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17 UNITED STATES DISTRICT COURT  
18 CENTRAL DISTRICT OF CALIFORNIA  
19 WESTERN DIVISION

20 FEDERAL TRADE COMMISSION,

21 Plaintiff

22 v.

23 BURNLOUNGE, INC.,  
a corporation;  
24 JUAN ALEXANDER ARNOLD,  
an individual;  
25 JOHN TAYLOR,  
an individual;  
26 ROB DEBOER,  
an individual; and  
27 SCOTT ELLIOTT,  
an individual;

28 Defendants.

Case No.

**MEMORANDUM OF POINTS AND  
AUTHORITIES IN SUPPORT OF  
PLAINTIFF'S APPLICATION FOR  
TEMPORARY RESTRAINING  
ORDER WITH CONDUCT  
PROHIBITIONS AND ASSET  
FREEZE, ORDER TO PRESERVE  
RECORDS AND PROVIDE  
BUSINESS AND FINANCIAL  
INFORMATION, AND ORDER TO  
SHOW CAUSE WHY A  
PRELIMINARY INJUNCTION  
SHOULD NOT ISSUE**

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1 **I. INTRODUCTION**

2 The Federal Trade Commission (“FTC”) is seeking a temporary restraining  
3 order (“TRO”) against Defendants BurnLounge, Inc. (“BurnLounge”), Juan  
4 Alexander Arnold, John Taylor, Rob DeBoer, and Scott Elliott. Since 2005,  
5 Defendants have marketed a pyramid scheme though out the country. Defendants  
6 recruit others into the scheme by selling product packages to them that include an  
7 Internet-based, virtual music store (“on-line store”). By joining BurnLounge,  
8 participants obtain the right to earn rewards for recruiting others into the scheme  
9 as well as for selling digital music through the on-line stores. Participants, who  
10 pay an additional monthly fee, can earn monetary rewards from BurnLounge and  
11 are known as “Moguls. The BurnLounge compensation program is based  
12 primarily on providing payments for the recruitment of new participants not retail  
13 sales of music, and the rewards for recruitment are essentially unrelated to retail  
14 sales of music. Such schemes are inherently deceptive and violate Section 5 of the  
15 Federal Trade Commission Act, 15 U.S.C. § 45(a). Through its very structure, the  
16 BurnLounge pyramid scheme will result in the majority of Moguls losing money  
17 and millions of dollars of consumer injury. Defendants also violate Section 5 of  
18 the FTC Act by misrepresenting the income to be earned through BurnLounge and  
19 failing to disclose that most Moguls will lose money. Plaintiff seeks a noticed *ex*  
20 *parte* TRO to stop Defendants’ illegal conduct, freeze their assets, require an  
21 accounting and expedited discovery and order that Defendants show cause why a  
22 preliminary injunction should not issue.

23 **II. VENUE**

24 Venue in this District is proper pursuant to Section 13(b)(2) of the Federal  
25 Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b)(2), and 28 U.S.C. § 1391.  
26 All Defendants do not reside in the same judicial district and a substantial portion  
27 of the events giving rise to the claim have occurred in the Central District of  
28 California. BurnLounge promotes, recruits, sells, and operates its business in the

1 Central District. (Gale ¶¶ 2-7, 9, Ex. 1-3, 8, pp. 1-2, 6-273, 318; Liggins ¶ 8, Ex.  
2 20, pp. 394, 493-96, 509; Marino ¶ 5, Ex. 33, pp. 886-87, 910; Menjivar ¶¶ 2, 7,  
3 Ex. 37, pp. 997-98, 1045, 1053.) In addition, its CEO, Juan Alexander Arnold,  
4 resides in the Central District. (Marino ¶ 5, Ex. 33, pp. 886, 915.)

### 5 III. THE PARTIES

6 Plaintiff **FTC** is an independent agency of the United States Government  
7 created by the FTC Act, 15 U.S.C. § 41 *et seq.* The FTC is charged *inter alia*,  
8 with enforcement of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), which  
9 prohibits unfair and deceptive acts and practices in and affecting commerce.

10 Defendant **BurnLounge** is a Delaware corporation (Liggins ¶ 3, Ex. 14-17,  
11 pp. 393, 398-417.) that began making sales in late 2005. (Jackson ¶ 6, Ex. 13, pp.  
12 347, 385.) In its first year of operation, BurnLounge was projected to have in  
13 excess of \$25 million in revenue, and it had sold 50,000 on-line stores. (Liggins  
14 Ex. ¶ 15, Ex. 27, pp. 396, 697, 703.)

15 The four individual defendants all promote the BurnLounge pyramid  
16 scheme. (*E.g.*, Gale ¶¶ 4-7, Ex. 1-2, pp. 2, 141-167, 219-41, 252-71; Jackson ¶¶  
17 3-6, Ex. 12-13, pp. 346-47, 352-72, 378-90; Liggins ¶¶ 6, 15, Ex. 18, 27, pp. 394-  
18 95; 422-43, 689-705; Marino ¶¶ 2, 5, Ex. 33, pp. 886-87, 894-96, 903-21;  
19 Menjivar ¶¶ 2, 7, Ex. 37, pp. 997-98, 1034-75.) Defendant Arnold is the CEO and  
20 Chairman of the Board of Directors of BurnLounge. (Menjivar ¶ 4, Ex. 36, pp.  
21 997, 999; Liggins ¶ 3, Ex. 15, pp. 393, 403; Gale ¶¶ 6-7, Ex. 2, pp. 2, 223-24.) He  
22 resides in the Central District of California and is the originator of the BurnLounge  
23 concept. (Marino ¶¶ 2-5, Ex. 33, pp. 886-87, 909, 915.) Defendant Taylor, who is  
24 a resident of Houston, Texas, is the number one Mogul in BurnLounge. (Liggins ¶  
25 12, Ex. 24, pp. 395, 608; Jackson ¶¶ 5-6, Ex. 13, pp. 346-47, 385.) He was  
26 projected to earn \$700,000 through BurnLounge in 2006. (Marino ¶¶ 2, 5, Ex. 33,  
27 pp. 886-87, 919.) Defendant DeBoer, is a resident of South Carolina, and has  
28 been involved with BurnLounge since late 2005. (Liggins ¶¶ 6, 10, Ex. 18, 22, pp.



1 394, 421-422, 441-42, 556; Gale ¶¶ 6-7, Ex. 2, pp. 2, 199, 202, 204.) The final  
2 defendant, Scott Elliott, who resides in Dallas, Texas, started with BurnLounge in  
3 January 2006. (Jackson ¶¶ 5-6 Ex. 13, pp. 346-47, 378-379; Liggins ¶ 7, Ex. 19,  
4 pp. 394, 483.)

#### 5 **IV. DEFENDANTS' PRACTICES**

##### 6 **A. The BurnLounge Program**

7 Defendants promote their scheme in a variety of ways, including  
8 websites, meetings, live conference calls, and prerecorded messages. The  
9 websites contain recorded audio and video messages explaining the program as  
10 well as written material such as a description of the BurnLounge compensation  
11 program. In addition, the websites contain telephone numbers of prerecorded  
12 messages that a customer can call to receive additional information concerning the  
13 program. Defendants have also conducted a nationwide campaign of recruitment  
14 meetings and telephonic conferences to solicit potential customers.<sup>1</sup>

15 Defendants present the opportunity to participate in the BurnLounge  
16 program as a timely way to profit on a shift in technology in the music industry  
17 from delivery through media (*i.e.*, compact disks) to delivery in digital format via  
18 the Internet. (Liggins ¶ 11, Ex. 23, pp. 395, 596; Marino ¶¶ 2, 5, Ex. 33, pp. 886-  
19 87, 903; Menjivar ¶¶ 2, 7, Ex. 37, pp. 997-98, 1054-59; Liggins Supp. ¶ 7, Ex. 41,  
20

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21 <sup>1</sup> This memorandum is supported by seven volumes of exhibits. These  
22 exhibits include the following: descriptions of the BurnLounge compensation  
23 program and other instructions on how the BurnLounge program works; transcripts  
24 of audio promotional material contained on websites; transcripts of prerecorded  
25 telephone messages and live conference calls. There are also transcripts of  
26 recruitment meetings held in New York, New York, Los Angeles, California,  
27 Lawrenceville, Georgia, Deerfield, Illinois and Vienna, Virginia. Finally, there are  
28 expert declarations by Dr. Peter Vander Nat who performed a detailed analysis of  
the compensation plan and the sales materials and concluded that the program is a  
pyramid scheme. This memorandum summarizes his conclusions, but his  
declarations, containing more details, are contained at pp. 1173-222 and 1306-10.  
Specific citations to these materials are provided herein as they are discussed.

1 pp. 1123, 1153.) Defendants claim that substantial incomes are being made by  
2 BurnLounge participants. (*See infra* pp. 12-14.) As validation of the company's  
3 offerings, BurnLounge touts its licenses with major record labels to sell music,  
4 affiliations with corporate sponsors such as Cadillac and Nokia, and the  
5 participation of some music and sports celebrities as BurnLounge retailers, such as  
6 Justin Timberlake and Shaquille O'Neal. (Liggins ¶¶ 9, 14, 20, Ex. 21, 26, 32, pp.  
7 394-96, 535-36, 679, 861-62, 879; Marino ¶¶ 2, 5, Ex. 33, pp. 886-87, 894, 907;  
8 McKenney ¶¶ 2, 6, Ex. 35, pp. 924-25, 974-75.)

9 BurnLounge offers product packages for sale at prices that range from  
10 \$29.95 to \$429.95 before sales tax.<sup>2</sup> (Gale ¶¶ 8, 11, Ex. 5, 10, pp. 3-5, 275, 333-  
11 34; Liggins 2nd Supp. ¶ 5, Ex. 47, pp. 1228, 1298-99.) All packages include the  
12 right to use proprietary software through which the participant operates an on-line  
13 store. Through the on-line stores, BurnLounge sells digital music to consumers.  
14 Consumers purchase the music and receive a digital copy by downloading it  
15 through the Internet. (Gale ¶¶ 9, 11, Ex. 8, 10, pp. 4-5, 284, 327, 333; Liggins 2nd  
16 Supp. ¶ 5, Ex. 46-47, pp. 1228, 1250, 1293, 1297.) According to BurnLounge, it  
17 has licensed more than two million song titles from independent and major record  
18 labels. (Gale ¶¶ 4-5, Ex. 1, pp. 2, 87; Liggins ¶ 11, Ex. 23 pp. 395, 597.)

19 There are two basic classes of BurnLounge participants who operate its on-  
20 line stores: "Retailers" and "Moguls." (Gale ¶¶ 9, 11, Ex. 8, 10, pp. 4-5, 287, 328,  
21 333; Liggins 2nd Supp. ¶¶ 4-5, Ex. 46-47, pp. 1228, 1253, 1294, 1297.) All who  
22 acquire a product package become a Retailer. (*Id.*) Retailers who want to earn  
23 monetary rewards must become a Mogul. To become a Mogul, a Retailer must be  
24 at least 18 years old and agree to pay an additional monthly fee of \$6.95. (Gale ¶¶  
25 8-9, 11, Ex. 5, 8, 10, pp. 3-5, 275, 287-88, 313, 334; Liggins ¶ 10, Ex. 22, pp. 395,  
26

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27 <sup>2</sup> In 2007, BurnLounge also began offering a free product package.  
28 (*Compare* Gale ¶ 11, Ex. 10, pp. 4-5, 333-34 *with* Liggins 2nd Supp. ¶¶ 3, 5, Ex.  
47, pp. 1227-28, 1298.)

1 560-561; Liggins 2nd Supp. ¶¶ 4-5, Ex. 46-47, pp. 1228, 1253-54, 1299.) Only  
2 Retailers who purchase a product package (“a paid product package”), as opposed  
3 to acquiring a free one, are eligible to become a Mogul. (Liggins 2nd Supp. ¶¶ 4-  
4 5, Ex. 46-47, pp. 1228, 1253, 1299.)

5 BurnLounge offers three paid product packages: (1) the Basic Package,  
6 which sells for \$29.95 per year; (2) the Exclusive Package for \$129.95 per year  
7 plus \$8 per month; and (3) the VIP Package for \$429.95 per year plus \$8 per  
8 month. (Gale ¶¶ 8-9, 11, Ex. 5, 8, 10, pp. 3-5, 275, 312, 333-334; Liggins 2nd  
9 Supp. ¶ 5, Ex. 47, pp. 1228, 1298-99.) The first \$29.95 charged for each of these  
10 product package pays for the on-line store. (Gale ¶¶ 8-11 Ex. 5, 8-10, pp. 3-5,  
11 275, 310, 327, 330, 337.) More expensive packages provide the participant with  
12 add-ons such as DVDs about the music industry, downloadable music selected by  
13 the company, and preferred seating and entry to select concert venues (Liggins  
14 ¶ 16, Ex. 18, pp. 394, 437; Gale ¶¶ 4-5, 9, 11, 12, Ex. 1, 8, 10, 11, pp. 2-5, 64, 89-  
15 90, 327, 333-34, 342-45), but more importantly they provide a participant with an  
16 increased ability to earn rewards through the compensation program. (Gale ¶¶ 9-  
17 11, Ex. 8, 10, pp. 4-5, 287-88, 308-09, 312-313, 338; Vander Nat ¶ 21, pp. 1182-  
18 83; Liggins 2nd Supp. ¶¶ 4-5, Ex. 46-47, pp. 1228, 1253-54, 1302-03.) By far the  
19 largest rewards for recruitment are provided to Moguls who purchase the \$429.00  
20 VIP package. (Vander Nat, ¶¶ 19, 21-22, pp. 1182-83.) Promoters of  
21 BurnLounge stress this package (e.g., Liggins ¶¶ 6, 7, 10, 11, 13, 14, 16, 17, 20,  
22 Ex. 18, 19, 22, 23, 25, 26, 28, 29, 32, pp. 394-96, 437, 461-62, 566, 569-70, 598,  
23 654, 672-73, 715, 753, 868; Jackson ¶¶ 3-6, Ex. 12, 13, pp. 346-47, 355, 385;  
24 Liggins Supp. ¶ 7, Ex. 41, 43, pp. 1122-24, 1154, 1166-71; Liggins 2nd Supp. ¶ 2,  
25 Ex. 45, pp. 1227, 1233-34.), as do promotional and training materials. (Liggins  
26 2nd Supp. ¶¶ 3-4, 7, Ex. 39 [encouraging participants to “sponsor, sponsor,  
27 sponsor” by hosting weekly “VIP Mixers”], 40 [“V.I.P. package . . . maximizes  
28 profits], 43 [“New VIP Retailer Playbook”], pp. 1139-45, 1147, 1166-71.)

1 All participants can earn points under the BurnLounge compensation  
2 program (Gale ¶¶ 9, 11, Ex. 8, 10, pp. 4-5, 307, 316, 335; Liggins 2nd Supp. ¶¶ 4-  
3 5, Ex. 46-47, pp. 1228, 1274, 1300), which has two parts: (1) bonuses for  
4 recruitment, and (2) Concentric Retail. (*See infra* pp. 6-8.) Retailers can redeem  
5 the points for purchases through their on-line stores. Only Moguls can redeem the  
6 points for dollars. (Gale ¶¶ 9, 11, Ex. 8, 10, pp. 4-5, 307, 316, 335; Liggins 2nd  
7 Supp. ¶¶ 4-5, Ex. 46-47, pp. 1228, 1274, 1283, 1300.) For Moguls, one point  
8 equals one dollar. (Gale ¶ 11, Ex. 10, pp. 4-5, 335; Liggins 2nd Supp. ¶5, Ex. 47,  
9 pp. 1228, 1300.)

10 **i. BurnLounge Pays Recruitment Bonuses.**

11 BurnLounge pays two types of recruitment bonuses. These bonuses are  
12 earned from selling BurnLounge packages to new recruits. BurnLounge calls  
13 these “Product Package Bonuses” and “Mogul Bonuses.” (Gale ¶¶ 9, 11, Ex. 8,  
14 10, pp. 4-5, 312-313, 337-341; Liggins 2nd Supp. ¶¶ 4-5, Ex. 46-47, pp. 1228,  
15 1278-79, 1302.)

16 There are three Product Package Bonuses, which are earned by selling  
17 BurnLounge product packages with the same name. These three bonuses are: (1)  
18 the Basic Bonus; (2) the Exclusive Bonus; and (3) the V.I.P. Bonus. (*Id.*) These  
19 bonuses are respectively \$10, \$20, \$50 when paid to Moguls. To qualify to earn  
20 Product Package Bonuses, the participant must have sold two albums to non-  
21 Moguls in the prior calendar month with the exception that during the first month  
22 the requirement is waived. (Gale ¶ 9, 11, Ex. 8, 10, pp. 4-5, 308, 338; Liggins 2nd  
23 Supp. ¶ 4, Ex. 46, pp. 1228, 1275-76, 1278.)

24 The second type of recruitment bonus is the Mogul Bonus. This bonus is  
25 only paid to Moguls and is earned through sales of Exclusive and VIP Packages.  
26 (Gale ¶ 9, 11, Ex. 8, 10, pp. 4-5, 312-313, 338-339; Liggins 2nd Supp. ¶¶ 4-5, Ex.  
27 46-47, pp. 1228, 1279, 1302-04.) The Mogul Bonus is based on a binary  
28 structure. In a binary structure, each participant has a position in the pyramid

1 immediately below which are two other positions filled by subsequent recruits. As  
2 a result, each participant in the binary structure has the potential to develop two  
3 teams of subsequent or “downline” recruits. (Vander Nat ¶¶ 16, 35, pp. 1180,  
4 1193; Gale ¶¶ 6, 7, 11, Ex. 2, 10, pp. 2, 4-5, 261, 340-41; Liggins 2nd Supp. ¶¶ 4-  
5 5, Ex. 46-47, pp. 1228, 1279, 1304.) The Mogul Bonus rewards a Mogul not only  
6 based on his sales of VIP and Exclusive Packages, but also on sales of those  
7 packages by that Mogul’s downline in the binary structure. (Gale ¶¶ 9, 11, Ex. 8,  
8 10, pp. 4-5, 312-13, 340; Vander Nat ¶ 33, p. 1192; Liggins 2nd Supp. ¶¶ 4-5, Ex.  
9 46-47, pp. 1228, 1279, 1304.)

10 In order to qualify to earn a Mogul Bonus, a Mogul must meet the following  
11 one-time requirements: (1) recruit two other participants by selling them either the  
12 Exclusive or VIP Package and (2) sell two albums to non-Moguls. (Gale ¶ 9, 11,  
13 Ex. 8, 10, pp. 4-5, 308-310, 338-339; Liggins 2nd Supp. ¶¶ 4-5, Ex. 46-47, pp.  
14 1228, 1253-54, 1275, 1303.) To remain qualified to earn the Mogul Bonus, the  
15 only on-going sales requirement is two albums per month to non-Moguls. The  
16 album sales requirement is waived during the first month. (*Id.*)

17 Mogul Bonuses are earned through a point system. Sale of an Exclusive  
18 Package generates 100 points and sale of the VIP package generates 400 points for  
19 the Mogul who makes the sale and for each Mogul in his or her upline (Gale ¶ 9,  
20 11, Ex. 8, 10, at pp. 4-5, 312-13, 339-41; Liggins 2nd Supp. ¶¶ 4-5, Ex. 46-47, pp.  
21 1228, 1279, 1304), i.e., Moguls located in a direct line in the binary structure  
22 above the Mogul actually making the sale. The points are accrued by the Mogul  
23 making the sale and his upline once the new recruit sells two albums. (Liggins  
24 ¶ 19, Ex. 31, pp. 396, 836-37.) In order to earn a Mogul Bonus, the Mogul must  
25 accumulate 300 points in each of the two teams. (Gale ¶ 9, 11, Ex. 8, 10, pp. 4-5,  
26 312-313, 340; Liggins 2nd Supp. ¶¶ 4-5, Ex. 46-47, pp. 1228, 1279, 1305.) The  
27 amount of the Mogul Bonus varies from \$25 to \$50 depending upon the package  
28 the Mogul purchased and in some cases music sales. (Gale ¶ 9, 11, Ex. 8, 10, pp.

1 4-5, 312, 338; Liggins 2nd Supp. ¶¶ 4-5, Ex. 46-47, pp. 1228, 1279, 1302.) The  
2 Mogul Bonus is a powerful incentive to recruit because it rewards a Mogul for his  
3 recruitment and that of his downline.

4 **ii. Concentric Retail**

5 Concentric Retail, the other part of the compensation program, provides  
6 rewards for product sales through on-line stores. BurnLounge defines “product”  
7 to include digital music downloads, the first \$29.95 of each of the three  
8 BurnLounge packages, and the \$8 monthly fee paid as part of the Exclusive and  
9 VIP Packages. (Gale ¶ 9, 11, Ex. 8, 10, pp. 4-5, 310, 337; Liggins 2nd Supp. ¶¶ 4-  
10 5, Ex. 46-47, pp. 1228, 1277, 1301.) As a result, Concentric Retail also provides  
11 rewards for recruitment. In addition, Retailers and Moguls earn half a point (50¢  
12 cents for Moguls) per album sale priced \$9.90 to \$19.79 or 20 percent of  
13 BurnLounge’s profit margin on the sale, whichever is greater, sold through their  
14 on-line stores. (Gale ¶ 9, 11, Ex. 8, 10, pp. 4-5, 309, 311, 335-337; Liggins 2nd  
15 Supp. ¶¶ 4-5, Ex. 46-47, pp. 1228, 1277-78, 1300-01.) When specified levels of  
16 recruitment and product sales are satisfied, Concentric Retail also rewards  
17 Retailers and Moguls for product sales by others whom they directly recruit or  
18 who are related to them indirectly through subsequent recruitment up to six levels  
19 away. (*Id.*)

20 **iii. BurnLounge Rewards Recruitment Over Music Sales.**

21 BurnLounge provides decisively larger rewards for recruiting than for retail  
22 sales of digital music. (Vander Nat ¶¶ 9, 48, 68, pp. 1176, 1203, 1218-19.) For  
23 example, while BurnLounge pays Product Package Bonuses of \$10 to \$50 for  
24 selling the Product Packages, it only guarantees a minimum commission of 50¢  
25 for the sale of a \$9.90 album. (*See supra* pp. 6-8.) In addition, BurnLounge pays  
26 Mogul Bonuses that rewards recruitment. As the binary structure grows through  
27 recruiting, the Mogul Bonus dwarfs other forms of compensation. (Vander Nat  
28 ¶¶ 9, 48, 68, pp. 1176, 1203, 1218-19.)

1 The declaration of Plaintiff's expert witness, Peter Vander Nat, Ph.D.,  
2 demonstrates that the BurnLounge compensation program is constructed to  
3 provide much greater rewards from recruitment than for selling music. As part of  
4 his analysis, Dr. Vander Nat calculated rewards that would be paid under the  
5 BurnLounge compensation program assuming that (1) a new Mogul, John Doe,  
6 had purchased a VIP package and satisfied the minimum qualifications to earn  
7 Mogul Bonuses by selling two VIP packages and two albums, and (2) each new  
8 Mogul who purchased a VIP package from John Doe also bought a VIP package  
9 and qualified for the Mogul Bonus in same way and their recruits did the same  
10 thing, and so forth. (Vander Nat ¶ 31, Table I, pp. 1190-91.) Under these  
11 assumptions, the binary structure would grow exponentially by a power of two.  
12 After ten levels of recruitment, John Doe would have 2046 Moguls in his  
13 downline (Vander Nat, ¶ 32, Table I, pp. 1191), and BurnLounge would pay \$17  
14 in Mogul and Package Bonuses for every \$1 of required retail sales of music.  
15 (Vander Nat ¶ 9, 46-47, pp. 1176, 1200-01.) Moreover, BurnLounge would have  
16 to pay \$346 in such bonuses for every \$1 of earnings based of retail sales of  
17 music. (Vander Nat ¶ 9, 48, pp. 1176, 1203.)

18 Dr. Vander Nat also examined the relative compensation provided under the  
19 BurnLounge compensation program for recruitment and music sales assuming that  
20 a VIP Mogul satisfied the requirements of Concentric Retail in order to earn  
21 commissions at the highest level, i.e., each participant recruited six new  
22 participants and satisfied the music sales qualifications for Concentric Retail to  
23 earn at the highest level. (Vander Nat ¶¶ 67-68, pp. 1216-19.) With these  
24 assumptions, Dr. Vander Nat concluded that 90% of the compensation paid under  
25 Concentric Retail would arise from product package sales that are part and parcel  
26 of recruitment. Using the same assumptions, Dr. Vander Nat also concluded that  
27 of the total compensation received by such a participant from recruitment bonuses  
28 and Concentric Retail virtually all would be based upon recruitment of others.

1 (Vander Nat ¶ 68, pp. 1218-19.) From the foregoing, it can be seen that the  
2 BurnLounge compensation program is constructed to provide lopsided rewards for  
3 recruitment in comparison to those provided for music sales.

4 The importance of recruitment over retail sales of music in the  
5 compensation program is apparent in promotional and training materials that dwell  
6 on earnings from selling product packages and pay little attention to earnings from  
7 retail sales of music. (Liggins 2nd Supp. ¶¶ 4, 7, Ex. 40, 43, pp. 1147, 1166-71;  
8 *see also* Vander Nat ¶¶ 27-28, pp. 1185-88.) It is also exemplified in the  
9 following statements by Defendants DeBoer and Elliott:

10 Yes, we sell music, but my focus will never be the 99-cent low  
11 margin product. It will be the \$440 business that I'm putting people  
12 on my team, showing them how to sell music.

13 (Liggins ¶ 13, Ex. 25, pp. 395, 654.)

14 You make a nickel a song, That's why I'm telling you our focus is  
15 not the masses on music.

16 (Liggins ¶ 6, Ex. 18, pp. 394, 434.)

17 Is it about driving huge traffic to a website? No, it's not. It's about  
18 tying the business community to a brand, then utilizing the sphere of  
19 influence of that business community to drive \$20 of business per  
20 month.

21 (Jackson ¶¶ 5-6, Ex. 13, pp. 346-47, 383.) In summary, under the BurnLounge  
22 compensation program, music is a low profit item, and it is not the focus of sales.  
23 Instead, the focus is on selling the \$440 business, i.e., the VIP package.  
24 BurnLounge is not about driving huge traffic to the on-line stores to sell music.  
25 Instead, it is about selling the minimum amount of music per month (\$20) in order  
26 to qualify for the potentially lucrative recruitment bonuses on the sale of the  
27 product packages.

28 **iv. Break-even Analysis**



1 While the compensation plan provides lucrative rewards to a select few for  
2 recruiting others, at any point in time the vast majority of BurnLounge Moguls  
3 will not have recouped their investment. (Vander Nat ¶¶ 14, 32, 41-43, pp. 1179,  
4 1192, 1198-99.) Again, this is easily demonstrated. Because Moguls pay a  
5 monthly fee, their investment increases with time, as does the break-even point.  
6 For simplicity and to view the compensation plan in the light most favorable to  
7 BurnLounge, we assume that the break-even point is reached during the first  
8 month and the amount invested equals the initial outlay to purchase a BurnLounge  
9 package. With this assumption and the assumptions from the example about John  
10 Doe in the preceding section, it is true that the recruits who populate the bottom  
11 three levels of the binary structure will not have recouped their investment.  
12 (Vander Nat ¶¶ 41-42, pp. 1198-99.) When there are less than ten levels, the  
13 percentage of participants in the bottom three levels is more than 87.5%. (Vander  
14 Nat ¶ 42 fn. 19, p. 1199.) When there are ten levels or more to the binary  
15 structure below the top position, the bottom three levels contain 87.5% of the  
16 participants. (Vander Nat ¶¶ 41-42, pp. 1198-99.)

17 Relaxing some of the assumptions of the foregoing example only increases  
18 the rate of those failing to recoup their investment. For instance, the foregoing  
19 example assumes optimal recruitment, *i.e.*, all recruits are successful in obtaining  
20 balanced recruitment and therefore balanced points. If in reality some recruits fail  
21 to achieve balanced points, the percentage of those failing to recoup their  
22 investment will be even higher. (Vander Nat ¶ 31, p. 1190.) Similarly, the  
23 foregoing analysis assumes sales of VIP packages, which is the package  
24 emphasized by promoters. (*See supra* p. 5.) If instead it were assumed that  
25 recruits in the downline of John Doe Mogul purchased either the VIP package or  
26 the less expensive Exclusive package, the percentage of those failing to recoup  
27 their investment would also increase. (Vander Nat ¶ 42 fn. 20, p. 1199.) As a  
28

1 result, it is clear that the vast majority of Moguls will not recoup their investment.<sup>3</sup>  
2 (Vander Nat ¶ 42, p. 1199.)

3 **B. Representations Regarding Potential Income**

4 A theme of the presentations regarding BurnLounge is that participants can  
5 make substantial income by participating. For example, Defendants have made  
6 claims of profitability such as the following at meetings throughout the country as  
7 well as during live and prerecorded telephone conference calls promoting  
8 BurnLounge or training its participants:

9 **Alex Arnold**

10 [I]f you build a community that sells a few movies and sells a few  
11 games and sells a few downloads, you will have a license to print  
12 money. . . . J.T. made \$50,000 two weeks ago. He's going to make  
13 probably \$700,000 this year, and he's a good old boy from Texas that  
14 can't read.

15 (Marino ¶¶ 2, 5, Ex. 33, pp. 886-87, 918-19.)

16 In this industry, direct sales, I created a seven-figure income by the  
17 time I was 25 years-old, and now, I plan on doing that for hundreds,  
18 thousands of people worldwide selling entertainment and digital  
19 content over the course of the next three years.

20 (Gale ¶¶ 4, 5, Ex. 1, pp. 2, 162.)

21 **John Taylor**

22 [O]ver the last six months, I've had a chance to generate well over  
23 \$340,000 in income. In the last 30 days, it was over \$70,000. . . .

24 . . . .

---

25  
26 <sup>3</sup> The inevitability of losses for those at the bottom of the pyramid does  
27 not depend upon saturation having been reached for potential participants. Rather,  
28 it exists for whatever time period which is being considered. (Vander Nat ¶ 43, pp.  
1199-200.)

1           So, Scott [Elliott], you know, seven people in the company  
2           have - - you know, I've had a chance to work with that have  
3           generated well over \$200,000 in the last six months. We've got  
4           residual checks in the company right now today that are a six-figure  
5           income, well over six figures.

6 (Liggins ¶ 7, Ex. 19, pp. 395, 479-80.)

7           Some of you in this room are worth millions. There's some of you in  
8           this room that want to make money. There's some of you in here that  
9           are looking for 1,000 a month, looking for 1,000 a week, and there's  
10          some of you looking for 1,000 a day. Just depends on what you want  
11          out of this business.

12 (Menjivar ¶ 7, Ex. 37, pp. 998, 1045-46.)

13           **Rob DeBoer**

14          Guys, we've made just under \$300,000. Todd Ellis' next door  
15          neighbor has made \$280,000. We've got a dozen people that have  
16          made over \$100,000.

17 (Liggins ¶ 6, Ex. 18, pp. 441-42.)

18          [M]y 10 best friends who have never done anything like this, didn't  
19          know anything about the industry, they've all made between 1 and  
20          \$300,000 in the last seven months. In Columbia. You guys live in  
21          Chicago.

22 (McKenney ¶¶ 2, 6, Ex. 35, pp. 924-25, 972-73.)

23          And for a low entry level of \$450 to participate and get the support  
24          and help with proven retailers that have already maximized the  
25          business model, that have already earned tens of thousands and  
26          hundreds of thousand of dollars with, frankly, an inferior product.

27 (Liggins Supp. ¶ 7, Ex. 41, pp. 1123, 1156.)

28           **Scott Elliott**

1 Our professional BurnLounge team is then available to answer all  
2 questions on your behalf until we drive your personal income to  
3 \$1,000 per week.

4 (Liggins ¶ 11, Ex. 23, pp. 395, 601.)

5 I'm sitting in this room here in Los Angeles with 40 of the top leaders  
6 from across the country, individuals generating 5,000 a week,  
7 \$10,000 per week, \$20,000 per week and more in a matter of an eight  
8 month period. Now, I'm not saying that's going to happen for  
9 everyone. I'm not saying that there's any guarantees here. What I  
10 am saying is that you have before you right now today the ability to  
11 create wealth in your life.

12 (Jackson ¶¶ 5-6, Ex. 13, pp. 346-47, 388-89.)<sup>4</sup> As set forth in Section V. B, *infra*  
13 pp. 17-18, Defendants' income representations are deceptive because the vast  
14 majority of participants will not realize such income from the pyramid scheme.

## 15 **V. DEFENDANTS HAVE VIOLATED SECTION 5 OF THE FTC ACT**

### 16 **A. Defendants Are Promoting a Pyramid Scheme**

---

17  
18 <sup>4</sup> See also Liggins ¶¶ 8, 10-11, 14, 16-20 (pp. 394-96), Ex. 20, pp. 492,  
19 497-99, 501-02, 509, 519-20 (Taylor: various six and seven-figure incomes), Ex.  
20 22, p. 555 (Taylor: very, very healthy six-figure income), Ex. 23, p. 600 (Elliott:  
21 \$20,000 per week), Ex. 26, pp. 678-80 (Taylor: \$1,000 a week to six-figures), Ex.  
22 28, pp. 728-29, 734 (Taylor: \$6,000 a week to \$40,000 a month to six-figures), Ex.  
23 29, pp. 742, 746-48, 756, 759 (Elliott: \$1,000 to \$20,000 per week and more), Ex.  
24 30, pp. 770-71 (Taylor: \$25,000 per week and \$50,000 to \$100,000 per month),  
25 Ex. 31, p. 804 (Taylor: low six-figures to high six figures and closing in on seven-  
26 figures), Ex. 32, pp. 880-82 (Taylor: \$1,000 a week to \$5,000 a day); Marino ¶¶  
27 2, 5, Ex. 33, pp. 886, 895, 904, 911, 916-19 (DeBoer: six-figure incomes in six  
28 months. Taylor: \$1,000 a day. Arnold: "paying people 10, 25, \$50,000 a  
month"); Liggins Supp. ¶ 7, Ex. 42-43, pp. 1123-24, 1163, 1171 (Defendant  
DeBoer encourages others to download the "New VIP Retailer Playbook" showing  
levels of rewards for recruiting through sales of VIP packages, such as \$550,  
\$6,500 and \$45,000); Liggins 2nd Supp. ¶ 2, Ex. 45, pp. 1227, 1241 (DeBoer:  
potentially earn thousands, tens of thousands, hundreds of thousands).

1 BurnLounge is operating a pyramid scheme. (Vander Nat ¶¶ 14, 50 , pp.  
2 1179, 1203-04; Vander Nat Supp. ¶ 2, p. 1306.) Such schemes have an  
3 “intolerable capacity to mislead,” and “the Federal Trade Commission Act forbids  
4 such tactics.” *Koscot Interplanetary, Inc.*, 86 FTC 1106, 1180-82 (1975), *aff’d*  
5 *mem. sub nom, Turner v. FTC.*, 580 F.2d 701 (D.C. Cir. 1978). Pyramid schemes  
6 are “characterized by the payment by participants of money to the company in  
7 return for which they receive (1) the right to sell a product *and* (2) the right to  
8 receive in return for recruiting other participants into the program rewards which  
9 are unrelated to the sale of product to ultimate users.” *Koscot*, 86 FTC at 1180  
10 (emphasis in original). Adopting the *Koscot* standard, the Ninth Circuit has stated  
11 that the reference in *Koscot* to rewards for recruitment “unrelated to the sale of  
12 products to ultimate users” concerns sales to ultimate users outside the pyramid.  
13 *See Webster v. Omnitrition International, Inc.*, 79 F.3d 776, 783 (9th Cir. 1996).  
14 According to the Ninth Circuit, the right to receive rewards for recruitment is the  
15 *sine qua non* of a pyramid scheme.

16 As is apparent, the presence of the second element, recruitment with  
17 rewards unrelated to product sales, is nothing more than an elaborate chain  
18 letter device in which individuals who pay a valuable consideration with the  
19 expectation of recouping it to some degree via recruitment are bound to be  
20 disappointed.

21 *Webster*, 79 F.3d at 781 (quoting *Koscot*, 86 FTC at 1180). “The promise of  
22 lucrative rewards for recruiting others tends to induce participants to focus on the  
23 recruitment side of the business at the expense of their retail marketing efforts,  
24 making it unlikely that meaningful opportunities for retail sales will occur.”  
25 *Webster*, 79 F.3d at 782. “Pyramid schemes are said to be inherently fraudulent  
26 because they must eventually collapse.” *Webster*, 79 F.3d at 781.

27 In the instant case, the most lucrative rewards offered by BurnLounge are  
28 bonuses for recruitment. (*See supra* pp. 8-10.) As demonstrated by Dr. Vander

1 Nat's analysis, if participants do only what they are required to do to earn Mogul  
2 Bonuses, BurnLounge would be obligated to pay \$346 in recruitment bonuses for  
3 every \$1 of commission on music sales. (Vander Nat ¶ 9, 48, pp. 1176, 1203.)  
4 Furthermore, even if participants sell more music so that they earn at the highest  
5 level of commissions in Concentric Retail, virtually all the rewards they would  
6 earn would be tied to recruitment through package sales. (*See supra* p. 10.)  
7 Clearly, the BurnLounge compensation program is based primarily on providing  
8 payments for the recruitment of new participants not on retail sales of music.

9 It is also true that the bonuses driving recruitment have no meaningful retail  
10 basis in music sales. (Vander Nat ¶ 12, pp. 1178.) The only retail requirement  
11 that BurnLounge imposes through its compensation program is the requirement of  
12 two album sales per month. (*See supra* pp. 6-7.) As demonstrated by Dr. Vander  
13 Nat's analysis, if participants undertake only what they are required to do,  
14 BurnLounge is obligated under its compensation program to pay \$17 in Mogul and  
15 Package Bonuses for each \$1 of required albums sales. (Vander Nat ¶¶ 9, 46-47,  
16 pp. 1176, 1200-01.) Obviously, the album sales cannot be the funding source of  
17 the Mogul and Package Bonuses.<sup>5</sup> Instead, the source of these monetary rewards  
18 is progressive recruitment of new participants. (Vander Nat ¶ 12, p. 1178.) As a  
19 result, the recruitment bonuses are not related to retail sales of albums in any  
20 meaningful way.<sup>6</sup> In summary, Defendants promote a pyramid scheme.

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21  
22 <sup>5</sup> This is especially true in light of the fact that BurnLounge retains only  
23 a fraction of each dollar of albums sales because it must pay the cost of the music  
24 to the copyright holder. At most, BurnLounge retains its gross margin on such  
25 sales. Moreover, BurnLounge represents that it pays 60% of its gross margin as  
26 compensation through Concentric Retail leaving only 40% of the gross margin for  
27 other uses. (Gale ¶¶ 4-5, Ex. 1, pp. 2, 124; Liggins ¶ 19-20, Ex. 31-32, pp. 396,  
28 828-29, 874.)

<sup>6</sup> Defendant DeBoer has instructed through a prerecorded voice on  
demand system that participants can actually give money to others, such as a

1           **B.     Income Misrepresentations**

2           Defendants’ use of income claims is deceptive. An act or practice is  
3 deceptive under Section 5(a) of the FTC Act when “first, there is a representation,  
4 omission, or practice that, second, is likely to mislead consumers acting  
5 reasonably under the circumstances, and third, the representation, omission, or  
6 practice is material.” *Cliffdale Associates, Inc.*, 103 F.T.C. 110, 164-65 (1994)  
7 *cited with approval in FTC v. Pantron*, 33 F.3d 1088, 1095 (9th Cir. 1994).

8           Defendants claim that participants have and can make substantial earnings.  
9 (*See supra* pp. 12-14.) Defendants’ income claims are misleading because the  
10 majority of participants in the pyramid scheme will not breakeven, even if it is true  
11 that some BurnLounge participants make the substantial incomes that are  
12 described. *See Nat’l Dynamics Corp. v. FTC*, 492 F. 2d 1333, 1335 (2nd Cir.  
13 1974) (where the Second Circuit opined that an advertiser should “not make  
14 deceptive use of unusual earnings realized only by a few.”); *Five-Star Auto Club,*  
15 *Inc.*, 97 F. Supp. 2d 502, 529 (S.D.N.Y. 2000); *see also FTC v. Arlington Press,*  
16 *Inc.*, 1999-1 Trade Cas. (CCH) ¶ 72,415 (C.D. Cal. 1999)(“Even if . . . literally  
17 true, a representation will be found to be deceptive and in violation of Section 5 of  
18 the FTC Act if its net impression is likely to mislead consumers.”). Income claims  
19 are also material.

20           BurnLounge is liable for the use of income claims by the individual  
21 defendants. This is true because the individual defendants are either actual or  
22 apparent agents of BurnLounge. *See FTC v. Goodman*, 244 F.2d 584, 592 (9th  
23 Cir. 1957) Alex Arnold, as CEO of BurnLounge, is its actual agent. The other

24 \_\_\_\_\_  
25 spouse or a neighbor’s child, so they can purchase albums from BurnLounge in  
26 order to satisfy a participant’s minimum sales requirement. (Liggins Supp. ¶ 7, Ex.  
27 41, pp. 1123, 1154-55.) Such sales cannot serve as a basis for showing a  
28 relationship between the recruitment rewards and sales to “ultimate users” under  
*Koscot*. Sales to a participant, even when disguised, are not sales to an “ultimate  
users” within the meaning of *Koscot*. *See Webster*, 79 F.3d at 783.

1 individual defendants, who are all BurnLounge participants, are apparent agents  
2 when making misleading income claims. If a “consumer believes the agent has  
3 been empowered by the principal to make the representations in question,”  
4 *Southwest Sunsites, Inc.*, 105 F.T.C. 7, 158 (1985), apparent agency exists. In the  
5 instant matter, Moguls do not buy inventory for resale. They simply act as barkers  
6 to attract business to BurnLounge. To join BurnLounge, a new recruit must  
7 register and make payment through the BurnLounge website and enter into an  
8 agreement with BurnLounge. (Gale ¶¶ 8-10, Ex. 3-10, pp. 2-5, 273-341.) Part of  
9 the agreement is agreement to terms stated in several documents, three of which  
10 prominently show the BurnLounge name and logo. (Gale ¶¶ 9, 11, Ex. 8, 10, pp.  
11 3-5, 283-329, 332-41.) By causing recruiting Moguls to solicit consumers to  
12 purchase a package from BurnLounge and to execute an agreement with  
13 BurnLounge, BurnLounge manifests to those consumers that the recruiting  
14 Moguls are agents to promote recruitment including making the income claims  
15 under consideration. As a result, BurnLounge is liable for the misrepresentation of  
16 income made by the individual Defendants.

### 17 **C. Failure to Disclose**

18 A material omission that is likely to mislead consumers acting  
19 reasonably under the circumstances is a deceptive act under Section 5. *FTC v.*  
20 *Pantron I Corp.*, 33 F.3d 1088, 1095. Failing, as Defendants have done, to  
21 disclose that the vast majority of participants in a multi-level marketing program  
22 have not earned substantial incomes is deceptive in violation of Section 5 of the  
23 FTC Act. *Five-Star Auto Club*, 97 F. Supp.2d at 531-32.

### 24 **D. Liability of Individual Defendants**

25 Defendants Arnold, Taylor, DeBoer and Elliot are individually liable for the  
26 violations of the FTC Act described herein. In order to establish their individual  
27 liability, it is sufficient for Plaintiff to show (1) that BurnLounge committed  
28



1 deceptive acts or practices in violation of Section 5 of the FTC Act, 15 U.S.C.  
2 § 45(a), of a kind usually relied on by reasonably prudent persons and that  
3 consumer injury resulted, (2) that the individual defendants participated directly in  
4 the wrongful practices or acts or that they had authority to control BurnLounge,  
5 and (3) that the individual defendants had some knowledge of the wrongful acts or  
6 practices. *See FTC v. Gill*, 265 F.3d 944, 958 (9th Cir. 2001); *FTC v. Affordable*  
7 *Media, LLC*, 179 F.3d 1228, 1234 (9th Cir. 1999); *FTC v. Publ’g Clearing House,*  
8 *Inc.*, 104 F.3d 1168, 1170 (9th Cir. 1997). The FTC need not establish that the  
9 individuals possessed the intent to defraud. *Publ’g Clearing House*, 104 F.3d at  
10 1171; *FTC v. Amy Travel Service, Inc.*, 875 F.2d 564, 573-74 (7th Cir. 1989). Nor  
11 must the FTC establish that Defendants had actual knowledge of the  
12 misrepresentations. Reckless indifference to the truth or falsity of the  
13 representations or an awareness of a high probability of fraud coupled with an  
14 intentional avoidance of the truth will suffice. *Affordable Media*, 179 F.3d at  
15 1234; *Publ’g Clearing House*, 104 F.3d at 1171.

16 The FTC need not show that consumers subjectively relied on the  
17 representations or omissions to show resulting injury. “[T]he FTC need merely  
18 show that the misrepresentations or omissions were of a kind usually relied upon  
19 by reasonable and prudent persons, that they were widely disseminated, and that  
20 the injured consumers actually purchased the defendant’s products.” *FTC v.*  
21 *Security Rare Coin & Bullion Corp.*, 931 F.2d 1312, 1316 (8th Cir. 1991). Such  
22 circumstance are present here. The misleading income claims have been widely  
23 disseminated by Defendants through meetings in various geographic locations,  
24 through telephone conference calls, and postings of prerecorded audio on the  
25 Internet, and many consumers have purchased.

26 Each of the individual defendants participated directly and extensively in  
27 the wrongful acts and had the required level of knowledge for liability. Alex  
28 Arnold, CEO and Chairman of the Board, is also liable for the additional reason

1 that he had the ability to control BurnLounge. The requisite knowledge can be  
2 inferred from the extensive involvement of the individual defendants in the  
3 practices under consideration. *See Amy Travel*, 875 F.2d at 574 (“[T]he degree of  
4 participation in business affairs is probative of knowledge.”); *Affordable Media*,  
5 179 F.3d at 1235. For example, Arnold is the originator of the BurnLounge  
6 concept and promotes it. (Gale ¶¶ 4-7, Ex. 1, 2, pp. 2, 138, 141-167, 219-241;  
7 Marino ¶¶ 2, 5, Ex. 33, pp. 886-87, 909-920; Menjivar ¶¶ 2, 7, Ex. 37, pp. 997-98,  
8 1052-1075; Liggins ¶ 8, 12, Ex. 20, 24, pp. 394-95, 517-518, 608-609.) Likewise,  
9 the other individual Defendants have extensive involvement. They explain the  
10 BurnLounge compensation program (*e.g.*, Gale ¶¶ 6-7, Ex. 2, pp. 2, 252-71;  
11 Jackson ¶¶ 3-4, Ex. 12, pp. 346, 352-72; Liggins ¶¶ 10, 19, 20, Ex. 22, 31, 32, pp.  
12 395-96, 562-87, 818-21, 871-75; Liggins Supp. ¶¶ 2, 7, Ex. 38, 42, 43, pp. 1122-  
13 29, 1162-63, 1166-71) recruit and train new participants (*e.g.*, Jackson ¶¶ 3-6, Ex.  
14 12-13, pp. 346-47, 352-72, 378-90; Liggins ¶¶ 6, 15, Ex. 18, 27, pp. 394-95, 422-  
15 43, 690-705; Marino ¶¶ 2, 5, Ex. 33, pp. 886-87, 894-96, 903-09; Menjivar ¶¶ 2, 7,  
16 Ex. 36, pp. 997-98, 1034-48), and use misleading earnings claims. (*See supra* pp.  
17 12-14, 17-18.) Their in-depth involvement evidences the requisite knowledge for  
18 individual liability.

## 19 VI. THE COURT HAS AUTHORITY TO GRANT THE TRO

20 The FTC's seeks a noticed *ex parte* TRO pursuant to Section 13(b) of the  
21 FTC Act, 15 U.S.C. § 53(b). The Second Proviso of Section 13(b) provides that  
22 "in proper cases the FTC may seek, and, after proper proof, the court may issue, a  
23 permanent injunction." The FTC may seek a permanent injunction against  
24 violations of "any provision of law enforced by the Federal Trade Commission."  
25 15 U.S.C. § 53(b); *FTC v. Evans Products Co.*, 775 F.2d 1084, 1086-87 (9th Cir.  
26 1985). A routine deception case such as this one, involving misrepresentations of  
27 material facts in violation of Section 5 of the FTC Act, is a "proper case." *FTC v.*  
28 *H.N. Singer, Inc.*, 668 F.2d 1107, 1111 (9th Cir. 1982).

1           Once the equitable power of a federal court has been invoked, the full  
2 breadth of the court's authority is available, including such ancillary final relief as  
3 rescission of contracts and restitution. *Id.* at 1113. Further, the court may grant a  
4 TRO and preliminary injunction, and whatever additional preliminary relief is  
5 necessary to preserve the possibility of final effective ultimate relief. *Id.* at 1111-  
6 12. Such relief may include an order freezing assets and an order permitting  
7 expedited discovery. See, *e.g., id.* at 1113; *see also* F.R.Civ.P. 34(b) (allowing the  
8 Court to order shortened time for response to request for production). In many  
9 previous routine Section 13(b) cases in this district, the Court has entered TRO's  
10 including the types of relief requested here, even when no notice was given.<sup>7</sup>

11           **A.     The Evidence Presented Justifies the Entry of a Temporary**  
12           **Restraining Order and Preliminary Injunction**

13           The FTC has submitted strong evidence that establishes Defendants'  
14 widespread and systematic deception. Section 13(b) of the FTC Act was designed  
15 to combat such abuses. For an agency that acts as "statutory guardian charged  
16 with safeguarding the public interest," the standard for preliminary injunctive  
17 relief in Section 13(b) is lower than that typically applied to private litigants.<sup>8</sup> *See*  
18 *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 808 (2nd Cir. 1975). A court  
19 in a Section 13(b) action must only (1) determine the likelihood that the FTC  
20 ultimately will succeed on the merits and (2) balance the equities. *FTC v. World*  
21 *Wide Factors, Ltd.*, 882 F.2d 344, 346 (9th Cir. 1989); *World Travel Vacation*

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23           <sup>7</sup>       *E.g., FTC v. Connelly*, SACV-06-701 DOC (RNBx); *FTC v. Universal*  
24 *Premium Services, Inc.*, CV-06-849 SJO(OPx); *FTC v. National Consumer*  
25 *Council Inc.*, SACV-04-0474 CJC (JWJx); *FTC v. Trek Alliance, Inc.*, CV-02-  
26 9270 JSL.

27           <sup>8</sup>       Irreparable injury, a traditional element for injunctive relief for  
28 private litigants, need not be shown. *World Travel Vacation Brokers*, 861 F.2d  
1020, 1029 (7th Cir. 1988). "Harm to the public interest is presumed." *World*  
*Wide Factors*, 882 F.2d 344, 346 (9th Cir. 1989).

1 *Brokers*, 861 F.2d at 1029. In weighing the equities between the public interest in  
2 preventing further violations of law and Defendants' interest in continuing to  
3 operate their business unabated, the public equities are accorded much heavier  
4 weight. *World Wide Factors, Ltd.*, 882 F.2d 344, 346-347; *World Travel*, 861  
5 F.2d at 1030-31. This is particularly true where the evidence demonstrates, as it  
6 does here, that a defendant's business is rooted in deception.

7 The requested relief should be granted in this case. First, the evidence of  
8 deceptive practices demonstrates a strong likelihood that the FTC will succeed on  
9 the merits. Second, Defendants' violations of a federal statute are continuing, and  
10 are likely to continue, unless Defendants are compelled to cease and desist. Third,  
11 because Defendants' business is grounded in deception, the equities weigh heavily  
12 in favor of granting preliminary relief.

13 The proposed preliminary relief is reasonable in scope. It prohibits  
14 Defendants from operating a pyramid scheme by banning the payment of bonuses  
15 relating to recruitment and prohibits the making of deceptive earnings claims and  
16 the omission of material information about earnings. The proposed preliminary  
17 relief does not prohibit Defendants from engaging in any lawful activity such as  
18 the sale of digital music.

#### 19 **B. Order Freezing Assets and Providing Expedited Discovery**

20 A district court's authority to enter orders to preserve the defendants' assets  
21 is ancillary to its equitable authority to order consumer redress. In this case,  
22 aggregate harm is very substantial and is likely to be millions of dollars. (*Vander*  
23 *Nat* ¶ 14, p. 1179.) The standard for an asset freeze is a showing of likelihood of  
24 success on the merits, combined with a possibility that the assets will be  
25 dissipated. *FSLIC v. Sahni*, 868 F.2d 1096, 1097 (9th Cir. 1989) (where the Ninth  
26 Circuit held a "likelihood" of dissipation need not be shown). Where business  
27 operations are permeated by deception, there is a strong possibility that assets may  
28 be dissipated. *See, e.g., Sahni*, 868 F.2d at 1097; *SEC v. Manor Nursing Centers*,

1 *Inc.*, 458 F.2d 1082, 1106 (2nd Cir. 1972). Thus, courts have ordered such relief  
2 solely on the basis of pervasive deception. *See Manor Nursing Centers*, 458 F.2d  
3 at 1106; *SEC v. R.J. Allen & Associates, Inc.*, 386 F. Supp. 866, 881 (S.D. Fla.  
4 1974).

5 Here, there is a likelihood of dissipation, given the pervasive nature of the  
6 deception and the substantial monetary liability Defendants face as a result of this  
7 lawsuit. An asset freeze is well justified under these circumstances. *See Singer*,  
8 668 F.2d at 1113 (asset freeze appropriate when FTC objective is "to obtain  
9 restitution of moneys fraudulently obtained"). A TRO that freezes Defendants'  
10 assets would preserve the possibility of full and effective relief for defrauded  
11 consumers by preserving the status quo pending a hearing on the preliminary  
12 injunction. The requested asset freeze is reasonable in scope and intended to  
13 safeguard funds for potential consumer redress without unduly infringing on  
14 Defendants. Pending the Court's ruling on an order to show cause whether a  
15 preliminary injunction should be entered, Plaintiff's requested asset freeze  
16 includes a provision for reasonable living expenses for the individual defendants,  
17 as well as a provision allowing the corporate defendant to pay ordinary and  
18 necessary operating expenses, but not bonuses and commissions, from frozen  
19 assets. In addition, Plaintiff requests that any corporate expenditure in excess of  
20 \$3,000 only be allowed if prior approval of the Court is obtained. The requested  
21 asset freeze also includes a provision allowing each defendant to pay up to  
22 \$10,000 for attorneys' fees related to this matter pending the Court's ruling on an  
23 order to show cause whether a preliminary injunction should be entered.

24 The proposed temporary TRO also contains a requirement for an accounting  
25 of assets which is a standard provision of an asset freeze, *FTC v. AmeriDebt, Inc.*,  
26 373 F.Supp.2d 558, 566 (D. Md. 2005), Finally, the TRO provides for expedited  
27 the discovery of moneys received by the corporate defendants and the amounts of  
28 money paid participants in the form of bonuses for recruitment and commissions

1 for the sale for digital music. It is anticipated at the preliminary injunction hearing  
2 a major issue will be the extent to which BurnLounge will be allowed to continue  
3 to operate pending a trial on the merits of the complaint for permanent injunction.  
4 Central to this issue is the extent to which BurnLounge conducts the legitimate  
5 business of selling digital music as opposed to operating a pyramid scheme. The  
6 requested financial information is central to this inquiry. It should be readily  
7 available to Defendants and easily produced because implementation of the  
8 compensation plan would necessitate creation of such records.

## 9 VII. NOTICE PURSUANT TO LOCAL RULE 7-19

10 At the time of this writing, Plaintiff's counsel has contacted or attempted to  
11 contact via e-mail and telephone the Defendants in the instant matter and  
12 Defendants' counsel, if known, are listed below. Plaintiff's counsel has given  
13 notice of Plaintiff's intent to file the Complaint and the application for a noticed *ex*  
14 *parte* TRO and the types of relief sought through the application. Plaintiff's  
15 counsel gave this notice to D.J. Poyfair of Shughart, Tomson and Kilroy<sup>9</sup>, counsel  
16 for BurnLounge, Inc., and Juan Alexander Arnold, and also to Defendants DeBoer  
17 and Taylor, personally, who have not yet retained counsel although both  
18 Defendants indicated an intent to obtain counsel. Plaintiff's counsel has also  
19 attempt to notify Defendant Elliott by e-mail and telephone but has not heard from  
20 him at this point. In order to finalize this memorandum for service on Defendants  
21 additional information concerning notice and identification of counsel, if any, will  
22 be provided by a declaration of Plaintiff's counsel.

## 23 VIII. CONCLUSION

24 This Court should issue the noticed *ex parte* TRO with conduct prohibitions  
25 and asset freeze, order to preserve records and provide business and financial  
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27 <sup>9</sup> 1050 17<sup>th</sup> Street Suite 2300, Denver, CO, 80265. 303-572-9300;  
28 djpoyfair@stklaw.com.

1 information, and order to show cause why a preliminary injunction should not  
2 issue, for the reasons set forth above.

3 Dated June 5, 2007

Respectfully submitted,

4 WILLIAM BLUMENTHAL  
General Counsel

5 *Ken Abbe by Raquel E. McKen*  
6 ~~CHRIS M. COUILLOU~~  
7 DAVID C. FIX  
GERALD S. SACHS  
8 KENNETH ABBE (Local Counsel)

9 Attorneys for the Plaintiff  
Federal Trade Commission

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