restitution claim may be excepted from discharge even if the plan of arrangement is confirmed.²⁸ Until these two questions are resolved, it cannot be said that the bankruptcy proceeding is a barrier to any order of restitution by the Commission.

Complaint counsel have advanced other arguments designed to refute respondents' contention, but these need not be explored at this time.

The principal question relating to restitution is whether there remain reachable funds in the hands of the respondents to whom the restitution order is proposed to be directed. Among other things, the Internal Revenue Service has tax liens of \$5.7 million against Turner Enterprises and Koscot and \$928,980 against Turner (RB p. 12, n. 2; Appendix I, p. 4). These, of course, are priority claims. Nevertheless,

²⁸ Acting on a motion by complaint counsel that was certified by the administrative law judge, the Commission, on Jan. 7, 1975, entered an order to its General Counsel to "take such action as is necessary and appropriate for the protection of the public interest in any restitutionary claim or any other claim for consumer redress which may arise" out of this proceeding. In entering the order, the Commission noted the report in complaint counsel's motion that respondent Koscot "is in bankruptcy proceedings wherein a settlement is pending which could foreclose any claim in restitution which might arise out of this action" and held that such a foreclosure "would be contrary to the public interest."

Initial Decision

further inquiry appears to be appropriate before any determination is made as to the availability of funds for restitution.

Respecting the restitution provisions of the order (Section V), the administrative law judge has adopted the proposals of complaint counsel, even though he has some reservations regarding the practicality of administering such proposals. However, he has not undertaken to tailor an alternative procedure for the following reasons: (1) the plan proposed by complaint counsel, as representatives of the Bureau of Consumer Protection, which presumably will be involved in enforcing the order, is entitled to due deference in what is almost a matter of first impression; and (2) the mechanics of the refund plan may be academic because (a) the order may be subject to review in the United States Court of Appeals for the Ninth Circuit, a circumstance that led the Commission to withdraw the restitution order in *Holiday Magic, supra*, in view of that court's ruling that the Commission lacked power to order restitution, and because (b) the Commission may elect, in the light of such circumstance, or for other reasons, to avail itself of the provisions of the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act, Pub. Law 93-637, approved Jan. 4, 1975, § 206(a)(b), 88 Stat. 2201-02, 15 U.S.C. § 57 b. Moreover, developments in collateral litigation described *supra* may inject factors requiring alteration of the refund plan.

In view of the somewhat nebulous status of restitution as applied to this proceeding, the undersigned gave consideration to omitting any detailed provisions with respect thereto while making findings and conclusions dealing with the subject matter. However, he concluded that, whatever deficiencies there may be in the present restitution provisions, they at least provide a basis for appeal by the respondents and for appropriate consideration by the Commission.

On the basis of the foregoing findings and conclusions, the following order is entered:

ORDER

Definitions: For the purposes of this order, the following definitions shall apply:

- (a) The term "distributorship" means any continuing commercial relationship created by written agreement or understanding where: (1) the participant is granted the right or is permitted to offer, sell, or distribute goods or commodities manufactured, processed, or distributed by the respondents; or (2) the participant is granted the right or is permitted to offer or sell services established, organized, approved, or directed by the respondents.

(b) "Participant" means any person to whom a distributorship is granted.

(c) "Person" means any individual, group, association, limited or general partnership, corporation, or any other business entity.

(d) "Business day" means any day other than Saturday, Sunday, or the following holidays: New Year's Day, Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans' Day, Thanksgiving, and Christmas.

(e) "Koscot" means Koscot Interplanetary, Inc., and its successors or assigns.

(f) The term "distributor," as used in Section V of this order shall mean any person who paid Koscot \$500 or more in exchange for which such person received, *inter alia*, the right to resell Koscot products.

I

It is ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly, through any corporate or other device, in connection with the advertising, offering for sale, or sale of products, services, franchises, or distributorships, or in connection with the seeking to induce or inducing the participation of persons, firms, or corporations therein, or in connection with any merchandising, marketing, or sales promotion program, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Offering, operating, or participating in, directly or indirectly, any marketing or sales plan or program wherein the financial gains to participants during their first year in the plan or program are, or are represented to be, based in any manner or to any degree upon their recruiting of other participants into the plan or program whereby such participants obtain the right to recruit yet other participants.

2. Offering, operating, or participating in, any marketing or sales plan or program wherein a participant gives or agrees to give a valuable consideration in return (1) for the opportunity to receive compensation in return for inducing other persons to become participants in the plan or program, or (2) for the opportunity to receive something of value when a person induced by the participant induces a new participant to give such valuable consideration, *Provided*, That the term "compensation," as used in this paragraph only, does not mean any payment based on actually consummated sales of goods or services to

persons who are not participants in the plan or program and who do not purchase such goods or services in order to participate in the plan or program.

3. Requiring or suggesting that a prospective participant or a participant in any merchandising, marketing, or sales promotion program purchase any product or services or pay any other consideration, either to respondents or to any other person, in order to participate in said program, other than payment for the actual cost to respondents, as determined by generally accepted accounting principles, of those items respondents deem to be reasonably necessary sales materials in order to participate in any manner therein; *Provided*, That necessary sales material shall not include any product inventory.

II

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly, through any corporate or other device, in connection with the advertising, offering for sale, or sale of products, franchises, or distributorships, or in connection with the seeking to induce or inducing the participation of persons, firms, or corporations in any merchandising, marketing, or sales promotion program, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Representing, directly or by implication, including the use of hypothetical examples, that participants in any merchandising, marketing, or sales promotion program, will earn or receive, or have the potential or reasonable expectancy of earning or receiving, any stated or gross or net amount, or representing in any manner the past earnings of participants, unless in fact the earnings represented are those of a substantial number of participants in the community or geographic area in which such representations are made, and the representation clearly indicates the amount of time required by such past participants to achieve the earnings represented, and failing to maintain adequate records which disclose the facts upon which any claims of the type referred to in this paragraph of the order [II(1)] are based; and from which the validity of any such claim can be determined.

2. Misrepresenting the ease of recruiting or retaining participants in any merchandising, marketing, or sales promotion programs, as distributors or as sales personnel.

3. Representing, directly or by implication, that any participant in

any merchandising, marketing, or sales promotion program can attain financial success.

4. Misrepresenting the supply or availability of potential participants or customers in any merchandising, marketing, or sales promotion program in any given community or geographical area.

5. Misrepresenting that participants can expect to remain active in business for any length of time, or misrepresenting in any manner the longevity or tenure of past or current participants, as, for example, by using a hypothetical illustration of how a marketing program operates, which has the tendency or capacity to imply that participants remain active for a given period, when in fact such period is more than the average length of time for which such participants do remain active.

6. Misrepresenting the reasonably necessary and anticipated costs of doing business for prospective distributors, dealers, sales personnel, or franchisees.

7. Representing, directly or by implication, that products will be or have been advertised, either locally or nationally, or in the geographic area in which such representations are made, without clearly and truthfully representing the manner, mode, extent, and amount of the advertising.

8. Representing that a training program will be or is being offered without clearly and truthfully representing the specific type and nature of the training, the number of hours or days of instruction, and the cost to the participant, if any.

9. Misrepresenting the availability of product in any manner, including, but not limited to, misrepresenting the amount of inventory available, the extent to which an order can be filled at a given time, the length of time necessary to replenish items out of stock, and the length of time necessary to deliver an order to a participant.

10. Misrepresenting, directly or by implication, the extent of respondents' sales of products and services, the nature of such sales, including what proportion were derived from the sale of franchises or distributorships, or the market position of respondents in any market.

III

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their successors or assigns, and respondents Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann incident to selling any franchise or distributorship, shall:

1. Inform orally all persons to whom solicitations are made, and provide in writing in all applications and contracts, in at least ten-point bold type, that the application or contract may be cancelled for any

reason by notification to respondents in writing within at least seven (7) business days from the date of execution.

2. Refund immediately all monies to participants who:

(a) Cancel their contracts in accordance with paragraph 1 of this Section III; or

(b) show that respondents' contract solicitations or performance were attended by or involved violation of any of the provisions of this order.

3. Provide to a prospective franchisee or distributor at least fifteen (15) business days prior to the execution by the prospective franchisee or distributor of any franchise or distributorship agreement or any other binding obligation, or the payment by the prospective franchisee or distributor of any consideration in connection with the sale or proposed sale of a franchise:

(a) A certified balance sheet for the most recent year; a certified profit and loss statement for the most recent three-year period; and a statement of any material changes in the financial soundness of the franchisor since the date of such financial statements.

(b) A copy of Federal Trade Commission Consumer Bulletin No. 4, "ADVICE FOR PERSONS WHO ARE CONSIDERING AN INVESTMENT IN A FRANCHISE BUSINESS."

(c) A statement disclosing (a) the number of franchises or distributorships, whether active or inactive, already sold at the end of the last calendar year, and (b) the number of franchises or distributorships, whether active or inactive, already present in the market area in which the prospective franchisee or distributor plans to operate.

IV

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly through any corporate or other device, in connection with the offering for sale, or distribution of goods or commodities in commerce, as "commerce" is defined in the Federal Trade Commission Act and in the Clayton Act, shall forthwith cease and desist from:

1. Entering into, maintaining, promoting, or enforcing any contract, agreement, understanding, marketing system, or course of conduct with any dealer or distributor of such goods or commodities to do or perform or attempt to do or perform any of the following acts practices, or things:

(a) Fix, establish, or maintain the prices, discounts, rebate

overrides, commissions, fees, or other terms or conditions of sale relating to pricing upon which goods or commodities may be resold; *Provided*, That in those States having Fair Trade laws, products may be marketed pursuant to the provisions of such laws.

(b) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct which fixes, establishes, or maintains the prices, discounts, rebates, overrides, commissions, fees, or other terms or conditions of sale relating to pricing upon which goods or commodities may be resold; *Provided*, That in those States having Fair Trade laws, products may be marketed pursuant to the provisions of such laws.

(c) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct requiring, inducing, or coercing any distributor to refrain from selling any merchandise in any quantity to or through any specified person, class of persons, business, or class of businesses.

(d) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct which discriminates, directly or indirectly, in the net price of any merchandise of like grade and quality by selling to any purchaser at net prices higher than the net prices charged to any other purchaser who in fact competes in the resale or distribution of such merchandise with the purchaser paying the higher price.

2. Discriminating, directly or indirectly, in the net price, or terms or conditions of sale of any merchandise of like grade and quality by selling to any purchaser at net prices, or upon terms or conditions of sale, less favorable than the net prices or terms or conditions of sale upon which such products are sold to any other purchaser to the extent such other purchaser competes in the resale of any such products with the purchaser who is afforded less favorable net price or terms or conditions of sale, or with a customer of the purchaser afforded the less favorable net price or terms or conditions of sale.

3. Preventing distributors from entering into consignment agreements or selling their business to another individual.

4. Engaging, either as part of any contract, agreement, understanding, or course of conduct with any distributor or dealer of any goods or commodities, or individually and unilaterally, in the practice of:

(a) Publishing or distributing, directly or indirectly, any resale price, product price list, order form, report form, or promotional material which employs resale prices for goods or commodities without stating early and visibly in conjunction therewith the following statement:

The prices quoted herein are suggested prices only. Distributors are free to determine themselves their own resale prices.

(b) Publishing or distributing, directly or indirectly, any schedule of discounts, rebates, commissions, overrides, or other bonuses to be paid by one distributor or class of distributors to any other distributors or class of distributors, without stating clearly and visibly in conjunction therewith the following:

The discounts [rebates, commissions, etc.] quoted herein are suggested only. Distributors are free to determine for themselves any amounts to be paid.

Provided, That in those States having Fair Trade laws, products may be marketed pursuant to the provisions of such laws.

5. Requiring any distributor or dealer or other participant in any merchandising program to obtain the prior approval of respondents for any product advertising or promotion, or proposed product advertising or promotion, unless any selling prices and names of any selling outlets are required to be deleted from such proposed advertising or promotion prior to submission for prior approval.

V

It is further ordered, That the corporate respondents, Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., their successors or assigns, and the individual respondents, Glenn W. Turner, Ben Bunting, and Hobart Wilder shall jointly and severally be obligated and required to refund all sums of money paid by any distributor to Koscot; *Provided*, That such refund shall be reduced by:

(a) Any amount of money paid by the corporate respondents to each such distributor, including any refund made either voluntarily or pursuant to settlement or court order; and

(b) the difference between the wholesale value of initial inventory purchased and the wholesale value of inventory presently due to any distributor as reflected by the books and records of Koscot. Such wholesale value shall be calculated at thirty-five percent (35%) of the retail value as shown by the retail prices of Koscot that were in effect on Mar. 24, 1972.

It is further ordered, That such refunds shall be accomplished in the following manner:

1. Within thirty (30) days from the effective date of this order, respondents Koscot Interplanetary, Inc., Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder shall each prepare and shall deliver to the Federal Trade Commission and to each of the other respondents named in this Section V a certified statement designating all sums of money and other assets they retain as of the effective date of this order and such other assets which they expect to subsequently receive that are directly or indirectly attributable to the

association with Koscot, Glenn W. Turner Enterprises, Inc., Glenn W. Turner, or their agents, successors, subsidiaries, or assigns and shall specify with regard to each asset designated:

- (a) The present form of the asset, *i.e.*, cash, stocks, real property, etc.;
- (b) the date the asset was received or is expected to be received, the person from whom the asset was received, or is expected to be received, and the form of the asset on the date it was received or is expected to be received;
- (c) the current market value of each asset and the market value of the asset on the date it was received; and
- (d) any judgment, court orders, or other legal encumbrance on such assets.

2. Within thirty (30) days from the effective date of this order, respondent Koscot shall compile from its books and records a list of all distributors entitled to a refund pursuant to the provisions of this order and shall specify, with regard to each such distributor:

- (a) The full name and last known address of each distributor;
- (b) the full amount paid by each distributor;
- (c) any set-offs which respondents are entitled to deduct from the amount paid by each distributor pursuant to the terms of this order; and
- (d) the net amount that respondents would thereby be obligated to refund to each distributor.

A copy of the foregoing statement shall be filed with the secretary of the Federal Trade Commission within thirty (30) days after the effective date of this order, with copies thereof also delivered to respondents Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder.

3. Simultaneously with the filing of the statement described in ¶ 2, above, Koscot shall mail the notice set out below which includes in such notice the calculations provided for therein to each distributor identified in such statement. A copy of such notice, together with a copy of this order, an acceptance card, and a preaddressed envelope as described below, shall be mailed in an envelope which together with the name and address of the distributor shall contain the following legend in 16-point, boldface type "IMPORTANT REFUND NOTICE." The notice itself shall be confined to the following language which shall appear in 12-point, boldface type:

IMPORTANT NOTICE

Pursuant to the Order of the Federal Trade Commission which is attached to this notice, you are entitled to a refund of all sums of money paid to Koscot Interplanetary, Inc., in exchange for the right to participate in the Koscot marketing program less (1) all amounts paid to you by Koscot or by Glenn W. Turner Enterprises, Inc., including any

refund made either voluntarily or pursuant to a private settlement or court judgment, and (2) the wholesale value of any product that you actually received from your initial inventory. According to the books and records of Koscot Interplanetary, Inc., the net refund to which you are entitled is as follows:

[Supply name of participant]

[To be calculated from
Koscot's books and
records]

Total Investment:

Set-offs for:

(1) All money payments:

(2) Wholesale value of
initial inventory
that you actually
received:

Total amount of set-offs:

Refund (total investment
less set-offs)

If you accept this offer, you will receive the amount of refund listed above *unless the total amount of funds available for the purpose of making refunds is insufficient to satisfy the claims of all participants entitled to a refund who accept this offer*. If the total amount of funds is insufficient, then each claim will be reduced on a pro-rata basis.

If you accept this offer, then sign the enclosed acceptance card and return it to Koscot Interplanetary, Inc., within sixty (60) days of the date of this letter. If such card is not returned or is postmarked within sixty (60) days after the date of this letter, you will forfeit all rights to any refund under the provisions of this proffer.

If you believe there are any material discrepancies between the amounts listed above and the amount to which you are entitled under the formula set forth in the attached order, then indicate the reasons for this on the card or on an attached statement to the card.

IMPORTANT NOTICE

In order to have your claim included, it must be postmarked and returned within sixty (60) days of the date of this Notice.

Dated: [to be inserted]

Koscot Interplanetary, Inc.
4805 Sand Lake Road
Orlando, Florida 32809

The acceptance cards shall be approximately 5 x 7 inches in area and contain the following language:

I hereby accept the offer of refund which Koscot Interplanetary, Inc., has proffered to me pursuant to the Order of the Federal Trade Commission.

(Signature)

(Address)

4. Within one hundred twenty (120) days after the date of the filing

of the notice provided for in ¶ 3, *supra*, Koscot shall submit a report to Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder and to the Federal Trade Commission which sets forth a list of the distributors who have indicated their agreement to participate in the arrangement for refunds provided for in this order. Such reports shall identify the claimants by their names and addresses, shall reflect the amounts to which each such claimant is entitled under the provisions of this order and shall reflect the aggregate amounts of such claims. In determining the amounts of such claims, respondent Koscot shall make a good-faith effort to correct any errors which may exist in their books and records which were brought to its attention by such claimants.

5. Within fifteen (15) days of the submission of the report to the Federal Trade Commission provided for in ¶ 4, *supra*, Koscot, Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder shall submit to the Federal Trade Commission for its approval a plan for the disbursement of funds required by this order. Such plan shall contain at least:

(a) The total amount of assets available for payment of the amount due under this order;

(b) the proportionate contribution from each respondent subject to the provision of Part V of this order if their aggregate assets available for payment exceed the amount due under this order;

(c) the procedures to be used to liquidate immediately the assets required to provide for payment of the amount due under this order;

(d) the procedures to be used in the disposition of funds required by this order.

6. Upon approval of such plan as provided for in ¶5, *supra*, Koscot, Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder shall within thirty (30) days thereafter implement all provisions of such plan, including the refund to claimants of the amounts provided for in this order.

VI

It is further ordered, That respondents Koscot Interplanetary, Inc., Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, Hobart Wilder, their successors and assigns shall forthwith deliver a copy of Section II of this order to cease and desist to all present and future salespeople, franchisees, distributors, participants, or other persons engaged in the sale of franchises, distributorships, products, or services on behalf of respondents, and secure from each such person a signed statement acknowledging receipt thereof.

VII

It is further ordered, That the corporate respondents and their successors and assigns shall notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondents, such as dissolution, assignment, or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporations which may affect compliance obligations arising out of this order.

VIII

It is further ordered, That respondents Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann shall each promptly notify the Commission of his present business address and a statement as to the nature of his business or employment and shall each promptly notify the Commission of the discontinuance of his present business or employment, including in such notice his new business address and a statement of the nature of his new business or employment and a description of his duties and responsibilities therewith.

IX

It is further ordered, That each of the respondents herein and their successors and assigns shall, within sixty (60) days after service upon them of this order, file with the Commission a report in writing, setting forth in detail the manner and form in which they have complied with the provisions of this order. Thereafter, within two hundred and ten (210) days after service upon them of this order and every one hundred twenty (120) days thereafter until the provisions of Section V of this order have been satisfied, respondents Koscot Interplanetary, Inc., Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder shall file with the Commission a further report in writing, setting forth in detail the manner and form in which they have complied with Section V of this order.

X

It is further ordered, That the complaint herein be, and it hereby is, dismissed as to Michael Delaney and Terrell Jones; *Provided, however,* That the dismissal as to Terrell Jones is without prejudice to the right of the Commission to institute further proceedings against him if the public interest so warrants.

OPINION OF THE COMMISSION BY DIXON, *Commissioner*

Complaint in this matter was issued on May 24, 1972, charging respondents with numerous violations of Section 5 of the Federal Trade Commission Act (15 U.S.C. § 45) and Section 2(a) of the Clayton Act (15 U.S.C. § 13(a)) in connection with their operation of a multilevel marketing program involving the sale of cosmetics and cosmetics distributorships. Hearings were held, not without interruption, before Administrative Law Judge Donald Moore, who issued his initial decision on Mar. 20, 1975. The law judge recommended entry of a lengthy order prohibiting numerous unfair and deceptive practices and requiring Koscot and individual respondents Turner, Wilder, and Bunting to make restitution to purchasers of distributorships.

Both sides have appealed. There appears to be little disagreement among them as to the form which the Commission's final order should take, although much disagreement as to the reasons for this result. Respondents have not disputed the findings of fact of the administrative law judge, except in conclusory terms, and we shall adopt them as those of the Commission. Respondents have also raised no objections to those parts of the order which enjoin future conduct,¹ reserving their attack for the requirement of restitution. Complaint counsel have suggested that the Commission withdraw order provisions relating to restitution, and reserve the option to consider use of the provisions of Section 19 of the Federal Trade Commission Act (15 U.S.C. § 57b) to obtain consumer redress at a later date. Complaint counsel also suggest certain minor modifications in the order, and urge the Commission to elaborate on the rationale of the administrative law judge in holding respondents' use of a multilevel pyramid type marketing plan to be inherently deceptive and unfair.

Background

Respondents operated a multilevel marketing plan which individuals might enter at one of several levels. At the lowest level, that of "beauty advisor," one could purchase cosmetics at a 40 percent discount for resale to consumers. "Supervisors" received a 55 percent discount and

¹ In briefing the question of relief before the administrative law judge, respondents raised no objections to the non-stitutionary relief proposed by complaint counsel, which the law judge adopted. In their appeal brief before the Commission respondents indicated certain objections to the order language. At oral argument, however, counsel for respondents indicated that his reservations about the order language had been resolved (Transcript of Oral Argument, 3-4, Oct. 2, 1975).

appointed and supplied beauty advisors, while "distributors" received a 65 percent discount and sold to those below them (I.D. 36).² The big money, however, derived not from the sale of cosmetics to consumers, but from the act of recruiting other participants into the marketing program. Distributors were required to pay Koscot an amount ranging up to \$5000 for initial inventory and the right to recruit others. A distributor who recruited another would receive \$2650 of the recruit's \$5000 payment. Supervisors paid \$2000 for their position, of which a distributor who recruited the supervisor received \$700. If one supervisor recruited another, \$500 of the \$700 commission would go to the recruiting supervisor, and \$200 to the distributor who had recruited the recruiting supervisor (I.D. 37). Variations on this scheme are set forth in the initial decision and incorporated findings (I.D. 38). In general, respondents' plan extracted large sums of money from individual participants by offering the promise that they could recoup these sums and more by inducing others to make similar payments (I.D. 40).

To some degree, and particularly at the lowest level, individuals were also induced to participate by the prospect of making money via the sale of cosmetics to consumers. The record indicates, however, that respondents' devotion to this facet of their business frequently fell short of what one would expect from an organization seriously committed to the retailing of cosmetics (I.D. 76-98). Implementation of the Koscot marketing plan was attended by a wide variety of specific misrepresentations and high pressure sales tactics, chronicled by the law judge at I.D. 54-119. The record also reveals a staggering human toll—money borrowed, jobs quit, homes mortgaged, and even personal bankruptcy for some who dared to be great (Tr. 2249, 2343, 2345-46, 2460, 2491, 2483-84, 2491, 2564, 2737, 2769, 3027-28, 3286-87, 3312, 3352-53, 3373, 3480-81, 3485, 3503-04, 3555-57, 3571, 3626-27, 3668-69, 3754-55, 3759-60, 3872, 3893, 3896, 4065).

Illegality of Entrepreneurial Chain Marketing System

Awash amidst evidence of deception and overreaching, the administrative law judge had no difficulty concluding that respondents' practices violated Section 5. He based his conclusions on the actual deception which was proven to have occurred, and on the inherent capacity of respondents' multilevel marketing plan to deceive (I.D. p. 51 [p. 1157, herein]). On appeal, complaint counsel urge that the

² The following abbreviations are used herein:

I.D.—Initial Decision (Finding No.)

I.D. p.—Initial Decision (Page No.)

Tr.—Transcript of Testimony (Page No.)

Commission enlarge the reasoning upon which the administrative law judge based his finding that respondents' plan was inherently unlawful. Complaint counsel proposed adoption of an alternative finding of law to the effect that:

Respondents' marketing plan contemplates upon the payment of consideration, participants would thereby acquire the right to engage in two income-producing activities, one of which contemplated the sale of similar rights to others for which substantial compensation would be paid, while the other contemplated the sale of products or services. Since implicit in the holding out of such rights is the representation that substantial rewards would be gained therefrom, and since the operation of such plan due to its very structure precludes the realization of such rewards to most of those who invest therein, such plan is inherently deceptive. Furthermore, such plan is contrary to established public policy in that it is generally considered to be unfair and unlawful and is by its very nature immoral, unethical, oppressive, unscrupulous, and exploitative. Therefore, such plan was and is inherently unfair and the operation of the Koscot marketing plan by respondents, having caused substantial injury to the participants therein as well as to other members of the public, constitutes an unfair and deceptive act and practice and an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act.

The Commission has previously condemned so-called "entrepreneurial chains" as possessing an intolerable capacity to mislead. *Holiday Magic, Inc.*, Docket No. 8834, slip op. pp. 11-14 [84 F.T.C. 748 at pp. 1036-1039] (Oct. 15, 1974); *Ger-Ro-Mar, Inc.*, Docket No. 8872, slip op. pp. 8-12 [84 F.T.C. 95, at pp. 145-149] (July 23, 1974), *rev'd in part* 518 F.2d 33(2d Cir. 1975). Such schemes are characterized by 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. In general such recruitment is facilitated by promising all participants the same "lucrative" rights to recruit.

As is apparent, the presence of this second element, recruitment with rewards unrelated to product sales, is nothing more than an elaborate chain letter device in which individuals who pay a valuable consideration with the expectation of recouping it to some degree via recruitment are bound to be disappointed. Cf. *Twentieth Century Co. v. Quilling*, 130 Wis. 318, 110 N.W. 173, 176 (1907). Indeed, even where rewards are based upon sales to consumers, a scheme which represents indiscriminately to all comers that they can recoup their investments by virtue of the product sales of their *recruits* must end up disappointing those at the bottom who can find no recruits capable of making retail sales.³

Complaint counsel argue, in a keen analysis, that the right to sell

³ The presence of a quota for distributors is not likely to eliminate the inherently deceptive nature of an

product in an entrepreneurial chain is also likely to prove worthless for many participants, by virtue of the very nature of the plan as opposed to any particular dishonest machinations of its perpetrators. That is so, argue counsel, because the mere presence of a lucrative right to sell franchises will encourage both a company and its distributors to pursue that side of the business, to the neglect or exclusion of retail selling. The short-term result may be high recruiting profits for the company and select distributors, but the ultimate outcome will be neglect of market development, earnings misrepresentations, and insufficient sales for the insupportably large number of distributors whose recruitment the system encourages. Certainly the facts of this case and of *Holiday Magic, supra*, as well as expert testimony in the record (Tr. 1195 ff 1691 ff), bear out complaint counsel's contentions. At the very least we would conclude that a company which offers its distributors substantial rewards for recruiting other distributors, and charges them substantial amounts for this right, creates overwhelming barriers to the development of a sound retail distribution network and resultant meaningful retail sales opportunities for participants.

What compels the categorical condemnation of entrepreneurial chains under Section 5 is, however, the inevitably deceptive representation (conveyed by their mere existence) that any individual can recoup his or her investment by means of inducing others to invest. That these schemes so often do not allow recovery of investments by means of retail sales either merely points up that there is very little positive value to be lost by not allowing such schemes to get started in the first place.

A discussion of "inherent" illegality and capacity to deceive may seem pointless given the more than 4000 pages of transcript detailing the actual deception and injury in which the Koscot plan resulted. Nothing could be further from the truth. It is regrettably clear that responsible authorities, including this Commission, have acted far too slowly to protect consumers from the manipulations of respondents and others like them. As this is written the corporate respondent, Koscot, is in Chapter XI reorganization proceedings, while the individual respondents plead poverty. The administrative law judge estimated that \$44 million was taken from consumers (I.D. p. 59 [p. 1163, herein]), and no more than a fraction of that is presently accounted for. Whether

entrepreneurial chain, unless realistic quotas are imposed by *market area* rather than by arbitrary geographical unit. In this case, for example, it appears that while statewide quotas were announced and occasionally enforced, this did not prevent saturation of local markets within States (with most of the State's quota being exhausted within an area too small to accommodate so many distributors). In addition, there are strong disincentives for recruiters to disclose honestly the existence of a quota and the extent to which it is being approached, since this will alert prospective recruits to the imminent disappearance of further opportunities for profiting by recruitment and render them less likely to participate.

more than a small fraction of the consumer loss will ever be recovered is open to serious doubt. These particular individual respondents may not, under the watchful eyes of federal authorities, repeat their misdeeds, but once has clearly been too much.

We think that failure to act more promptly can be traced to the previous inability of relevant authorities to obtain *summary* relief against the practices involved. The necessity to prove that a marketing plan, manifestly deceptive on its face, has in fact resulted in injury to numerous consumers, is a lengthy process. Only where the law condemns the mere institution of such a plan, without the necessity to demonstrate its consequences, is meaningful relief likely to be obtained. In the years since Koscot's heyday, many States have enacted laws which categorically proscribe entrepreneurial chain methods of selling. Similarly, the Commission has held that the Federal Trade Commission Act forbids such tactics, and has announced that it will henceforth not hesitate to seek recently-authorized injunctive relief should it seem warranted, *Holiday Magic, Inc.*, *supra*, page 14 [84 F.T.C. 748, at 1038]. The viability of a Federal remedy, however, will depend, if not upon congressional enactment, then upon the willingness of courts to recognize the serious potential hazards of entrepreneurial chains and to permit summary excision of their inherently deceptive elements, without the time-consuming necessity to show occurrence of the very injury which justice should prevent. To require too large an evidentiary burden to condemn these schemes can only ensure that future generations of self-made commercial messiahs will dare to be great and dare anyone to stop them.

Restitution and Consumer Redress

Both sides have recommended that the Commission delete those portions of the administrative law judge's order requiring respondents to make restitution. Counsel for respondents argues that the Commission lacks authority to include a provision requiring restitution in an order to cease and desist. Complaint counsel argue that while the Commission does have such authority, it should rely instead upon its power to obtain redress for consumers pursuant to §206 of the Magnuson-Moss-Warranty—Federal Trade Commission Improvements Act of 1975 (adding Section 19 of the Federal Trade Commission Act).

We agree with complaint counsel that under the circumstances of this case any further efforts by the Commission to obtain compensation for consumers should be made pursuant to the provisions of Section 19 of the Federal Trade Commission Act. We have no doubt that the statutory prerequisites for consumer redress have been made out here. Respondents were apprised in the notice order of the complaint that

recompense for consumers would be sought. And succeeding adjudication has revealed that practices which respondents knew or should have known to be fraudulent or dishonest led to consumers' loss of substantial amounts of money.

As matters now stand, the respondent Koscot is in an arrangement proceeding, pursuant to Chapter XI of the Bankruptcy Act. Whether any further restitutionary action by the Commission as to Koscot will be possible or desirable remains in doubt. Vacation of the administrative law judge's proposed order regarding restitution will remove that as a source of contention in the arrangement proceedings. The Commission's action is, however, taken without prejudice to the institution of such action against corporate respondents as may in the future seem appropriate pursuant to Section 19 of the Federal Trade Commission Act.

With respect to individual respondents Turner, Wilder, and Bunting, there have been intimations from their counsel at various points in these proceedings that pursuit of restitution is a futile gesture because they are in dire financial straits. Respondents have, however, previously refused to provide a verified accounting of their assets, claiming that to do so would abridge their Fifth Amendment rights because of simultaneously pending criminal proceedings. It appears, however, that these proceedings have now ended as to respondents. Therefore, upon the conclusion of this adjudication, the Commission will endeavor to ascertain the financial status of these individuals in order to determine whether Section 19 proceedings as to them would serve a purpose. We can hardly quarrel with respondents' claim that the Commission should not beat a dead horse, but in view of the enormity of the abuses in this case, the Commission has a solemn duty to assure itself that the analogy is a valid one.

Miscellaneous

Complaint counsel urge that Paragraph I(2) of the law judge's proposed order be reformulated so as to prevent in all cases the use of bounty-seeking "headhunters," individuals who would receive compensation based upon the number of others they could induce to participate in respondents' sales program. As now formulated, the law judge's order would permit respondents to enlist certain individuals as headhunters, provided they were not required to pay a valuable consideration for that right. The revised order would still permit payment of compensation to headhunters provided it was based upon actually consummated retail sales by recruits.

Respondents have not objected to this change and we believe it is warranted under the circumstances. As complaint counsel point out,

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while the order prevents respondents from requiring an initial payment for participation in a plan, it does not prevent participants from making initial inventory purchases if they so desire. Thus there remain incentives for indiscriminate recruitment by headhunters, and incentives for headhunters in any program to ignore other requirements of the order designed to ensure that recruitment is undertaken honestly. By requiring that compensation for recruitment be based in all cases upon retail sales by those recruited, the order provides a readily monitored means to ensure that recruitment of distributors is based on market demand, which is the goal of any legitimate business enterprise.⁴

Complaint counsel have also urged the Commission to supplement the administrative law judge's conclusions of law with respect to the Robinson-Patman charges in the complaint. Counsel's proposals are hereby adopted.⁵

On its own motion the Commission has broadened those portions of the order relating to Section 5 violations to proscribe covered conduct "affecting" commerce, inasmuch as the Commission's authority has been broadened in that respect. We have placed the Robinson-Patman prohibitions of the law judge's order in a separate section (V) applicable only to activities "in commerce." Provisions of the law judge's Section V concerning restitution have been deleted, along with corresponding provisions in the definitions section and compliance paragraph (IX). Finally the Commission has modified the wording of paragraph I(1) to conform to the language used in *Holiday Magic*.

An appropriate order is appended.

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This matter having been heard by the Commission upon the cross-appeals of complaint counsel and respondents' counsel from the initial decision and upon briefs and oral argument in support thereof and opposition thereto, and the Commission, for the reasons stated in the accompanying opinion, having granted the appeals in part:

It is ordered, That pages 1-65 [p. 1117-1167, herein] of the initial decision of the administrative law judge be, and they hereby are, adopted as the findings of fact and conclusions of law of the

⁴ Of course we do not construe the order as modified to prevent respondents from paying an individual a fixed salary in return for performing recruitment functions.

⁵ "10. Koscot Interplanetary, Inc., a Florida corporation, whose principal office and place of business is located at 4805 Sand Lake Road, Orlando, Florida, sells and distributes in commerce, as commerce is defined in the Clayton Act, as amended, a line of cosmetics, toiletries, and associated items, sold under the trade name of Koscot.

11. Koscot Interplanetary, Inc., in the sale and distribution of its line of cosmetics, toiletries, and associated items was and is in substantial competition with other distributors and sellers of identical or similar cosmetics and toiletries.

12. Many of the distributors to whom Koscot Interplanetary, Inc., sold or sells one or some or all of the items in its product line are in substantial competition with each other in the resale of Koscot products to their customers."

Commission, with the following exceptions: conclusion of law 12, page 53 [p. 1159, herein]; those portions of pages 53-65 [p. 1159-1167, herein] ("Rationale of the Order") which are inconsistent with the opinion of the Commission herein.

Other findings of fact and conclusions of law of the Commission are contained in the accompanying opinion.

It is further ordered, That the following order to cease and desist be, and it hereby is, entered:

ORDER

Definitions: For the purposes of this order, the following definitions shall apply:

(a) The term "distributorship" means any continuing commercial relationship created by written agreement or by understanding in which:

(1) The participant is granted the right or is permitted to offer, sell, or distribute goods or commodities manufactured, processed, or distributed by the respondents; or (2) the participant is granted the right or is permitted to offer or sell services established, organized, approved, or directed by the respondents.

(b) "Participant" means any person to whom a distributorship is granted.

(c) "Person" means any individual, group, association, limited or general partnership, corporation, or any other business entity.

(d) "Koscot" means Koscot Interplanetary, Inc., and its successors or assigns.

I

It is ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly, through any corporate or other device, in connection with the advertising, offering for sale, or sale of products, services, franchises, or distributorships, or in connection with the seeking to induce or inducing the participation of persons, firms, or corporations therein, or in connection with any merchandising, marketing, or sales promotion program, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Offering, operating, or participating in, directly or indirectly, any

marketing or sales plan or program wherein the financial gains to participants are or are represented to be based in any manner or to any degree upon their recruiting of other participants who obtain the right under the plan or program to recruit yet other participants whose function in the program includes during their first year of participation the recruitment of participants.

2. Offering, operating, or participating in, any marketing or sales plan or program wherein a participant is given or promised compensation (1) for inducing another person to become a participant in the plan or program, or (2) when a person induced by the participant induces another person to become a participant in the plan or program; *Provided*, That the term "compensation," as used in this paragraph only, does not mean any payment based on actually consummated sales of goods or services to persons who are not participants in the plan or program and who do not purchase such goods or services in order to resell them.

3. Requiring or suggesting that a prospective participant or a participant in any merchandising, marketing, or sales promotion program purchase any product or services or pay any other consideration, either to respondents or to any person, in order to participate in said program, other than payment for the actual cost to respondents, as determined by generally accepted accounting principles, of those items respondents deem to be reasonably necessary sales materials in order to participate in any manner therein; *Provided*, That necessary sales material shall not include any product inventory.

II

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly, through any corporate or other device, in connection with the advertising, offering for sale, or sale of products, franchises, or distributorships, or in connection with the seeking to induce or inducing the participation of persons, firms, or corporations in any merchandising, marketing, or sales promotion program, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Representing, directly or by implication, including the use of hypothetical examples, that participants in any merchandising, marketing, or sales promotion program, will earn or receive, or have the potential or reasonable expectancy of earning or receiving, any stated

or gross or net amount, or representing in any manner the past earnings of participants, unless in fact the earnings represented are those of a substantial number of participants in the community or geographic area in which such representations are made, and the representation clearly indicates the amount of time required by such past participants to achieve the earnings represented, and failing to maintain adequate records which disclose the facts upon which any claims of the type referred to in this paragraph of the order [II(1)] are based; and from which the validity of any such claim can be determined.

2. Misrepresenting the ease of recruiting or retaining participants in any merchandising, marketing, or sales promotion programs, as distributors or as sales personnel.

3. Representing, directly or by implication, that any participant in any merchandising, marketing, or sales promotion program can attain financial success.

4. Misrepresenting the supply or availability of potential participants or customers in any merchandising, marketing, or sales promotion program in any given community or geographical area.

5. Misrepresenting that participants can expect to remain active in business for any length of time, or misrepresenting in any manner the longevity or tenure of past or current participants, as, for example, by using a hypothetical illustration of how a marketing program operates, which has the tendency or capacity to imply that participants remain active for a given period, when in fact such period is more than the average length of time for which such participants do remain active.

6. Misrepresenting the reasonably necessary and anticipated costs of doing business for prospective distributors, dealers, sales personnel, or franchisees.

7. Representing, directly or by implication, that products will be or have been advertised, either locally or nationally, or in the geographic area in which such representations are made, without clearly and truthfully representing the manner, mode, extent, and amount of the advertising.

8. Representing that a training program will be or is being offered without clearly and truthfully representing the specific type and nature of the training, the number of hours or days of instruction, and the cost to the participant, if any.

9. Misrepresenting the availability of product, in any manner, including, but not limited to, misrepresenting the amount of inventory available, the extent to which an order can be filled at a given time, the length of time necessary to replenish items out of stock, and the length of time necessary to deliver an order to a participant.

10. Misrepresenting, directly or by implication, the extent of

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respondents' sales of products and services, the nature of such sales, including what proportion were derived from the sale of franchises or distributorships, or the market position of respondents in any market.

III

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their successors or assigns, and respondents Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann incident to selling any franchise or distributorship, shall:

1. Inform orally all persons to whom solicitations are made, and provide in writing in all applications and contracts, in at least ten-point bold type, that the application or contract may be cancelled for any reason by notification to respondents in writing within at least seven (7) business days from the date of execution.

2. Refund immediately all monies to participants who:

(a) Cancel their contracts in accordance with paragraph 1 of this Section III; or

(b) show that respondents' contract solicitations or performance were attended by or involved violation of any of the provisions of this order.

3. Provide to a prospective franchisee or distributor at least fifteen (15) business days prior to the execution by the prospective franchisee or distributor of any franchise or distributorship agreement or any other binding obligation, or the payment by the prospective franchisee or distributor of any consideration in connection with the sale or proposed sale of a franchise:

(a) A certified balance sheet for the most recent year; a certified profit and loss statement for the most recent three-year period; and a statement of any material changes in the financial soundness of the franchisor since the date of such financial statements.

(b) A copy of Federal Trade Commission Consumer Bulletin No. 4, "ADVICE FOR PERSONS WHO ARE CONSIDERING AN INVESTMENT IN A FRANCHISE BUSINESS."

(c) A statement disclosing (a) the number of franchises or distributorships, whether active or inactive, already sold at the end of the last calendar year, and (b) the number of franchises or distributorships, whether active or inactive, already present in the market area in which the prospective franchisee or distributor plans to operate.

IV

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers,

agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly through any corporate or other device, in connection with the offering for sale, or distribution of goods or commodities in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, shall forthwith cease and desist from:

1. Entering into, maintaining, promoting, or enforcing any contract, agreement, understanding, marketing system, or course of conduct with any dealer or distributor of such goods or commodities to do or perform or attempt to do or perform any of the following acts, practices, or things:

(a) Fix, establish, or maintain the prices, discounts, rebates, overrides, commissions, fees, or other terms or conditions of sale relating to pricing upon which goods or commodities may be resold; *Provided*, That in those States having Fair Trade laws, products may be marketed pursuant to the provisions of such laws.

(b) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct which fixes, establishes, or maintains the prices, discounts, rebates, overrides, commissions, fees, or other terms or conditions of sale relating to pricing upon which goods or commodities may be marketed pursuant to the provisions of such laws.

(c) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct requiring, inducing, or coercing any distributor to refrain from selling any merchandise in any quantity to or through any specified person, class of persons, business, or class of businesses.

2. Preventing distributors from entering into consignment agreements or selling their business to another individual.

3. Engaging, either as part of any contract, agreement, understanding, or course of conduct with any distributor or dealer of any goods or commodities, or individually and unilaterally, in the practice of:

(a) Publishing or distributing, directly or indirectly, any resale price, product pricelist, order form, report form, or promotional material which employs resale prices for goods or commodities without stating clearly and visibly in conjunction therewith the following statement:

The prices quoted herein are suggested prices only. Distributors are free to determine for themselves their own resale prices.

(b) Publishing or distributing, directly or indirectly, any schedule of discounts, rebates, commissions, overrides, or other bonuses to be paid by one distributor or class of distributors to any other distributors or

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class of distributors, without stating clearly and visibly in conjunction therewith the following:

The discounts [rebates, commissions, etc.] quoted herein are suggested only. Distributors are free to determine for themselves any amounts to be paid.

Provided, That in those States having Fair Trade laws, products may be marketed pursuant to the provisions of such laws.

4. Requiring any distributor or dealer or other participant in any merchandising program to obtain the prior approval of respondents for any product advertising or promotion, unless any selling prices and names of any selling outlets are required to be deleted from such proposed advertising or promotion prior to submission for prior approval.

V

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly through any corporate or other device, in connection with the offering for sale, or distribution of goods or commodities in commerce, as "commerce" is defined in the Federal Trade Commission Act and in the Clayton Act, shall forthwith cease and desist from:

1. Entering into, maintaining, promoting, or enforcing any contract, agreement, understanding, marketing system, or course of conduct with any dealer or distributor of such goods or commodities to require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct which discriminates, directly, or indirectly, in the net price of any merchandise of like grade and quality by selling to any purchaser at net prices higher than the net prices charged to any other purchaser who in fact competes in the resale or distribution of such merchandise with the purchaser paying the higher price.

2. Discriminating, directly or indirectly, in the net price, or terms or conditions of sale of any merchandise of like grade and quality by selling to any purchaser at net prices, or upon terms or conditions of sale, less favorable than the net prices or terms or conditions of sale upon which such products are sold to any other purchaser to the extent such other purchaser competes in the resale of any such products with the purchaser who is afforded less favorable net price or terms or

conditions of sale, or with a customer of the purchaser afforded the less favorable net price or terms or conditions of sale.

VI

It is further ordered, That respondents Koscot Interplanetary, Inc., Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, their successors and assigns shall forthwith deliver a copy of Section II of this order to cease and desist to all present and future salespeople, franchisees, distributors, participants, or other persons engaged in the sale of franchises, distributorships, products, or services on behalf of respondents, and secure from each such person a signed statement acknowledging receipt thereof.

VII

It is further ordered, That the corporate respondents and their successors and assigns shall notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondents, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporations which may affect compliance obligations arising out of this order.

VIII

It is further ordered, That each individual respondent (Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann) shall promptly notify the Commission of each change in his business or employment status, including discontinuance of his present business or employment, and each affiliation with a new business or employment following the effective date of this order. Such notice shall include the address of the business or employment with which respondent is newly affiliated and a description of the business or employment as well as a description of the respondent's duties and responsibilities in that business or employment.

IX

It is further ordered, That each of the respondents herein and their successors and assigns shall, within sixty (60) days after the effective date of this order, file with the Commission a report in writing, setting forth in detail the manner and form in which they have complied with the provisions of this order.

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X

It is further ordered, That the complaint herein be, and it hereby is, dismissed as to Michael Delaney and Terrell Jones; Provided, however, That the dismissal as to Terrell Jones is without prejudice to the right of the Commission to institute further proceedings against him if the public interest so warrants.
