For Opinion See 2001-2 Trade Cases P 73499 , 2001-2 Trade Cases P 73498 , 2001-2 Trade Cases P 73497 , 2001-2 Trade Cases P 73496 , 2001-2 Trade Cases P 73495 , 2001 WL 34134696

United States District Court, N.D. Oklahoma.
FEDERAL TRADE COMMISSION, Plaintiff,
v.
SKYBIZ.COM, INC., et al., Defendants.
No: 01-CV-396-K(E).
July 9, 2001.

Plaintiff's Response to Defendant's Brief Regarding the Significance of Product Value on the Pending Claims and the Relief Sought by the FTC

Federal Trade Commission, Southwest Region, 1999 Bryan Street, Ste 2150, Dallas TX 75201-6803, 214 979-9350, Attorneys for Plaintiff, Federal Trade Commission.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

FEDERAL CASES

Plaintiff Federal Trade Commission ("Commission" or "FTC") submits this brief in response to the brief of Defendants SkyBiz.com, Inc., World Service Corporation, WorldWide Service Corporation, James S. Brown, Elias F. Masso, and Kier E. Masso, ("Defendants")[FN1] on the significance of product value and the relief sought. The FTC respectfully submits that product value is irrelevant to whether Defendants have violated the FTC Act and that Defendants should be enjoined from their deceptive acts and practices. Moreover, broad preliminary equitable relief is appropriate to ensure that effective final relief is available.

FN1. "SkyBiz" refers to the enterprise operated by all of the Defendants in this matter.

I. *The Value Of The Product Is Irrelevant to the Issue of Deception.*

The complaint in this cause charges defendants with the deceptive marketing of a business opportunity, not the sale of a worthless product.[FN2] Whether a product has value is irrelevant to both a pyramid analysis and an analysis of misrepresentations or omissions regarding the income potential of a business opportunity. This is true for several reasons, discussed below. First, the legal determination of whether a scheme is a pyramid does not depend on the product's alleged value. Second, the alleged "fact" of value should not lead the Court away from the issue: deceptive marketing. Third, the Defendants, having emphasized the money to be made from the SkyBiz compensation program over the value of the Web Pak when they marketed their scheme to victims, should not now be permitted to rely on "product value" to shield their deception. Fourth, whether the product has value does not govern whether the Defendants should be prohibited from deceptively marketing a business opportunity to sell the product. No case holds that the value of a product is a defense to the conduct of a pyramid scheme.

FN2. Defendants assert that their evidence of product value is uncontroverted. While the value, if any, of defendants' SkyBiz e-Commerce Web Pak is not relevant to any issue before the Court, it is worth noting the evidence in the record that defendants' customers considered the Web Pak to be of little or no value apart from the business opportunity. PX 5 ¶ 10; PX 12 ¶ 8; PX 227; Transcript of June 26, 2001 [Ken Klein, Darlene L. Syrell] at ____; Transcript of June 27, 2001 [Kathy Nelson] at ____. *See also* PX 1 at p. 8 (only 428 consumers purchased the Web Pak without becoming associates); PX 69 (App No 1664-65 ¶ 9, 1680, 1734) and PX 73 (App No 2254) (most websites not used by purchasers).

A. Pyramid Analysis Does Not Depend on Value

More than a quarter century of jurisprudence makes clear that the alleged value of a product is not relevant to the analysis of whether a marketing program is a pyramid scheme. The sole issue is the creation of a scam in which the structure of the compensation plan ensures that the vast majority of participants will not realize the promised rewards. A plan which holds out the opportunity of making money, by means of recruiting others, with that right to recruit being passed on as an inducement for those others to join, and being passable by them *ad infinitum,* contains an intolerable potential to deceive.

In re Holiday Magic, 84 F.T.C. 749, 1037 (1974) (App No 3342-3343).

The seminal case on pyramid schemes is *In re* Koscot Interplanetary, Inc., 86 F.T.C. 1106 (1975) (App No 3057-3121). *Koscot* is often cited for the proposition that the characteristic of a pyramid scheme is "the right to receive in return for recruiting other participants into the program rewards which are unrelated to the sale of the product to ultimate users." Koscot, 86 F.T.C. at 1180 (App No 3112). Note, however, that *Koscot* assumes that a sale of a product has taken place and that, therefore, the product must have some market value.[FN3] But even recognizing that a sale must have taken place, *Koscot* pointedly ignores product value in its analysis. Instead, it focuses on whether the scheme promised "rewards unrelated to the sale of the product." The opinion explains why:

FN3. Defendants assert that "In *Koscot Interplanetary, Inc.*, the Commission found that the company was formed without a product to sell, it was formed solely to recruit more people." Defendant's Brief at 5. The opinion itself belies this statement. In fact, the *Koscot* opinion adopts the findings of the ALJ, who notes that the company was organized to sell cosmetics - not unlike Amway - in a wholesale-to-retail structure:

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 doing so, respondents have caused their products to be shipped from their places of business in various States to purchasers ....

Koscot, 86 F.T.C. 1106, 1128 (1975) (ALJ's Opinion, para. 29) (App No 3074-3075). The ALJ does note that "for approximately a year following the ... institution of the marketing plan, respondents were engaged solely in the marketing of distributorships," but thereafter began the sale of cosmetics. *Koscot*, 86 F.T.C. at 1132 (App No 3077).

[E]ven where rewards are based upon sales to consumers, a scheme which represents indiscriminately to all consumers that they can recoup their investments by virtue of the product sales of their recruits must end up disappointing those who can find no recruits capable of making retail sales.

Koscot, 86 F.T.C. at 1180 (App No 3112). The opinion in that case concludes that Koscot's scheme was an illegal pyramid because "recruitment with rewards unrelated to product sales, is nothing more than an elaborate chain letter device in which individuals who pay valuable consideration with the expectation of recouping it to some degree via recruitment are bound to be disappointed." *Koscot*, 86 F.T.C. at 1180 (App No 3112).

The *Amway* decision, upon which Defendants rely, demonstrates the continued judicial focus on inherently deceptive structure of a pyramid scheme, rather than the issue whether the underlying product has "value." In 1979, the FTC declined to hold that the best known multilevel marketing program in history was a pyramid. *In re Amway Corp., Inc.*, 93 F.T.C. 618 (1979) (App No 2967-3056). The decision of the Commission runs many dozens of pages and ultimately concludes that Amway's structure was not inherently deceptive. However, nowhere in this analysis does the issue of product value play a part: only the structure of the compensation plan does. The opinion takes pains to restate the *Koscot* characteristics and explains how Amway survives the analysis, without regard to product value. The key to the *Amway* decision is that "a sponsoring distributor receives nothing from the mere act of sponsoring. It is only when the newly recruited distributor begins to make wholesale purchases ... and sales ... that the sponsor begins to earn money from [the] recruit's efforts." *Amway*, 93 F.T.C. at 716 (App No 3040). Thus the *Amway* decision assumes, but ignores in its analysis, that the products have value to consumers.

The complete absence of product value from the legal analysis continues through the most recent pyramid cases. No court has considered it: not *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776 (9th Cir. 1996), not *FTC v. Five-Star Auto Club*, 97 F. Supp.2d 502 (S.D.N.Y. 2000). In a different kind of Section 5 case, *FTC v. Figgie Int'l, Inc.*, 994 F.2d. 595 (9th Cir. 1993), the court faced down the "product value" defense succinctly: liability under the Federal Trade Commission Act "is premised not on the fact that Figgie sold [products], but on the dishonest or fraudulent practices it used to sell them." Thus, the issue is not product value but deception in the sale of the scheme.

B. The "Fact" of Product Value Should Not Mislead the Court's Analysis

Only one expert testified about whether SkyBiz's scheme is a pyramid and inherently deceptive.[FN4] Dr. Peter Vander Nat testified that because of the structure of the compensation scheme, SkyBiz's scheme is both inherently deceptive and a pyramid. PX 2. It is important to note that Dr. Vander Nat's conclusion is not premised on or affected by product value. Nowhere in Dr. Vander Nat's analysis regarding whether SkyBiz is a pyramid does the variable "value" appear, nor need it. This is because, according to Dr. Vander Nat, the very structure of the compensation plan guarantees that

94% of all Associates who succumb to SkyBiz's misrepresentations about the business opportunity will not recoup their investment no matter what the product value - or pricing - is (PX 2 (App No 3, ¶ 7)):

> FN4. Defendants claim that Dr. Chiasson determined that SkyBiz is a "fair value." Defendants correctly and very carefully assert that Dr. Chiasson "determined pricing" based on the "predicted market price" There is no indication that Dr. Chiasson was competent to determine market value or that he did in fact make a determination of value, as opposed to a determination of "pricing." In fact, even where Dr. Chiasson speaks of "fair market value," ("My conclusion was that SkyBiz has a fair market value..."), it is clear that he is talking about competitive pricing ("... given predictions based on the competitive surveys ... of their competitor products)." PX 226 at 1428:16-18. In any event, in the Canadian criminal proceeding, unlike the instant case, product value can be an issue.

Unbeknownst to general participants - and whatever the product may or may not be worth - the terms of the compensation plan secure the result that the vast majority will fail to obtain monetary rewards.

PX 2 (App No 18, ¶ 33). Regardless whether the product is worth more or worth less, the very structure of the SkyBiz pyramid guarantees that the same percentage of people will lose. Under the SkyBiz structure, 94% of all Associates will fail to recoup their investment no matter what the price or value of the product is because of the mathematics of the SkyBiz structure. *See* PX 2 (App No 12-14, ¶¶ 22-25).

Defendants faced with charges of violation of Section 5 often argue that their products have value. Courts have not found the argument to be compelling. In one recent case, the Ninth Circuit Court of Appeals used the example of a "rhinestone merchant" to explain why product value was not relevant:
[T]here is nothing dishonest about selling rhinestone jewelry; it has some value. However, it is dishonest to represent that rhinestone jewelry is actually diamond, and to charge diamond prices for it.

Figgie Int'l, 994 F.2d at 604. Thus the focus must not be on value, but on the representations made in the sale. The court continues:
Customers who purchased rhinestones sold as diamonds should have the opportunity to get all of their money back.... The seller's misrepresentations tainted the customer's purchasing decision. If they had been told the truth, perhaps they would not have bought rhinestones at all, or only some.... The fraud in the selling, not the value of the thing sold, is what entitles consumers in this case to full refunds or to refunds for each [product] that is not useful to them.

Figgie Int'l, 994 F.2d at 606.

Similarly, Dr. Vander Nat noted that the alleged value of the SkyBiz product does not properly define the issue. He notes that inherent value does not necessarily affect a buying decision: "Even though a commodity may have some market value, there may still be any number of people who would not be willing to pay the current market price." PX 2 (App No 18, ¶ 34). However, if the seller adds some additional value-such as a lottery ticket in addition to a piece of jewelry- "many people may now decide to pay $110 for the package, while they would not have bought the commodity alone." *Id.*

It should be noted that Dr. Vander Nat's assertion that the SkyBiz scheme produces "determined" losses-that is, ensures losses--for approximately 94% of its participants, remains completely unchallenged by Defendants.

C. The Defendants, Having Not Emphasized the "Value of the Product" in Perpetrating Their Scheme, Should Not Now Be Permitted to Hide Behind It.

Although the Defendants now claim that SkyBiz sold a product with "value," they certainly did not emphasize the value of their Web Pak when they marketed the product to Associates. In CD ROMs and videotapes and on the

website, SkyBiz - these Defendants, not any rogue salesmen - emphasized the money-making business opportunity, not the value of the website. PX 13 (App No 196, 198, 199); PX 69 (App No 1789). The first comparison of the SkyBiz websites to other available websites occurred in the recent criminal prosecution in Canada, in which the Defendant's expert attempted to compare SkyBiz and its competitors. PX 73 (App No 2253-2254). In fact, SkyBiz clearly saw its competitors not as other Internet service providers or other web-hosts. Rather, SkyBiz considered its competitors to be other MLMs. PX 85 (App No 3530-3531); PX 99 (App No 4033-4034); Transcript of June 28, 2001 [Brown] at 85:3-86:18.

There is strong evidence that Defendant SkyBiz's marketing strategy was effective: the vast majority of consumers purchased not a "valuable product," but a business opportunity. Consumer declarations underscore this point: the consumers were motivated to buy "the product" for the business opportunity. PX 4 (App No 31-32 ¶ 8); PX 5 (App No 78-79 ¶ 20); PX 6 (App No 117 ¶ 10); PX 7 (App No 127-28 ¶ 3); PX 9 (App No 161 ¶ 9); PX 11 (App No 170 ¶ 7,171 ¶ 11, 12). The only two existing surveys of SkyBiz customers, including one sponsored by the Defendants, indicated that 85% of SkyBiz customers ignored the valuable product for which they had supposedly paid. PX 69 (App No 1664-1665 ¶ 9, 1680, 1734); PX 73 (App No 2254).

D. The Defendants' deceptive marketing practices should be enjoined.

Assuming, *arguendo,* that Defendants sell a product with value, the Court should prohibit their deceptive marketing practices. Even were it true that some Associates desired only a web site, and even were it further true that the Associates purchasing a business opportunity wanted at least one website *qua* website, the Defendants have not stated a defense to their deceptive marketing practices. The Defendants in *Omnitrition* made similar arguments: that because the first level of their program was not "rewards for recruiting," the whole program was exempt from the *Koscot* test. The Ninth Circuit Court of Appeals disagreed:

The program is unquestionably *not* a pyramid scheme if only the distributor level is taken into account; the participant pays no money to Omnitrition, has the right to sell products and has no right to receive compensation for recruiting others into the program. The distributor level, however, is only a small part of the entire program. Taking into account the 'supervisor' levels, a reasonable jury could conclude the *Koscot* factors are met here.

Omnitrition, 79 F.3d at 782.

Applying the same analysis to SkyBiz, one might concede that an individual might want to purchase one website as a website. Thus the purchase by any individual of a first website might indicate that the website had value to that consumer.[FN5] However, Defendants have not explained why any consumer would need to purchase three websites, much less five websites or a "7-Pak" for use as a website. If the value of the website is the education programs which the Defendants now tout, or e-mail, then why would any consumer need more than one site to access these services? In fact, the emphasis placed by SkyBiz - not by its rogue salesmen - on purchasing multiple websites to leverage earnings from recruiting must lead to the conclusion that what SkyBiz sells, and what the vast majority of Associates purchased, was a business opportunity. See PX 69 (Segment 9) (Unied.com CD ROM shown during June 26, 2001 session of the Preliminary Injunction Hearing). When taking the "entire program" into account, it is clear that SkyBiz' program is an inherently deceptive pyramid scheme.

> FN5. However, the Temporary Receiver found from Defendants' own records that only 428 of Defendants' 1.9 million purchasers failed to sign up for the compensation program. PX 1 at p. 8.

The authorities upon which Defendants rely do not support their argument. The Commission in *Amway* emphasized that Amway actually makes its money by retail sales of products to consumers outside its marketing program. In fact, the single most important factor determining whether Amway's structure was legal appears to be the existence of retail sales. At the beginning of its discussion, the Commission opinion notes that Amway "retails its products directly to consumers." *Amway,* 93 F.T.C. at 711 (App No 3037). In discussing "Allegations that Amway Plan is a Pyramid

Scheme," the Commission emphasizes retail sales again: "It is only when the newly recruited distributor begins to make wholesale purchases from his sponsor and sales to consumers that the sponsor begins to earn money" and thus Amway "is not a plan where participants purchase the right to earn profits by recruiting other participants, who themselves are interested in recruitment fees rather than the sale of products." *Amway*, 93 F.T.C. at 711 (App No 3039-3040, 3040-3041).[FN6] The "sales" are sales to ultimate consumers outside the marketing chain.

> FN6. The sale of products and resultant profits, rather than rewards for recruitment, are the key. The Commission's statement that "Amway's products have a very high consumer acceptance," does not weigh the value of the products in the context of legal analysis, but refers to the fact that Amway is successful in selling, through multi-level marketing, products of a type that consumers usually expect to buy in supermarkets or other retail stores. *Amway*, 93 F.T.C. at 711 (App No 3036-3037). The value of the products is not discussed as an issue in the opinion.
>
> Defendants err in their reliance on *FTC v. Simeon Management Corp.*, 532 F.2d 708 (9th Cir. 1976), for the proposition that courts consider a product's value in determining the legality of a business. The issue in that case was the safety and efficacy of the program; here, the FTC challenges not the product, but the misrepresentations about a business opportunity that Defendants hawk in CD ROMs, video tapes, books, opportunity meetings and their website. (In *Simeon Management,* the Commission's ultimate finding of deception was upheld on appeal. *Simeon Management Corp. v. FTC*, 579 F.2d 1137 (9th Cir. 1978)).

Amway is not the only pyramid case to emphasize retail sales. In *In re Holiday Magic, Inc.*, 84 F.T.C. 749 (1974) (App No 3122-3366), the Commission distinguished the defendant's scheme in which payments were based on mere recruitment from one in which payments were based on "consummated retail sales." *Holiday Magic,* 84 F.T.C. at 1043 (App No 3346). Because Holiday Magic did not have retail sales, "[i]n essence, the Holiday Magic marketing plan is little more than an elaborate, modem-day version of the chain letter, with the capacity to [lure] a slightly more sophisticated, and more ambitious victim from his or her money." *Holiday Magic,* 84 F.T.C. at 1035 (App No 3342). In *Koscot,* the Commission characterized "entrepreneurial chains" with "an intolerable capacity to mislead" by the disconnect between retail sales and rewards. *Koscot,* 86 F.T.C. at 1180 (App No 3112). The opinion emphasizes that this fraudulent result arises principally from "rewards which are unrelated to the sale of the product to ultimate users" - that is, rewards unrelated to retail sales. Thus, it is clear in *Koscot* that the "retail sales" at issue are sales to *consumers, i.e.,* individuals outside the marketing scheme.

In Omnitrition, defendants to a pyramid charge attempted to use "Amway rules" to defend themselves. The defendants in *Omnitrition,* like the SkyBiz Defendants, wanted to count sales to wholesalers or distributors as "retail sales." *Omnitrition*, 79 F.3d 776. The Ninth Circuit Court of Appeals refused to be swayed. The court found that sales "within the pyramid" are not retail sales. *Omnitrition*, 79 F3d at 783. Under this analysis, SkyBiz has hardly any retail sales.

II. The Court Has the Power to Create a Remedy That *Prevents Further Deception By Defendants.*

Plaintiff contends that when consumers contracted with Defendants they were purchasing the right to earn compensation by recruiting other consumers into Defendants' SkyBiz scheme. The Web Pak was not what consumers were purchasing when they paid $125 and contracted with defendants. The Receiver reported to the Court that, based on Defendants' own data, of the 1.9 million sales made, only 428 consumers purchased the Web Pak without signing up to be an Associate. PX 1, at p. 8.

As Defendants state in their brief, the Court has broad equitable powers to fashion relief that is appropriate to this particular case. District courts have the power to fashion preliminary injunctive relief in a manner that will prevent deception by defendants and provide protection for effective final relief until a trial may be held. *FTC v. U.S. Oil & Gas Corp.*, 748 F.2d 1431, 1434 (11th Cir. 1984). Were the Court to determine that Defendants should be permitted to sell the Web Pak, proscriptions should be placed on Defendants to ensure that the deception charged in the Complaint

will not continue either by the Defendants or by Associates who have been induced to join the SkyBiz program with the promise of rewards and who have been told to use Defendants' promotional materials to recruit new Associates.

Just as restrictive language in the SkyBiz 2000 website has been ineffective in curbing fraudulent sales, so will the Court's order be ineffective without functional restrictions. The only way to ensure that the Defendants do not resurrect their illegal pyramid scheme is to, among other things, enjoin them from promoting or paying compensation to consumers for recruiting SkyBiz Web Pak purchasers. Moreover, the "product" itself must be modified to excise the Skynary "business web site." The only purpose of the business web site is to recruit into the SkyBiz pyramid, and it should be disabled to prevent additional deception. The remaining product would encompass only the tutorials, personal web site, and customer support. In addition, monitors must be put in place to ensure that only "web hosting" is taking place, not recruitment. Random monitoring and access to all transactional record and information should be immediately made available to the Receiver and the FTC.

III. The FTC's Authority to Enforce The FTC Act's Prohibition *Against Deception Reaches Sales to Foreign Consumers.*

SkyBiz's international sales are within the jurisdiction of the FTC Act and are properly within the scope of any preliminary injunction issued in this matter. SkyBiz performs its business activities within the jurisdiction of the United States. Moreover, the Federal Trade Commission Act authorizes enforcement action when entities operating from the United States engage in unfair or deceptive acts or practices harming foreign consumers.

First, SkyBiz's activities are performed within the United States. All sales are made by SkyBiz, not by Associates. Thus, SkyBiz makes all of its sales, including its international sales, from its home base in Tulsa, Oklahoma. SkyBiz specifically states on its web site that "[a]ll Associate contracts are entered into in the U.S., regardless of where the Associate is located, because such contracts are finally accepted by SkyBiz 2000 when its internet server delivers the product ordered and/or accepts an Associate's Application so SkyBiz 2000 is not operating in any other country." PX 85 (App No 3613). The operations of SkyBiz are at 6128 E. 38th Street, Tulsa, Oklahoma.[FN7] PX 85 (App 3619); PX 225 at p. 16.

FN7. SkyBiz' Associates Agreement contains the following provision:

JURISDICTION/VENUE This agreement shall be construed and enforced in accordance with the laws of the State of Oklahoma without reference [sic] legal principles that would cause the law of another jurisdiction to be applied. Causes of action between the parties hereto of any type, whether based on this agreement, on fraud or any other tort, or grounded in principles of strict liability or statutes of any kind, shall be heard exclusively in a court of competent jurisdiction in Tulsa County, Oklahoma, each party hereto submitting to the jurisdiction of such courts and expressly waiving the right to bring suits in all other courts. In any cause of action the winner shall be entitled to recovery of all reasonable attorney fees, court costs and other costs of the action.

PX 85 (App No 3619).

All SkyBiz promotional activities, including those addressed to foreign countries, are administered out of Defendants' offices in Tulsa. PX 85 (App No 3508, 3523). These promotional activities include the SkyBiz web site, the *Sky Mail* newsletter, and announcements of presentations by corporate sponsored presenters. PX 85 (App No 3505-3638). All of these are accessible by consumers with Internet access from all over the world. PX 85 (App No 3508, 3517-3523). Moreover, SkyBiz commission checks to all Associates are issued under the authority of the Tulsa office. PX 85 (App No 3518, 3533).

SkyBiz admits that its domestic and international activities are intertwined. PX 172 (App No 5606-5610). The ex-

penses relating to the international sales are intertwined with those of the domestic sales. In fact, Defendants' accountant testified that SkyBiz's revenue stream is allocated between domestic and international sales only by the percentage of sales made to United States consumers versus foreign consumers. He testified that SkyBiz allocates basic expenses such as commissions, chargebacks, and the World Service Corporation fee by the amount of international sales versus domestic sales, not by any method correlating actual expenses to particular sales. PX 221 at p. 25:7-26:10; 29:4- 32:8; 34:9-25. SkyBiz has engaged Deloitte & Touche to perform a "combined" audit of the SkyBiz domestic and international entities.[FN8] PX 221 at p. 40:22-42:8.

> FN8. Although an analysis of Defendants' conduct within the United States is not necessary in light of Congress' clear intent expressed in the language of the FTC Act, *see* discussion *infra,* Defendants' contacts with the United States set out in the text overwhelmingly establish the appropriateness of the extraterritorial application of the FTC Act. *Leasco Data Processing Equip. Co. v. Maxwell,* 468 F.2d 1326, 1334 (2d Cir. 1972) (finding when "there has been significant conduct within the territory, a statute cannot properly be held inapplicable simply on the ground that, absent the clearest language, Congress will not be assumed to have meant to go beyond the limits recognized by foreign relations law"); *Alfadda v. Fenn,* 935 F.2d 475 (2d Cir. 1991) (acknowledging both the "conduct" and "effects" tests as controlling in SEC extraterritorial application. The court held that defendant's negotiations and communications in the U.S. were more than preparatory to the fraud, which caused losses to foreign investors, consequently both the SEC Act and RICO applied extraterritorially.); *Psimenos v. E.F. Hutton & Co.,* 722 F.2d 1041 (2d Cir. 1983) (finding extraterritorial application because the conduct within U.S. directly caused foreign losses and U.S. did not want to become a base for fraudulent manufacturing, even if consumers were foreign citizens).

Second, the FTC Act clearly authorizes the Commission to prohibit deceptive sales made by entities operating from the United States to consumers in foreign countries. Section 5 of the FTC Act, which the Complaint alleges that Defendants violated, gives the Commission authority to prohibit "unfair or deceptive acts or practices in or affecting commerce." 15 U.S.C. § 45(a)(1). "Commerce" is defined in Section 4 of the FTC Act to include "commerce ... with foreign nations." 15 U.S.C. § 44. "[B]usiness dealings of the petitioner with customers in foreign countries is foreign commerce within the meaning of the Constitution and the [FTC] Act." *Branch v. FTC,* 141 F.2d 31, 34 (7th Cir. 1944). Moreover, it is well recognized that the Commission "seeks to protect foreign commerce," *Id* at 35. Thus, sales made by Defendants to consumers in foreign countries are "commerce" and are subject to enforcement action by the Commission.

Any other conclusion would be ludicrous. It would be difficult to conceive of a situation in which Defendants would be enjoined from further deception of consumers in the United States, but would be allowed to continue to deceive foreign consumers from their Tulsa headquarters.[FN9]

> FN9. Australia and Canada have initiated law enforcement proceedings against SkyBiz Associates in their respective countries. PX 74 (App No 2437-2446); PX 143 (App No 4740-4741); PX 144 (App No 4742-4743); PX 145 (App No 4744-4745); PX 146 (App No 4746-4747). Presumably, they have not filed charges against the Defendants in this case because of concern over jurisdiction.

Third, Defendants rely on dictum in *Neiman v. Dryclean U.S.A. Franchise Co.,* 178 F.3d 1126 (11th Cir. 1999), for their assertion that the FTC Act does not cover international sales. However, *Neiman* only decided the reach of the Franchise Rule, 16 C.F.R. § 436.1 (1998), in a private lawsuit brought by a disappointed prospective foreign franchisee whose franchise was to be entirely outside the United States. While the *Neiman* court did discuss Section 5 of the FTC Act, it observed that the language and history of the promulgation of the Franchise Rule make it clear that the FTC never intended that the Rule "protect franchisees in foreign countries." *Neiman,* 178 F.3d at 1131. Therefore, any question of the reach of the FTC Act is irrelevant to the holding in the case. The *Neiman* court's discussion of Section 5 of the FTC Act, the statutory provision under which this case is brought, is purely dictum.

That the FTC Act may apply extraterritorially is clear, despite the *Nieman* dictum. The Supreme Court in *EEOC v.*

Arabian Am. Oil Co., 499 U.S. 244 (1991), stated that "Congress has the authority to enforce its laws beyond the territorial boundaries of the United States." 499 U.S. at 248. The question became whether Congress intended the particular statute under review to have the extraterritorial reach beyond "places over which the United States has some sovereignty." *Id.* The Court presumed that Congress intended that a statute would relate only to domestic matters unless an intent to have broader reach is clearly expressed. *Id.* As discussed above, Congress has clearly stated that the "commerce" the FTC is authorized to regulate with regard to unfair and deceptive acts and practices under Section 5 of the FTC Act reaches commerce with foreign nations.

The *Neiman* court did discuss the reach of the FTC Act under the Supreme Court's analysis as set out in *EEOC.*[FN10] *Neiman*, 178 F.3d at 1130-31. However, the court's statement that the commerce definition in *EEOC* and that in the FTC Act are similar, is not supportable, *Neiman*, 178 F.3d at 1130-31. The court stated that Title VII, the relevant statute in *EEOC,* defined commerce as "trade ... among the several states; or between a State and any place outside thereof." *Neiman*, 178 F.3d at 1130. It then went on to quote the FTC Act definition of "commerce among the several states or with foreign nations," *Neiman*, 178 F.3d at 1130-31. The court's conclusion that the statutes are similar is refuted by the very wording of the FTC Act, which - unlike the original Title VII - specifically allows jurisdiction over commerce "with foreign nations." 15 U.S.C. § 44. Thus, the FTC Act under *Nieman's* logic can only be interpreted to express a Congressional intent to allow extraterritorial application of the FTC Act. At the time of the *EEOC* decision, Title VII did not provide this clear intent of Congress, because it did not specifically state that it covered commerce with "foreign nations." Moreover, shortly after the Supreme Court decided *EEOC,* Congress amended Title VII to ensure it would have extraterritorial application[FN11] by adding language similar to the FTC Act. If adding the language "in a foreign country" is sufficient to provide the extraterritorial application that Congress intended for Title VII, then obviously the FTC Act definition of commerce to include commerce with "foreign nations," is sufficient to give extraterritorial application to Section 5 of the FTC Act.

> FN10. *Neiman* was a private lawsuit, and the Federal Trade Commission had no role in briefing the issue of the extraterritorial application of the FTC Act. In any case, *Neiman* is an 11th Circuit case and is not controlling here.

> FN11. Dodge, *Understanding the Presumption Against Extraterritoriality,* 16 Berk. J. Int'l Law 85, 87 (1998).

Moreover, the *Neiman* court's dictum is contrary to other decisions brought under the prohibition of unfair and deceptive acts and practices contained in Section 5 of the FTC Act. In two cases brought by the FTC after *EEOC* - without any change in the relevant portion of the FTC Act - courts held that FTC had jurisdiction over unfair and deceptive acts or practices in sales to foreign consumers pursuant to Section 5 of the FTC Act. *FTC v. Magui Publishers, Inc.*, No. 91-55474, 1993 U.S. App. LEXIS 28684, at *13 (9th Cir. October 22, 1993) (holding the consumer protection provision of "the FTC Act confers jurisdiction over foreign sales"); *FTC v. Commonwealth Mktg. Group, Inc.*, 72 F. Supp. 2d 530, 545 (W.D. Pa. 1999) (finding offers for purchase and sales to foreign consumers were subject to the FTC Act).[FN12] In addition, the definition of "commerce" under which the Securities and Exchanges Commission ("SEC") enforces the securities laws is very similar to that in the FTC Act. The SEC Act defines commerce as commerce "among the several States, or between any foreign country and any State." 15 U.S.C. § 78c(17). This provision has also been held to permit extraterritorial enforcement of the securities laws by the SEC and private parties. *Alfadda v. Fenn*, 935 F.2d 475 (2d Cir. 1991); *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041 (2d Cir. 1983); *SEC v. Briggs*, 234 F. Supp. 618 (N.D. Ohio 1964) (reaffirming the longstanding rule that the SEC Act applies extraterritorially and that "[t]he whole spirit of these two statutes reflects ... a clear Congressional intent that process should be efficacious in foreign countries").

> FN12. In 1982, Congress amended Section 5 of the FTC Act to limit the extraterritorial enforcement of the FTC Act with regard to unfair methods of competition. 15 U.S.C. § 45(a)(3); Pub.L. 97-290. Congress left untouched the Commission's authority to pursue extraterritorial enforcement with regard to the agency's consumer protection mission, unfair and deceptive acts or practices. 15 U.S.C. § 45(a)(1). Because this case

is brought under the Commission's authority with respect to deceptive acts and practices, the limitation does not apply to this case. In any event, even if the amendment to Section 5 applied to the deceptive acts and practices alleged in this case, the extraterritorial application of Section 5 would be permitted under Section 5(a)(3)(A)(ii). 15 U.S.C. § 45(a)(3)(A)(ii).

The Defendants in this case are clearly engaged in "commerce among the several states and with foreign nations" and all of the deceptive activities in which they are engaged are subject to appropriate equitable relief ordered by the Court.

IV. *Appointment of A Special Master.*

As discussed in Section I above, the value of the product is not an issue in this proceeding. However, if the Court believes it is necessary to determine the value of the eCommerce Web Pak, the FTC contends that this is a task that must be assigned to a neutral third party with expertise in determining fair market value for determination. FTC proposes that the determination of value may be appropriately assigned to the Court's Receiver in this matter, Robb Evans and Robb Evans & Associates. Robb Evans testified at the Preliminary Injunction Hearing that he is competent to make this determination..

Appendix not available.

END OF DOCUMENT