

In the Matter of Holiday Magic Inc.

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Jeffrey A. Babener, principal attorney in the Portland, Oregon, law firm Babener & Associates, and editor of www.mlmlegal.com, represents many of the leading direct selling companies in the United States and abroad.

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In the Matter of Holiday Magic Inc.

Case: In the Matter of Holiday Magic Inc (1974)

Subject Category: Marketing, Anti-trust

Agency Involved: FTC

Court: Federal Trade Commission Appeal

Case Synopsis: The Federal Trade Commission brought an administrative action against Holiday Magic alleging false or misleading trade practices in recruiting distributors, and unreasonable restraint of trade for restricting who distributors may sell too and the prices at which they can sell.

Legal Issue: Were the policies of Holiday Magic false or misleading, or were they an unreasonable restraint of trade?

Court Ruling: The FTC administrative law judge held that the activities of Holiday Magic were false and misleading and did constitute an unreasonable restraint of trade. In appealing the ALJ's decision, the Commission adopted a majority of the findings as it's own. The commission held that the marketing system of Holiday Magic was essentially a pyramid scheme and was a false and misleading trade practice because the system is predicated on exploiting others to participate, who, because of the very nature of the system, have virtually no chance to earn a return. It was also false and misleading of the company to encourage the expectation of distributors to receive a return on their investment. Holiday Magic's

policies restricting a distributor's freedom to sell to customers of their choice, and at prices the distributor sets, were found to be unreasonable restraints of trade in violation of the Clayton Act. Holiday Magic was enjoined from restricting distributor's business decisions, promoting a pyramid scheme, and making false or misleading representations to distributors or prospective distributors.

Practical Importance to Business of MLM/Direct Sales/Direct Selling/Network Marketing/Party Plan/Multilevel Marketing: Holiday Magic fought this complaint through the FTC administrative hearing process. This process, while similar to a court proceeding, has a different appellate process than a regular court proceeding. An Administrative Law Judge hears the initial claim, with an appeal to the FTC Commissioners, and a further appeal to the Circuit and then Supreme courts.

In the Matter of Holiday Magic Inc. , 84 FTC 748 (1974) : The FTC administrative law judge held that the activities of Holiday Magic were false and misleading and did constitute an unreasonable restraint of trade. In appealing the ALJ's decision, the Commission adopted a majority of the findings as its own. The commission held that the marketing system of Holiday Magic was essentially a pyramid scheme and was a false and misleading trade practice because the system is predicated on exploiting others to participate, who, because of the very nature of the system, have virtually no chance to earn a return. It was also false and misleading of the company to encourage the expectation of distributors to receive a return on their investment. Holiday Magic's policies restricting a distributor's freedom to sell to customers of their choice, and at prices the distributor sets, were found to be unreasonable restraints of trade in violation of the Clayton Act. Holiday Magic was enjoined from restricting distributor's business decisions, promoting a pyramid scheme, and making false or misleading representations to distributors or prospective distributors.

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84 F.T.C. 748

IN THE MATTER OF

HOLIDAY MAGIC, INC., ET AL.

ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE

FEDERAL TRADE COMMISSION ACT AND SEC. 2(a) OF THE CLAYTON ACT

Docket 8834.

Complaint, Jan. 18, 1971

Decision, Oct. 15, 1974 [FN*]

Order requiring a San Rafael, Calif., distributor of cosmetics, toiletries, cleaning products and associated items, among other things to cease engaging in illegal price fixing and price discrimination and imposing selling, purchasing and territorial restrictions on its distributors. Further, respondent is required to cease using its openended, multilevel marketing plan which the Commission found to be deceptive.

Respondent is also ordered to make refunds to requesting distributors of monies unlawfully obtained in the event it ceases to be in compliance with an order of the District Court for the Northern District of California pertaining to repayment of funds to distributors.

Appearances

For the Commission: Joseph S. Broumman and D. Stuart Cameron.

For the respondents: Alvin H. Goldstein, Jr., Tuckman, Goldstein & Philips, San Francisco, Calif. Stein, Mitchell & Mezines, Wash., D. C.

COMPLAINT**

Pursuant to the provisions of the Federal Trade Commission Act (Title 15, U.S.C., Section 41, et seq.) and by virtue of the authority vested in it by said Act, the Federal Trade Commission having reason to believe that the parties listed in the caption hereof and more particularly described and referred to hereinafter as respondents, have violated the provisions of Section 5 of the Federal Trade Commission Act, and Section 2(a) of the Clayton Act, as amended, and it appearing to the Commission that a proceeding by it in respect thereof would be in the interest of the public, hereby issues its complaint, stating its charges as follows:

PARAGRAPH 1. Respondent Holiday Magic, Inc. is a corporation organized on or about Oct. 14, 1964, and is existing and doing business under and by virtue of the laws of the State of California. Respondent Holiday Magic, Inc. maintains its home office and principal place of business at 616 Canal Street, San Rafael, Calif.

PAR. 2. Respondent William Penn Patrick is chairman of the board of directors of said corporation, and was also its first president. Mr. Patrick was the founder of Holiday Magic, Inc. and together with others instituted the Holiday Magic marketing plan and distribution policies. Respondent William Penn Patrick, together with others, has been and is responsible for establishing, supervising, directing and controlling the business activities and practices of corporate respondent Holiday Magic. Mr. Patrick's office address is the same as that of said corporation.

In addition, respondent William Penn Patrick was formerly engaged in other marketing activities in commerce in a system of distribution involving applications and contracts, sales manuals and marketing plans, price lists and other literature similar to the present activities of respondent Holiday Magic, as alleged herein.

Respondent Fred Pape was president of corporate respondent Holiday Magic, Inc. Together with others, respondent Fred Pape was responsible for establishing, supervising, directing and controlling the business activities and practices of corporate respondent Holiday Magic. Mr. Pape's office address is 1790 E. Plum Lane, Reno, Nev.

Respondent Janet Gillespie was administrative vice president and a director of Holiday Magic, Inc. Together with others, respondent Janet Gillespie was responsible for establishing, supervising, directing and controlling the business activities and practices of corporate respondent Holiday Magic. Mrs. Gillespie's office address is 1790 E. Plum Lane, Reno, Nev.

PAR. 3. Respondents are engaged in the purchase, distribution, offering for sale and sale of cosmetics, toiletries, cleaning products and associated items which are marketed under the names Holiday Magic and Home Magic, to distributors located throughout the United States. The total monthly volume of sales of such products, using the retail list prices of said products has been in excess of 5 million dollars. Since distributors purchase at discount off list prices, actual sales are approximately 45 percent of this figure. In its short history the company has registered phenomenal growth. Comparable monthly figures are \$16,000 for Dec. 1964, its first month of operation, \$520,000 for July 1965, \$1,500,000 for June 1966, \$2,000,000 in Aug. 1966, and \$1,700,000 in Feb. 1969.

PAR. 4. In the course and conduct of its business of distributing Holiday Magic and Home Magic products, the respondents ship or cause such products to be shipped from the state in which they are warehoused to distributors located in various other States throughout the United States who engage in resale to other distributors and to members of the general public. There is now and has been for several years last past a constant, substantial, and increasing flow of such products in 'commerce' as that term is defined in the Federal Trade Commission Act and in the Clayton Act.

PAR. 5. Except to the extent that actual and potential competition has been lessened, hampered, restricted and restrained by reason of the practices hereinafter alleged, respondents' distributors and dealers, in the course and conduct of their business in distributing, offering for sale, and selling of Holiday Magic and Home Magic products are in substantial competition in commerce with one another, and corporate respondent and their distributors are in substantial competition in commerce with other firms or persons engaged in the manufacture or distribution of similar products.

PAR. 6. Respondents have formulated a distribution system involving distributors at wholesale and retail levels and they have published their marketing plan or distribution policies which are set forth in respondents' price lists, discount schedules, marketing manuals, sales bulletins, order forms, pamphlets and other materials and literature. To effectuate and carry out the aforesaid distribution system, policies or plan, respondents, together with their distributors, have entered into certain contracts, agreements, combinations or common understandings pursuant to the universal acceptance by the distributors of said marketing plan and have adopted, placed in effect and carried out, by various methods and means, the marketing plan to hinder, frustrate, restrain, suppress and eliminate competition in the offering for sale, distribution and sale of cosmetics, toiletries, cleaning materials and associated products.

PAR. 7. Corporate respondent's marketing plan is a distribution network which allows a potential distributor to enter at any one of three levels, i.e., Holiday Girl, Organizer and Master, and may eventually qualify at a fourth level, that of General. All distributors are independent contractors and except for the Holiday Girls who sell primarily at retail through party plans and doortodoor methods, are permitted to, and do, sell or attempt to sell at both wholesale and retail. The distributors' gross profit is the difference between the price or prices at which he purchases Holiday Magic products and the price or prices at which he resells them.

a. Holiday Girls and Organizers.

All Holiday Girls and Organizers buy their products at 30 percent off the retail list price. At the end of the calendar month, they receive from their sponsoring distributor who sold them these products, i.e., a General, Master or Organizer, a refund varying from zero to 25 percent off list based upon the monthly volume purchased. Once a distributor purchases a volume of \$5,000 (\$6,666.66 as of Sept. 30, 1969) in terms of retail list price in any one calendar month, he remains at the 25 percent refund level, is thereafter classified as a Master and can buy directly from respondent Holiday Magic or his General at 55 percent off retail list price.

b. Master.

Master distributors may purchase their needs either from Holiday Magic, Inc., directly or through a General. There is no effective limit as to the number of distributors that may be recruited, nor is there a limit as to the size of any distributor's organization. A distributor's organization includes all persons whom he supplies with products either directly or indirectly, or upon whose purchases he receives an override.

Individuals who desire to start as Masters must purchase an inventory valued at \$5,000 (\$6,666.66 as of Sept. 30, 1969) retail list price. The actual cost is at 55 percent off. An additional charge of \$250 for certain sales aids has also been an initial requirement. A Holiday Girl who recruits a Master will receive a Finder's Fee of \$100 from her General distributor. Any Organizer recruiting a Master will receive a Finder's Fee of \$100 plus a continuing override of 2 percent of all his purchases, based upon retail list price. Any organizer recruiting another Organizer who eventually qualifies for the Master position receives the same 2 percent override without the Finder's Fee. Masters recruited into the Holiday Magic program are denoted 'Workin' or 'Buyin.'

c. General.

General distributors purchase their product needs, as well as the needs of distributors in their organization, from respondent Holiday Magic, Inc. The General has the most advantageous discount, purchasing from respondent company at 65 percent off the retail list price.

All Holiday Girls, Organizers and Masters are part of a particular General's organization, and he receives an additional 10 percent override from respondent Holiday Magic, Inc. on all purchases from Masters in his organization. As an additional override, respondent Holiday Magic pays 1 percent of the retail list price purchase value to the old General of a Master who has been elevated to the General position. It is paid monthly, and is based on the purchases of the new General, and all of this General's organization.

A Master is eligible for the position of General only after he has completed the following:

1. He must introduce at least one other Master to his own Generaldenoted a Replacement Master because the Master qualifying for the position of General will be taking all of his organization with him as his permanent organization when he becomes a General.
2. He must pay a Release Fee of \$2500 (\$3,000 as of Sept. 30, 1969) to his old General because the old General will have sustained a loss of the 10 percent override of the departing organization.
3. He must pay for, and complete, a course of instruction.

d. General's Council.

A General's Council is a voluntary association of General and Master distributors formed in a given geographical area, usually the metropolitan area of a city, to share in the costs of retailing, business training, recruiting, and joint participation in any Holiday Magic activity of mutual interest. The amount of the dues is fixed at the discretion of the council members but respondent Holiday Magic requires all Masters and Generals to pay the same amount.

The Senior General of the council is the position of an executive representing the body of local distributors. It is his function to act as liaison between the company and all local distributors. As compensation for his services, the Senior General receives a 1 percent override from Holiday Magic on all business produced by all distributors in his council.

Among the services performed by the Senior General is the reporting of various sales data to the respondent company for members of the council. This information is supplied to the Senior General by the various distributors. Some of the items reported upon at the specific request of respondent Holiday Magic may include the individual sales slips of the Holiday Girls.

Three of the General's Council's activities are the coordination and allocation of routes to be assigned to individual Holiday Girl distributors, the allocation of leads supplied by respondent Holiday Magic, Inc., and the holding of Opportunity Meetings.

e. Opportunity Meeting.

It is at the Opportunity Meetings conducted by the General's Council that additional distributors are recruited into the Holiday Magic program. These meetings are held throughout the United States, and

have been attended by as many as hundreds of persons at a time. Both the script of the meeting and the film shown thereat concentrate upon the unlimited potential of money to be made in recruiting other distributors in a chain of distributors.

PAR. 8. Pursuant to, and in furtherance and effectuation of the aforesaid agreements and planned common course of action, respondents have done and performed and are doing and performing the following:

(1) Respondent Holiday Magic, Inc., its agents and officials, have advised all distributors that failure to adhere to the marketing plan is the basis for cancellation of their distributorship, and all distributors have actually or impliedly agreed to abide by all rules and regulations established by Holiday Magic in furtherance of the marketing plan, and to all subsequent changes.

(2) Respondent Holiday Magic, Inc. has entered into contracts, agreements, combinations or understandings with each of its distributors whereby said distributors agree to maintain the resale prices established and set forth by the company, notwithstanding that some of such distributors are located in states which do not have fair trade laws.

(3) Respondent Holiday Magic, Inc. has entered into contracts, agreements, combinations or understandings with each of its distributors whereby said distributors agree to maintain the discounts, overrides, rebates, bonus schedules, Finder's Fees and Release Fees, as established and set forth by the company.

(4) Respondent Holiday Magic, Inc. has entered into contracts, agreements, combinations or understandings with each of its distributors whereby said distributors are restricted as to whom they may purchase their products from, and to whom they may resell them. More specifically:

(a) The distributor agrees to purchase merchandise only from respondent company, or from his Sponsor, i.e., the distributor who introduced him to Holiday Magic, Inc.

(b) The sponsoring distributor agrees not to buy back any merchandise from his distributors.

(c) The distributor agrees not to make any consignment of the merchandise to any person, except in certain cases.

(d) The distributor agrees to restrict the retail sales and display of cosmetics to authorized retail markets, i.e., home service routes, beauty salons, wig shops, beauty schools, barber shops, health food stores, women's specialty stores, men's specialty stores, Holiday Magic retail salons, and temporary booths. No other commercial retail markets are authorized.

(5) Respondent Holiday Magic, Inc., in the course and conduct of its business in commerce, has been and now is discriminating in price, directly or indirectly, between different purchasers of its Holiday Magic products of like grade and quality by selling said products at higher prices to some purchasers than it

sells said products to other purchasers, many of whom have been and now are in competition with the purchasers paying the higher prices. More specifically:

(a) For several years last past respondent has priced its line of products in terms of list prices. One class of respondent's customers purchases at said list prices less a discount of 65 percent while the other class of customers purchase at list prices less a discount of 55 percent. Various members of each class of customers compete with each other and with various members of each of the other classes. Said 10 percent differential is actually a net cost discount of 22.2 percent in favor of the favored class of customers.

(b) A 1 percent commission on the list price value of the monthly sales volume of a new General is paid by respondent Holiday Magic to the old General of a Master who has been promoted to the General position. It is paid monthly and is based upon the purchases of the new General's Master distributors in his organization.

(c) For several years last past, respondent Holiday Magic, Inc. has entered into an agreement with each of its distributors whereby said distributors agree to maintain the discounts, rebates, and overrides when selling to, and purchasing from, one another. Said discounts result in price discrimination. More specifically:

1. A 2 percent commission on the list price value of the monthly sales volume of a new Master is paid by the General distributor to any Master or Organizer who recruits and sponsors said new Master distributor who may be either a 'Buyin' or 'Workin.' This is a continuing monthly payment and is paid to the day that either the new Master or the Sponsor becomes a General distributor.

2. Other discounts are based upon a sliding scale of volume. More specifically:

i. Organizer distributors purchase their products at 30 percent off list price and receive an additional bonus of up to 25 percent off list price based upon monthly sales volume, while Master distributors purchase at 55 percent off list price. Said zero to 25 percent differential is actually a net cost discount in the range of zero to 35.7 percent in favor of the Master. Various members of each class compete with each other.

ii. Organizer distributors purchase their products at 30 percent off list price and receive an additional bonus of up to 25 percent off list price based upon monthly sales volume, while General distributors purchase at 65 percent off list price. Said 10 percent to 35 percent differential is actually a net cost discount in the range of 22.3 percent to 50 percent in favor of the General. Various members of each class compete with each other.

iii. Organizer and Holiday Girl distributors purchase their products at 30 per cent off list price and receive an additional bonus of up to 25 percent off list price based upon monthly sales volume. Said zero to 25 percent differential is actually a net cost discount in the range of zero to 35 percent in favor of the

favorable distributors. Various members of each class of customers compete with each other and with various members of each of the other classes.

(6) Respondent Holiday Magic, Inc. has instituted various rules and regulations designed to further the objectives of its marketing plan, such rules and regulations being contrary to the competitive interests of the independent distributors directly affected by them, and unreasonable in their overall support of and impact upon the entirety of the Holiday Magic Marketing plan and distribution practices. More specifically:

(a) The distributor is prohibited from using advertising that is either not supplied by respondent corporation, or not approved by respondent in advance.

(b) The distributor must agree not to transfer to another organization without a prior release from all distributors above him in the marketing chain. Such transfers are discouraged by respondent Holiday Magic.

(c) In the event a partnership distributorship dissolves, the departing partner is required to revert back to his original Sponsor.

(d) In the event a General Distributorship dissolves, the principal or partner who is departing, should he continue with Holiday Magic, must requalify as a new Master Distributor under his original Sponsor, create a Replacement Master, and pay a \$2500 Release Fee (\$3,000 as of Sept. 30, 1969) to qualify for the General position again.

(e) The addition of partners to an existing General or Master distributorship or the sale of a General or Master distributorship must meet the same retail list price value purchase requirement as do Working Masters.

(f) A distributor may only own or have a financial interest in one Holiday Magic distributorship at a time, and may not simultaneously be a part of two separate distributorships.

(g) The distributor must agree not to enter into any agreement with a distributor in another Holiday Magic organization to make a division of profits, assets, or new recruits in violation of the marketing plan.

COUNT I

Alleging violation of Section 5 of the Federal Trade Commission Act, as amended, by respondents.

PAR. 9. The allegations of Paragraphs One through Eight are incorporated by reference in Count I as if fully set forth verbatim.

PAR. 10. Respondents' multilevel marketing program holds out to prospective distributors the lure of making large sums of money through a virtually endless chain of recruiting additional participants, from various fees, commissions, overrides or other compensation on the sales and/or further recruiting activities of their own recruited distributors, or distributors in their organizations.

The operation of the program contemplates geometrical increases in the number of distributors to insure participants the earnings represented and implicitly realizable from the program. However, because the overall number of potential participants remains relatively constant, the participants may be, and in a substantial number of instances will be, unable to find additional investors in a given community or geographical area by the time they enter respondents' merchandising program. This comes about because the recruiting of participants who came into the program at an earlier stage may have already exhausted the number of prospective participants. Based upon a geometrical progression of five additions per month per distributor, as demonstrated by respondents or their representatives at their Opportunity Meetings, the number of additional participants in their organizations at each monthly stage of growth would increase at such a rate that at the end of seven months, and giving effect to the continuing process of recruitment as contemplated under respondents' marketing plan, there would be an aggregate in excess of 97,000 participants in each distributor's organization. Thus, as to each of the individual participants therein, respondents' recruitment program must of necessity ultimately collapse when the number of potentially available distributors which can be recruited to serve a particular area is exhausted and/or the number of distributors theretofore recruited has so saturated the area with distributors as to render it virtually impossible to recruit any more.

Although some participants in respondents' multilevel merchandising program may realize a profit through recruitment, all participants do not have the potentiality of receiving equivalent sums of money, either through recruitment or compensation arising out of the retail sales of respondents' products, and the greater the number of distributors previously recruited, the lower the chances for such success. Some participants in the program receive little or no return on their investment.

For the foregoing reasons, respondents' multilevel merchandising program is operated in such a manner that the realization of financial gains is often predicated upon the exploitation of others who have been induced to participate therein, and who have virtually no chance of receiving the kind of return on their investment implicit in said merchandising program. Therefore, the use by respondents of the above-described multilevel merchandising program in connection with the sale of their merchandise was and is false, misleading and deceptive, and was and is an unfair act and practice within the intent and meaning of Section 5 of the Federal Trade Commission Act, as amended.

COUNT II

Alleging further violation of Section 5 of the Federal Trade Commission Act, as amended, by respondents.

PAR. 11. The allegations of Paragraphs One through Ten are incorporated by reference in Count II as if fully set forth verbatim.

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 need exercise little or no control, they will receive substantial financial gains. The realization of such gains need not depend upon the skill and effort of the individual participants, but instead may result from predominant elements of chance, such as the number of prior participants in the program, the ability of their own recruits to recruit other distributors, and the ability of their own recruits to either sell merchandise or recruit other persons who may be successful in selling merchandise.

The use by respondents of their multilevel program, which is in the nature of a lottery, is contrary to the established public policy of the United States, is false, misleading and deceptive, and was 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, as amended.

COUNT III

Alleging further violation of Section 5 of the Federal Trade Commission Act, as amended, by respondents.

PAR. 13. The allegations of Paragraphs One through Fourteen are incorporated by reference in Count III as if fully set forth verbatim.

PAR. 14. In the course and conduct of their business, and for the purpose of inducing the participation by others in their marketing program and for selling their merchandise, by and through statements and oral representations, and by means of brochures and other written material, respondents or their representatives represent, and have represented, directly or by implication, that:

1. Through 'want ads' in classified advertising sections of newspapers, employment is being offered.
2. It is not difficult for distributors to recruit and retain persons who will invest or participate in the program as distributors and/or as sales personnel.
3. Respondents' products will be or are advertised widely and substantially in the community or geographic area in which such representations are made.
4. Participants in respondents' marketing program have the reasonable expectancy of receiving large profits or earnings.

PAR. 15. In truth and in fact:

1. Respondents, their representatives and distributors are, for the most part, not offering employment through the use of 'want ads,' but use said advertisements instead to obtain leads to prospective investors in their marketing program.
2. It is difficult, and becomes increasingly more difficult, under respondents' geometrically expanding multilevel marketing system, to recruit and retain persons who will invest in respondents' program as distributors and/or as sales personnel.
3. Respondents do not advertise their products to the extent that they or their representatives represent.
4. Most participants in respondents' multilevel marketing program do not have a reasonable expectancy of receiving large profits or financial gains.

Therefore, the abovedescribed representations are false, misleading and deceptive, and are unfair acts or practices in commerce within the intent and meaning of Section 5 of the Federal Trade Commission Act, as amended.

COUNT IV

Alleging further violation of Section 5 of the Federal Trade Commission Act, as amended, by respondents.

PAR. 16. The allegations of Paragraphs One through Eight are incorporated by reference in Count IV as if fully set forth verbatim.

PAR. 17. The acts, practices, and methods of competition engaged in, followed, pursued or adopted by respondents, and the combination, conspiracy, agreement or common understanding entered into or reached between and among the respondents or others not parties hereto are unfair methods of competition and to the prejudice of the public because of their dangerous tendency to, and the actual practice of, fixing, maintaining or otherwise controlling the prices at which the Holiday Magic products are 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.

Said acts, practices and methods of competition, and the adverse competitive effects resulting therefrom, constitute 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, as amended.

COUNT V

Alleging further violation of Section 5 of the Federal Trade Commission Act, as amended, by respondents.

PAR. 18. The allegations of Paragraphs One through Eight are incorporated by reference in Count V as if fully set forth verbatim.

PAR. 19. The acts, practices, and methods of competition engaged in, followed, pursued or adopted by respondents, and the combination, conspiracy, agreement or common understanding entered into or reached between and among the respondents or others not parties hereto are unfair methods of competition and to the prejudice of the public because of their dangerous tendency to, and the actual practice of, restricting the customers as to whom the Holiday Magic distributors may resell their products to; restricting their distributors as to whom they may purchase their products from; restricting their distributors to reselling their products in certain kinds of retail outlets only; restricting the advertising rights of distributors; and restricting distributors as to the financial and marketing arrangements which they may chose to enter into with businesses or individuals of their own choosing.

Said acts, practices, and methods of competition, and the adverse competitive effects resulting therefrom, constitute 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, as amended.

COUNT VI

Alleging further violation of Section 5 of the Federal Trade Commission Act, as amended, by respondents.

PAR. 20. The allegations of Paragraphs One through Eight are incorporated by reference in Count VI as if fully set forth verbatim.

PAR. 21. The acts, practices, and methods of competition engaged in, followed, pursued or adopted by respondents, and the combination, conspiracy, agreement or common understanding entered into or reached between and among the respondents or others not parties hereto are unfair methods of competition and to the prejudice of the public because of the practice of allocating the territories in which various Holiday Magic distributors may resell their products.

Said acts, practices, and methods of competition, and the adverse competitive effects resulting therefrom, constitute 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, as amended.

COUNT VII

Alleging violation of Section 2(a) of the Clayton Act, as amended, by respondents.

PAR. 22. The allegations of Paragraphs One through Seven and subparagraph (5) of Paragraph Eight are incorporated by reference in Count VII as if fully set forth verbatim.

PAR. 23. The difference in net cost between a General's purchases and a Master's purchases results in a substantial discrimination in the net price for products sold to nonfavored direct and indirect Master distributor purchasers by respondent Holiday Magic.

In addition, various acts and practices of respondent Holiday Magic have resulted in further discriminations in the net price for products sold to other Holiday Magic distributors, who are indirect purchasers, and who are in competition with other direct and indirect purchasers of Holiday Magic cosmetic products.

In addition, the various fees, overrides, bonuses or other payments have resulted in discriminations among Holiday Magic's various direct and indirect purchasing distributors who are in competition with one another. These monies are direct and indirect payments by respondent Holiday Magic, and in effect are discriminations in the net price of Holiday Magic products to these various distributors.

The effect of respondent Holiday Magic's discrimination in net prices as alleged herein may be substantially to lessen competition or tend to create a monopoly in the line of commerce in which its favored purchasers are engaged, or to injure, destroy or prevent competition between the favored and non favored purchasers or with customers of either of them.

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

INITIAL DECISION*** BY EDGAR A. BUTTLE, ADMINISTRATIVE LAW JUDGE

MAY 31, 1974

THE PROCEEDINGS

A complaint was issued herein on Jan. 18, 1971, generally charging violations of Section 5 of the Federal Trade Commission Act and Section 2(a) of the Clayton Act, as amended, involving unfair trade practices based on operating a marketing plan in the nature of a lottery, price discrimination, marketing and price control, deception and misrepresentations. After joinder of issue by the filing of an answer which essentially denied the allegations, four prehearing conferences were held as follows: Apr. 2, 1971, May 24, 1971, Aug. 10, 1971, and Oct. 8, 1971. Hearings were commenced on Nov. 1, 1971 and ended on Feb. 15, 1973, for a total of 75 hearing days. Intervening recesses were allowed for purposes of discovery and other justifiable reasons. Hearings were conducted in the following cities: San Francisco, Calif., Detroit, Mich., Chicago, Ill., Miami, Fla., New York, N.Y., and Wash., D.C. There are 10,708 pages of hearing transcript; 855 Commission exhibits and approximately 100 respondents' exhibits. Eighty-six witnesses testified for complaint counsel and approximately 140 witnesses testified for respondents.

The record was reopened and closed on Mar. 28, 1973, to receive evidence not available heretofore, for which complaint counsel had previously made provision on the record.

THE COMPLAINT

Argument developed during the course of the hearings with regard to the interpretation of certain allegations of the complaint. Briefly stated, however, a reasonable construction thereof in entire context is clearly outlined as follows:

Count I

Allegedly respondents' multilevel marketing program holds out to prospective distributors the lure of making large sums of money through a virtually endless chain of recruiting additional participants, from various fees, commissions, overrides or other compensation on the sales and/or further recruiting activities of their own recruited distributors, or distributors in their organizations.

As also alleged although some participants in respondents' multilevel merchandising program may realize a profit through recruitment, all participants do not have the potentiality of receiving equivalent sums of money, either through recruitment or compensation arising out of the retail sales of respondents' products, and the greater the number of distributors previously recruited, the lower the chances for such success. Some participants in the program receive little or no return on their investment.

As further alleged for the foregoing reasons, respondents' multilevel merchandising program is operated in such a manner that the realization of financial gains is often predicated upon the exploitation of others who have been induced to participate therein, and who have virtually no chance of receiving the kind of return on their investment implicit in said merchandising program.

Count II

Allegedly the use by respondents of their multilevel unlimited distributor recruitment program of chance upon participant investment without the need for the exercise of business control thereafter or product marketing skill to acquire profit, if any, is in the nature of a lottery, is contrary to the established public policy of the United States, is false, misleading and deceptive, and was 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, as amended. [FN1]

Count III

Allegedly for the purpose of inducing the participation by others in their marketing program and for selling their merchandise, by and through statements and oral representations, and by means of brochures and other written material, respondents or their representatives misrepresent, and have misrepresented, directly or by implication, that:

1. The offering of employment through the use of want ads to obtain leads to prospective investors in the marketing program.
2. It is not difficult for distributors to recruit and retain persons who will invest or participate in the program as distributors and/or sales personnel.
3. Respondents' products will be or are advertised widely.
4. Participants in respondents' multilevel marketing program can reasonably expect to receive large profits or financial gains. (Count III refers to 'Most participants' but in context with complaint allegations in other Counts which are incorporated by reference omitting the word 'most' it would appear it cannot reasonably be construed quantitatively.) [FN1a]

Count IV

Allegedly fixing, maintaining or otherwise controlling the prices at which the Holiday Magic products are 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 constitute an unreasonable restraint of trade.

Count V

Allegedly restricting their distributors to reselling their products in certain kinds of retail outlets only; restricting the advertising rights of distributors; and restricting distributors as to the financial and marketing arrangements which they may choose to enter into with businesses or individuals of their own choosing constitute an unreasonable restraint of trade.

Count VI

Allegedly allocating the territories in which various Holiday Magic distributors may resell their products constitutes an unreasonable restraint of trade.

Count VII

Alleged violation of Section 2(a) of the Clayton Act, based on the following:

1. The difference in net cost between a General's purchases and a Master's purchases results in a substantial discrimination in the net price for products sold to nonfavored direct and indirect Master distributor purchasers by respondent Holiday Magic.
2. Further discriminations in the net price for products sold to other Holiday Magic distributors, who are indirect purchasers, and who are in competition with other direct and indirect purchasers of Holiday Magic cosmetic products.

3. In addition, the various fees, overrides, bonuses or other payments have resulted in discriminations among Holiday Magic's various direct and indirect purchasing distributors who are in competition with one another.

The administrative law judge has carefully considered the proposed findings of fact, and conclusions supplemented by briefs, submitted by complaint counsel and counsel for respondents. The following findings and conclusions if not herein adopted either in the form proposed or in substance are rejected as not supported by the record or as involving immaterial matters. The findings of fact are categorically arranged to reflect the complete *modus operandi* of the corporate respondent's business and participation therein rather than categorically as related to particular counts of the complaint since this would result in an unreasonable number of repetitive findings. The conclusions, however, relate the evidenced facts as alleged to the specific counts of the complaint with cited law applicable thereto. Adoption of any of respondents' proposed findings of fact verbatim or otherwise has been difficult since they are essentially argumentative or proposed conclusions of fact as distinguished from findings as to evidentiary facts. On the other hand complaint counsel in submitting proposed findings has relied essentially upon specific and accurate although lengthy documentary excerpts with some transcript citations. Some of this evidence is somewhat remotely material, but it is responsive to respondent counsel's justifiable demand that all relevant facts related to the Holiday Magic plan should be considered and evaluated in view of the seriousness of the many charges. The following numerous evidentiary findings and extensive conclusions therefrom are therefore necessarily rendered with this in view. [FN2]

FINDINGS OF FACT

I. Scienter Re Investigation

1. The record reflects that respondent Holiday Magic, Inc. was first made aware of the Federal Trade Commission investigation in July, 1967 (Tr. 9341, 9701). Obviously this may have some bearing on evidentiary evaluation and issue of relief.

II. Jurisdiction of the Commission

2. Respondents are engaged in the purchase, distribution, offering for sale and sale of cosmetics, toiletries, cleaning products and associated items which are marketed under the names Holiday Magic and Home Magic, to distributors located throughout the United States (Answer, p. 3).

3. In the course and conduct of their business of distributing Holiday Magic and Home Magic products, the respondents ship or cause such products to be shipped from the state in which they are warehoused to distributors located in various other States throughout the United States who engage in resale to other distributors and to members of the general public (Answer, p. 3). There is now and has been for several years last past a constant, substantial, and increasing flow of such products in 'commerce' as that term is defined in the Federal Trade Commission Act and in the Clayton Act (Answer, p. 3).

4. Holiday Magic, Inc. is in substantial competition in commerce with other firms or persons engaged in the manufacture or distribution of cosmetics, toiletries and cleaning products (Answer, p. 3).

5. The vast majority of the products distributed by respondents are cosmetics; of Holiday Magic, Inc.'s total sales, 88 percent or more have been of cosmetics (RX 16).

III. Cosmetic Industry

6. The gross dollar amount of retail cosmetics sales in the country as of 1970 was estimated at approximately 4.5 billion dollars (BaumgartenTr. 9483).

7. Approximately 25 percent of the sales of cosmetics at retail is described as the direct doortodoor market (BaumgartenTr. 9884).

8. Although the record does not reflect the total number of cosmetic firms principally engaged in door-to-door marketing (see Tr. 9486, 6116), the record shows that the largest cosmetic firm is Avon Cosmetics (BaumgartenTr. 9485; ShermanTr. 6137, 6117), which has approximately 47 percent of the doortodoor cosmetics market (BaumgartenTr. 9487) or approximately 12 percent of the total market in cosmetics.

9. Although Avon's advertising expenditures do not appear in the record, Avon engages in national television advertising (BaumgartenTr. 9493) and Avon engages in a substantial amount of advertising (BaumgartenTr. 9487). Doorto door selling itself is not considered to be advertising (BaumgartenTr. 9491). Avon has been in business for between 70 and 100 years (Tr. 9502, 6117).

10. Another doortodoor cosmetic firm is 'Varda,' which was established in 1969 (BaumgartenTr. 9486-88). Varda's retail sales to consumers totaled approximately 25 million dollars in 1970 (BaumgartenTr. 9486). Varda's marketing plan is more similar to that of Avon than it is to the marketing plan of Holiday Magic, Inc. (BaumgartenTr. 9488).

11. The Avon sales representatives are assigned routes. Otherwise the controls are minimal and there are no inventory requirements (BaumgartenTr. 9489).

12. The wholesale market for cosmetics today is what may be termed a buyer's market; that is, a wholesaler is in a position to take his pick of the lines he chooses to carry (ShermanTr. 6138). Competition in the cosmetics industry is 'fierce' (BaumgartenTr. 6574).

IV. Respondents

A. Respondent Holiday Magic, Inc.

13. Respondent Holiday Magic, Inc. is a corporation organized on or about Oct. 14, 1964, and is existing and doing business under and by virtue of the laws of the State of California (Answer, p. 2). Respondent

Holiday Magic, Inc. maintains its home office and principal place of business at 616 Canal Street, San Rafael, Calif. (Answer, p. 2).

14. To date, Holiday Magic, Inc. has reincorporated as a Nevada corporation, although it continues to maintain its principal place of business at 616 Canal Street, San Rafael, Calif. Marketing Enterprises, Inc. owns 100 percent of the stock of Holiday Magic, Inc. and U.S. Universal, Inc. owns Holiday Magic, Inc. Respondent William Penn Patrick is on the board of directors of U.S. Universal (CoultasTr. 972021).

15. A rented three bedroom home was Holiday Magic's first location, at San Jose, Calif. (CX 89B, CX 90C). In June 1965, Holiday Magic, Inc. moved to its San Rafael quarters (CX 90C).

16. Prior to Sept. 1968, Holiday Magic, Inc. purchased its cosmetics products from Synergistic Industries, Inc. but thereafter from a broad field of cosmetics manufacturers (CX 37A). At present, Holiday Magic, Inc. buys approximately 50 percent of its products from Commercia USA, a sister corporation (CoultasTr. 9685).

17. Holiday Magic, Inc. is a closely held corporation which employed approximately 90 persons in Apr. 1967 (CX 21E). Holiday Magic, Inc. sold to its distributors FOB San Rafael, Calif. as of Apr. 1967 (CX 21E). More recently, Holiday Magic, Inc. has utilized major distribution centers in N.J. and Ga. (Physical Exhibit A; Tr. 979293).

18. Holiday Magic, Inc.'s sales.

Monthly 'sales volume' figures for Holiday Magic, Inc. are \$16,254.34 for Dec. 1964, its first month of operation; \$520,658.10 for July 1965; \$1,524,203.30 for June 1966; and \$2,050,641.26 for Aug. 1966 (CX 15C).

Holiday Magic, Inc.'s 'cosmetic sales' for its fiscal year ending Sept. 1965 were \$2,773,155; for Sept. 1966, \$11,080,223; for Sept. 1967, \$30,369,813; for Sept. 1968, \$12,587,627; for Sept. 1969, \$19,518,939; for Sept. 1970, \$13,453,288; and for fiscal year ending Sept. 1971, \$11,063,624 (RX 16).

Holiday Magic Inc.'s Home Magic sales for the fiscal years ending Sept. 1970 and Sept. 1971 were \$1,881,542 and \$673,746, respectively (RX 16).

The 'cosmetic sales' and 'sales volume' figures are in terms of the retail list prices of the said products sold to distributors (RX 16; LipskaTr. 9255, 9212; PangerlTr. 10291).

19. Sales volume is not retail sales, and Holiday Magic, Inc. keeps no records with respect to the amount of products that actually are sold to consumers at retail (Tr. 9631, 9633, 9635, 976768, 5667).

20. The 'success' of the Holiday Magic program has been based upon the Marketing Plan.

(a) CX 78Z4 and CX 79Z4 'With our marketing plan we could be 75 percent as effective with another commodity.'

(b) CX 2BW and Because of the marketing plan, holiday Magic could have experienced the same rapid growth with any product, or product of low quality.

(c) CX 78Z45, CX 79Z42 'Because of its sound marketing plan, Holiday Magic could have experienced nearly the same rapid growth and success with a mediocre product.'

After having completed the marketing plan, William Penn Patrick searched for a consumer product that would fit the plan (Physical Exhibit A; Tr. 798485).

B. Respondent William Penn Patrick

21. Respondent William Penn Patrick is chairman of the board of directors of Respondent Holiday Magic, Inc. and was its first president (Answer, p. 2). Respondent William Penn Patrick was the founder of respondent Holiday Magic, Inc., and together with others instituted the Holiday Magic marketing plan and distribution policies (Answer, p. 2).

22. Respondent William Penn Patrick was chairman of the board of directors of respondent Holiday Magic, Inc. until very recently (CoultasTr. 9655); Mr. Patrick first held the position of president of Holiday Magic, Inc. in the winter of 1965, but relinquished this post to respondent Fred Pape in 1967 (CoultasTr. 9654).

23. Mr. Patrick has described Holiday Magic, Inc. as his 'brain child' and 'first love' (CX P318A, B) and is the man responsible for developing the Holiday Magic marketing program singlehandedly (CX 61A, CX 90C).

24. At first, Mr. Patrick gave all the Holiday Magic Opportunity Meetings (CX 5GW and 12/65 ; see also Physical Exhibit A; Tr. 6874).

25. Respondent William Penn Patrick, together with others, has been responsible for establishing, supervising, directing and controlling the business activities and practices of corporate respondent Holiday Magic (Answer, p. 2).

(a) The board of directors directed the policy of Holiday Magic, Inc. (CoultasTr. 9657).

(b) It was the responsibility of the board of directors to terminate distributors for violating rules and regulations of Holiday Magic, Inc. (CX 79Z8990, CX 78Z8687).

(c) The president and the officers supervised the daytoday activities of Holiday Magic, Inc. (CoultasTr. 9657).

26. Respondent William Penn Patrick, together with others, continues to be responsible for establishing, supervising, directing and controlling the business activities and practices of Holiday Magic, Inc. (CoultasTr. 972021).

C. Respondent Fred Pape

27. Respondent Fred Pape formerly was president of respondent Holiday Magic, Inc. (Answer, p. 2). Mr. Pape became president of Holiday Magic, Inc. in 1967 (CoultasTr. 9654) and retained the post through sometime in 1968 (CoultasTr. 9655).

28. Respondent Fred Pape was the first Master Distributor in Holiday Magic, Inc., and made \$186,000 his first year in the business (CX 85PMark Evans notes which were approved by Pape; Tr. 93940).

29. Mr. Pape's office address at the time of the filing of the complaint was 1790 E. Plum Lane, Reno, Nev. (Answer, p. 2).

30. Together with others, respondent Fred Pape was responsible for establishing, supervising, directing and controlling the business activities and practices of corporate respondent Holiday Magic.

(a) 'As William Penn Patrick stumped the State of California in his bid for the gubernatorial nomination, Fred Pape took the reins of 'the fastest growing corporation in the nation' and raised Holiday Magic to even greater heights' (CX 1840L).

(b) According to former president Ben Gay, Fred Pape (and Janet Gillespie) ran the business when Patrick was running for nomination (GayTr. 993132).

31. President and officers supervised the daytoday activities of Holiday Magic, Inc. (CoultasTr. 9657).

32. When Fred Pape was president, his job was that of chief executive officer. He carried out the policies that has been established in the board meetings by the board and Mr. Patrick. He played the role of a company president (Coultas Tr. 9659).

D. Respondent Janet Gillespie

33. Respondent Janet Gillespie formerly was administrative vice president and a director of respondent Holiday Magic, Inc. (Answer, pp. 23).

34. Janet Gillespie was the first Organizer Distributor in Holiday Magic, Inc. (GillespieTr. 9279; CX 5G). She became a member of the board of directors of Holiday Magic, Inc. in 1965 (GillespieTr. 9286), was named vice president administration in Aug. 1965 (gillespieTr. 9283; CX 1F) and was international vice president as late as Nov. 1968 (CX 142C).

35. Janet Gillespie has been described as a member of the 'corporate team' as well as a charter member of Holiday Magic (CX 6HWandJan. 1966).

36. Together with others, respondent Janet Gillespie was responsible for establishing, supervising, directing and controlling the business activities and practices of corporate respondent Holiday Magic.

(a) Board of directors directed the policy of Holiday Magic, Inc. (Coultas Tr. 9657).

(b) Responsibility of board of directors to terminate distributors for violating rules and regulations of Holiday Magic, Inc. (CX 78Z8687; CX 79Z89 90; GayTr. 9928).

37. Presidents and officers supervised the daytoday activities of Holiday Magic, Inc. (CoultasTr. 9657). Sherman Coultas, Holiday Magic's director of legal services (Tr. 9653) also testified that he had worked with Janet Gillespie daily and that she was involved 'in the overall facets of the business' (Tr. 9658). 'She did just about anything that had to be done insofar as running the business and coordinating the activities of secretaries and clerks and administrative people.'

V. Holiday Magic Publications

38. Respondents have formulated a distribution system involving distributors at wholesale and retail levels and they have published their marketing plan or distribution policies which are set forth in respondents' price lists, discount schedules, marketing manuals, sales bulletins, order forms, pamphlets and other materials and literature (Answer, p.3).

A. Holiday Magic Wands

39. Holiday Magic Wands appear in the record as CX 1 through CX 68. The Wands are in the format of a newspaper, and are published monthly by Holiday Magic, Inc., for distribution throughout the United States (CX 1A, CX 70Z92).

40. The Holiday Magic Wand is designed as a valuable recruiting tool by Holiday Magic, Inc. for its distributors (See CX 1B, CX 1C, CX 6C, CX 7H, CX 12F, CX 17G, CX 18F, CX 27F, CX 79Z92; GillespieTr. 935657). A socalled 'Permanent Wand' which is undated appears in the record as CX 64AH. The permanent Wand is used for recruiting purposes, and is sent to Holiday Magic Councils and handed out to prospective distributors (CX 155F; AlexanderTr. 5623).

41. The Wands are mailed by Holiday Magic, Inc. directly to Master and General Distributors (CX 1802C, CX 1800Z10Z11; GillespieTr. 9291) and were also sent out indirectly to Organizers and Holiday Girls through a policy of distributing twenty copies of the Wand to Masters and Generals and 'urging' their distribution to Organizers and Holiday Girls in their organizations (Gillespie Tr. 934344, 9292; 9350; CX 1601, CX 532, CX 1800Z11) as well as to use for recruiting purposes (CX 533).

42. Holiday Magic has also at times distributed the Wands directly to Holiday Girls (CX 136HFamily News5/31/68). The Holiday Girl Demonstration Kits also each contain one copy of the Wand (GillespieTr. 9350).

43. Holiday Magic, Inc. describes the value of the Wands as follows:

What a wonderful training and recruiting tool the Wand is! It should always be carried and used for 'prospecting', explaining the progress and history of Holiday Magic, and 'closing the sale.' 'After all Joe, look at all these people and their wonderful success. Now, why not you, too?' The Magic Wand can be the greatest recruiting tool you have if you will only use it. Each month you receive your complimentary copies. * * * 'With all this in mind, the Master or General who does not take full advantage of this newspaper is losing more than he will ever knew' (CX 79Z92).

And again:

And don't forget that the Holiday Magic Wand is one of our best Direct Approach aids, it will always excite a potential prospect's curiosity to the point of wanting to attend one of the business opportunity meetings. (CX 1840Z60Z61).

44. Early issues of the Wand also contained a 'Solution Box' column, designed to instruct distributors in the intricacies of the Holiday Magic Marketing Plan. At CX 8FWand 3/66:

All distributors who have any question regarding any phase of Holiday Magic should write the company. The authoritative answer to your question will appear in this column. This is YOUR column, so please use it to broaden your knowledge.

b. Holiday Magic Family News

45. Like the Wands, the Family News publications are designed to keep distributors up to date on the material covered therein (CX 28A). Family News appear in the record as CX 118124, CX 127CX 168, CX 170172.

46. The Family News is distributed to employees and distributors of Holiday Magic, Inc. throughout the United States (RugglesTr. 601).

C. Holiday Magic Bulletins

47. Holiday Magic, Inc. also utilizes a bulletin format to disseminate information to its distributors in the field. The bulletins are normally addressed to all Master and General Distributors (see CX 672, CX 665, CX 663, CX 630AB, CX 609, CX 549). On occasion bulletins will be sent to 'All Distributors' (see CX 473). Information Bulletins that are sent to Masters and Generals only are intended, with 'discretion,' to be relayed to Holiday Girls as well (CX 78Z9).

,48. Distributors are advised to place all bulletins received from Holiday Magic in a binder, as they will need to refer to them from time to time (CX 1800Z12).

D. Manuals

49. Holiday Magic Manuals appear in the record at CX 76116, CX 1800, CX 1842, CX 1840, CX 1841; and elsewhere.

These manuals are published regularly by Holiday Magic, Inc. and deal with a variety of subjects, from the holding of Opportunity Meetings and the training of Master and General Distributors in the art of recruiting (CX 78, 79, CX 1840, CX 1841, 1842, cx 90, 96, 97, 98, 99) to the techniques for selling cosmetics (CX 91, 92, 107, 108) and the establishment of a cosmetic wholesale retail business (CX 106).

50. Although only one or two manuals are given to all distributors at no cost to them (GillespieTr. 9347), it can be assumed that every Distributor at whatever level is cognizant and aware of what is in the manuals (Gillespie 9348, 9359).

51. The purpose of the manuals is to provide Masters and Generals with procedures and techniques to enable them to build and sustain an effective Holiday Magic program (CX 1800DMasters' and Generals' Manual).

52. Distributors are told to 'Know and practice anything written in this manual and you will achieve every objective that you might set for yourself' (CX 1800R).

53. Distributors are advised that almost any question that they can conceive of regarding the Holiday Magic program will be answered by the written material provided by Holiday Magic (CX 1800Z13, CX 78Z101, CX 70Z101).

54. Manuals are available to prospects as well as distributors, who may read them over before joining Holiday Magic (see Tr. 2980).

55. The purpose of [the Masters' and Generals'] manual is to provide Masters and Generals with procedures and techniques which will save time, experimentation, and expensive errors. Holiday Magic, Inc. expects each Master and General to be thoroughly knowledgeable in the methods used to build and sustain an effective Holiday Magic Cosmetic Program. (CX 78F, CX 79F Masters' and Generals' manuals appear in the record as CX 78AZ103, CX 79AZ103, CX 1800.)

VI. The Marketing Plan Generally

56. Corporate respondent's marketing plan is a distribution network which allows a potential distributor to enter at any one of three levels, i.e., Holiday Girl, Organizer and Master, and may eventually qualify at a fourth level, that of General (Answer, p. 3). 'Distributor' refers to all levels in the Holiday Magic

marketing plan (GillespieTr. 9364) and refers to any wholesaler or retailer of Holiday Magic products (CX 104M).

57. The distributors' gross profit is the difference between the price or prices at which he purchases Holiday Magic products and the price or prices at which he resells them (Answer, p. 3).

58. All Distributors are independent contractors (Answer, p. 4).

59. Every position in Holiday Magic requires a different level of investment (GuardTr. 10404; CX 1842, CX 90PS).

VII. Holiday Magic Distributors

A. Holiday Girl Distributor

60. Holiday Girls are required to invest \$39 worth of product and sales aids in order to qualify for that position (CX 78Z48, CX 79Z45, CX 1842R, CX 90P) or purchase a 'minikit' for \$11.99 (CX 90P).

61. Holiday Girls may be recruited and sponsored into Holiday Magic either by an Organizer, Master or General Distributor (CX 90P, CX 90Q; Tr. 2432, 2540, 3344; see also CX 90S).

62. Holiday Girls buy their product needs from their 'Sponsor' who would be either a General Distributor, Master Distributor, or Organizer Distributor (CX 78Z48, CX 79Z45; Tr. 903233, 3314, 2519, 2678, 5216, 2452, 2604).

63. Holiday Girls purchase their products at a 30 percent discount off of list retail list price (CX 78Z48, cx 79z45, cx 2065b, cx 2065d, cx 2080a, b, c; cx 2081a, b, c; cx 2083, cx 2084a, b; cx 2086, cx 2091a, cx 2093a, cx 2096a, cx 2099a, b; cx 2100, cx 2106, cx 2108A, CX 2112AC).

See also Part XIX.

64. At the end of each calendar month, Holiday Girls receive a cash refund bonus from their sponsors based upon total retail volume ordered during that calendar month. The amount of the refund bonus is computed according to the following Refund Bonus Schedule:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

(CX 78Z48, CX 79Z46, CX 77F, CX 649, CX 78Z33, CX 27A; see also Part XIX.)

65. There is a substantial turnover of distributors at the Holiday Girl level (ChristieTr. 5992; DempseyTr. 6035; HabuaryTr. 6082; CoultasTr. 9680, 9752).

66. Holiday Girls on the average are active from four to six weeks.

(a) Holiday Girls and Avon ladies do essentially the same kinds of work (BaumgartenTr. 9500). Avon has an exceedingly high turnover rate (CoultasTr. 9764) estimated to be as high as 1400 percent in the course of one year (Davis Tr. 6272).

(b) Dorothy Sovereign, who was with the Avon company for 7 1/2 years (Tr. 8688) as Avon's top selling Avon lady (Tr. 8710) as well as Holiday Magic's top retailer (Tr. 87078710) and who herself recruited approximately 100 Holiday Girls since she has been with the company, testified that Holiday Girls, on the average, last six weeks (Tr. 8695, 8701) about the same as Avon ladies (Tr. 8696).

67. Holiday Girls purchase cosmetics products for their personal use as well as for resale (CoultasTr. 9756, Semling Tr. 5875).

68. It can be reasonably presumed that the address of the Holiday Girl indicates the central area from which the Holiday Girl is doing business (see Tr. 4625, 7928).

69. Holiday Girls are retailers only under the Holiday Magic marketing plan and do not sell or attempt to sell at wholesale (CX 79Z98, CX 78Z65).

See CX 90UOnce your prospect enrolls [as a Holiday Girl] try to upgrade him to the Organizer level. (Put an 'X' on Organizer position.) Kid him (with caution) by such comments as 'Of course you're not going to trot down the street with that Holiday Girl kit in your hand. Don't you really think that you ought to be an Organizer so you can sponsor other businessmen like yourself into the program right away?'

B. Organizer Distributor

70. Organizer Distributors were required to invest approximately \$130.41 for one of every item in the Holiday Magic line (CX 1842R, CX 90P, CX 79Z98). As of approximately July 31, 1970, the required investment for the Organizer Distributor position jumped to \$299, for which the new Organizer received a Holiday Magic onepack of products, a MiniKit; a ten cassette library of recorded messages from motivational sales people, a one year subscription to 'Perception' magazine and a two day course taught by Instructor Generals (CX 165HFamily News7/31/70).

71. Organizers may sponsor other Organizers into the business, who in turn may sponsor other organizers into the business ad infinitum (CX 1842Y, CX 79Z29, CX 85S, CX 86B, CX 104N, CX 90P).

72. Organizer or Holiday Girls sponsored by other Organizer must buy their products from the sponsoring organizer (CX 79Z29, CX 104N, (CX 70Z99).

73. The Organizer serves as a subwholesaler and 'apprentice Master,' functions in the selection of personnel, hires, trains, and supervises Holiday Girls and other Organizers (CX 104N, CX 1802R, CX 90P, CX 79Z99).

74. There is no maximum number of other Organizer distributors that another Organizer may bring into the Holiday Magic program (Tr. 3702).

(a) The Holiday Magic Opportunity Meeting presentation shows a diagram of Organizers each having recruited five other organizers per month, in explaining the Holiday Magic opportunity. The diagrams look as follows:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

(b) Since the Opportunity Meeting script supposes that the Organizer Distributors will each on the average 'reproduce themselves five times' (CX 79Z31) an accurate pictorial of the opportunity meeting presentation with respect to the Holiday Magic marketing plan would look as follows after three months only:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

75. An Organizer Distributor buys and sells Holiday Magic products at the same 30 percent discount from list price, and is entitled to the refund as appears in the Refund Bonus Schedule, based upon cumulative monthly purchases in each calendar month (CX 77F, CX 649, CX 78Z48, CX79Z46, CX 78Z33, CX 104C, CX 105C).

See CX 4CWand: 11/65 Solution Box Column:

Question: How do I explain to an Organizer why he doesn't get a bigger percentage in his monthly refund schedule?

Answer: If an Organizer, who is actually a SubWholesaler, buys a Distributor Kit and a OnePack, he has purchased \$120.40 plus applicable taxes in his area. Thus, if his Holiday Girl sells any amount over \$100, this means a 35% on our volume schedule. Obviously, then, the Organizer cannot have any override since they are both in the 35% area.

* * * * *

76. An Organizer Distributor may 'earn' his way to the position of Master Distributor through creating \$5,000 retail volume in one calendar month (CX 1842S, CX 79Z100). This is known as the 'WorkIn Master' (CX 79Z100, CX 79Z95; Rule 23).

The Organizer will thereby receive credit for the total volume created, either through sales of product to Holiday Girls or to other Organizers (CX 1842T, CX 86B, CX 1840Z69, CX 90Q).

77. Examples given by Holiday Magic for workin Masters are seventeen girls working parttime averaging three hundred dollars a month totaling \$5100 or by sponsoring six suborganizers into the wholesale end

of the business who would purchase six onepacks each during a calendar month (presumably to recruit five others in turn and distribute a onepack to each (CX 1842T, CX 1940Z72, CX 90Q).

78. Approximately 25 percent of the Organizers recruited will become Masters if 'properly trained' in the first 10 days in Holiday Magic (CX 1840Z48, CX 85B; see Part XII 4(a)).

79. Organizer Distributors sell or attempt to sell at retail as well as at wholesale to other Organizer Distributor or Holiday Girls whom they sponsored into the Holiday Magic program (CX 79Z98, CX 79Z99; Tr. 5181, 5176, 5478, 2437, 2679, 5025, 5478, 7873).

C. Master Distributor

80. A Master Distributor can attain his position either as a 'Buyin' a 'Work in' or combination 'Buy-in/Workin' (CX 79H, CX 784).

(a) Buyin Master

1. A buyin Master may be introduced to Holiday Magic, Inc. by a General Distributor, a Master Distributor, an Organizer Distributor or a Holiday Girl Distributor (CX 79H, CX 78H).

2. A buyin Master is a person who becomes a Master Distributor by a lump sum capital investment for Holiday Magic products and sales aids (CX 79Z98, CX 79H; Tr. 2542).

3. The cost of the Master Distributorship has fluctuated from \$2500 to \$4500 (Tr. 9574, 959192, 2542).

(b) Workin Master

1. A Distributor may become a 'workin' Master by purchasing for resale from his sponsor the required volume, which has varied from \$5,000 to \$7,777.77 at the retail list price value (CX 79H, CX 79Z 100, Tr. 9606).

2. See Part VII B7.

(c) Workin/Buyin Master

A distributor may become a 'Workin/Buyin' Master by selling a portion of the required volume through his organization and purchasing from his sponsor or from Holiday Magic, Inc. the balance in one lump sum, which can be done in any one day of the month (CX 79H, CX 78H; Tr. 7183).

81. Master Distributors buy their Holiday Magic products at a discount of 55 percent off of retail list price (CX 79Z31, CX 70Z46, CX 78Z49).

82. Master Distributors buy directly from Holiday Magic, Inc.

(a) At CX 70Z31 'As a Master Distributor you buy directly from Holiday Magic.'

(b) CX 78TA General Distributor 'can work wholesale or retail or both as he desires. Does not supply his Masters with product.' A Master Distributor 'Buys product directly from factory to supply his Organizers and Holiday Girls.'

(c) Stipulation of respondents' counsel at Tr. 262123):

Q. Mr. Lzzard, I show you a document marked CX 439 for identification and ask if you will be able to identify this, please.

(The document referred to was marked CX 439 for identification).

A. Yes, sir, this is a bulletin, one of many dozens I received as a master distributor from the company in San Rafael, California. This one pertains to new warehouses available.

MR. CAMERON: Your Honor, I would like to offer this into evidence at this time.

MR. WOLFSON: Objected to on the grounds that that couldn't possibly have any probative value to the issues involved in this case.

HEARING EXAMINER BUTTLE: What is the purpose?

MR. CAMERON: Your Honor, we have this under our price discrimination category in our allocation, and this will show where masters and generals purchased their product, and to show the chain of distribution.

MR. WOLFSON: What difference can it possibly make where they purchased it?

HEARING EXAMINER BUTTLE: You say this will show where the masters and generals purchased their product?

MR. WOLFSON: It doesn't even show that.

MR. CAMERON: Your Honor, it is part of the mosaic of the marketing operation.

MR. WOLFSON: Now, that is not original, Judge.

HEARING EXAMINER BUTTLE: No; I wish I'd never used the word.

Well, now the reason you are giving me is no reason for my receiving it, so what else do you have to say?

MR. CAMERON: Your Honor, I think it is important, especially in our price discrimination allegation in the complaint, to show where distributors purchased their product from.

HEARING EXAMINER BUTTLE: Well, they'll stipulate with you that the distributors purchased their product from Holiday Magic, won't they? Now, that is what you said you wanted to introduce it for, isn't it?

MR. CAMERON: Well, I'd like to O.K.

HEARING EXAMINER BUTTLE: I guess so. All right.

MR. WOLFSON: He gave up.

HEARING EXAMINER BUTTLE: They will stipulate with you that masters and generals purchased their product from Holiday Magic; am I correct?

MR. WOLFSON: Yes, Judge, they gave up, they said they are going to withdraw it anyway, Mr. Brownman.

HEARING EXAMINER BUTTLE: Mr. Mitchell do you stipulate to that?

MR. MITCHELL: Sure, Your Honor.

MR. CAMERON: I'll take it back.

HEARING EXAMINER BUTTLE: That doesn't even prove it.

MR. WOLFSON: That is right.

(The documents referred to, heretofore marked for identification CX 439, was withdrawn).

(d) CX 106C 'Only Master and General Distributor's orders should be submitted to Holiday Magic. All other distributors purchase through their sponsor.'

(e) Testimony of former Administrative Vice President and Director Gillespie '[Holiday Magic adopted a numerical cross file for Masters and Generals but not for Holiday Girls] Because Holiday Magic did business with the Masters and Generals' (Tr. 9369); [O]bviously Masters and Generals normally purchased from the company * * *' (Tr. 9415, 9419).

(f) See also Part XLV 1.

83. Master Distributors sell or attempt to sell at retail as well as at wholesale to Organizers or Holiday Girls whom they sponsored into the Holiday Magic Program (CX 79Z99; Tr. 3077, 3458, 2452, 2604, 4187).

D. General Distributor

84. In order for a person to become a General Distributor, he must fulfill three qualifications:

(a) He must first be a Master Distributor (CX 1842U, CX 1940Z75, CX 90R).

(b) Submit a certified check for \$2500 to Holiday Magic, Inc. which is called a General's release fee and will be held in escrow until the third requirement is met (CX 1842UV, CX 1840Z7576, CX 78M, CX 90R).

The 'release fee' has ranged from \$2500 to \$3000 to \$4500, and has also been denoted by respondents as a 'contract settlement sum' and a 'general's performance fund' (Tr. 253435, 9530, 991819; CX 2000).

(c) He must 'recreate himself' by bringing in a replacement Master to his sponsoring General Distributor, before the sponsoring General Distributor will release him from Master Distributor to become a General Distributor (CX 1842V, CX 1840Z76, CX 78M, CX 90RS).

(d) Formerly a fourth requirement was that the Master Distributor attend Instructor General class (IG) as a prerequisite to becoming a General (CX 1842U, CX 1840Z74, CX 90R). The requirement is now moot since Instructor General school is a requirement to become a Master Distributor as of Apr. 30, 1970 (CX 159F Family News 4/10/70).

85. As a practical matter, Holiday Magic, Inc. recognizes only two requirements for a Generalship position: the release fee and the replacement Master.

(a) At CX 1842Z2

Now, that newly created master distributor will want to become a general distributor to earn the kind of money a General does! But, [in] order for a master distributor to become a General Distributor, there are two major qualifications that must be completed. The first is to post a \$2500 dollar General release fee with the factory, and the second is to bring in a replacement master to your sponsoring General before he will release you to become a General Distributor!

(b) See also

1. Witness Davis was congratulated by Holiday Magic on having become a General Distributor only twelve days after having been congratulated for becoming a Master Distributor (CX 1391, 1393; Tr. 1358).

2. When Crosby was congratulated by Holiday Magic, Inc. on becoming a Master Distributor and the same day was congratulated by Holiday Magic, Inc. on becoming a General Distributor (CX 1349, CX 1350). Note that Crosby's 'Application' to become a General is dated 9/23/69, whereas the letter informing him of his Master status (and General status) was dated 9/24/69.

3. Other examples of Masters becoming Generals very quickly are: (CX 35F (2 weeks); CX 3D (10 days); CX 45G (2 weeks); CX 35C (7 days), Tr. 2067 (45 weeks); Tr. 3136 (3 days); Tr. 5311 (week or two); Tr. 406061 (next day).

4. See CX 18A; GayTr. 9956.

86. General Distributors purchase Holiday Magic products directly from Holiday Magic, Inc. at a discount of 54 percent off of retail list price (Answer, p. 4; CX 104M; see also VIIC3).

87. General Distributors sell or attempt to sell at retail as well as at wholesale to Organizer Distributors and Holiday Girl Distributors whom they sponsored into the Holiday Magic Program (Tr. 4553, 783839, 5140, 2525, 5218, 2479).

E. Replacement Masters

88. The strength of the Holiday Magic Marketing Plan, as Holiday Magic describes it, lies in the replacement master requirement.

CX 1842V This means he must bring in a replacement Master Distributor to you, his sponsoring General Distributor, before you will release him from Master Distributor to become a General Distributor.

Herein lies the strength of the Holiday Magic marketing plan Why Holiday Magic has grown so rapidly because he must always replace himself with a working indian before he can become a chief. Your number of Masters will never decrease you will only grow in the number of Generals you have.

This replacement Master was brought into the sponsoring General Distributor which just caused another \$5,000 in retail product to be purchased from the factory * * *

VIII. Holiday Magic Distributors Statistics Numbers and Geographic Areas

89. As of approximately Feb. 26, 1969, Holiday Magic Records indicate that 9252 persons had become Master Distributors throughout the country, of which 2940 became Generals. The Record further reflects that as of approximately Dec. 31, 1968, (only two months earlier) there had been a total of 43,713 Organizer Distributors and 41,918 Holiday Girl Distributors (CX 457A).

90. Inasmuch as Organizer, Master and General Distributors are all qualified to sponsor and recruit Holiday Girls into the Holiday Magic program, on the average, persons in their lifetime as Holiday Magic distributors actually recruited and sponsored less than one Holiday Girl each (CX 457A).

91. It can also be found that since 2940 persons became General distributors, an equal number were at one point in the program Replacement Masters (CX 457A).

92. A breakdown of Organizers and Holiday Girls by state reveals the following, as of 1/29/69:

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CX 457A, B, C)

93. As of approximately Apr. 26, 1972, approximately 504 Masters had been recruited in the State of Florida, of whom 219 had become Generals and 285 remained as Masters (CX 2081AZ21).

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Fort Pierce Of the 34 Masters and Generals, 32 were recruited in calendar year 1966 as Masters (another one was recruited on 12/31/65!) and 23 of the 34 were recruited as Masters and Generals in just the first six months of 1966 (CX 2081AZ21).

Okeechobee Of the total of 11 Masters and Generals all were recruited as Masters and Generals during a five month period from May to Sept. 1966 (CX 2081AZ21).

94. As of approximately Nov. 1970, Holiday Magic had on record for the State of Illinois approximately 1918 Masters of whom 511 were able to qualify as General Distributors (CX 200AZ177; Tr. 4738).

Of these Masters and Generals, the following can be gleaned in conjunction with Census figures in the record as RX 156

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95. Through a process of addition, one can find that since Master Distributor numbering started on a sequential basis throughout the country as of May 1969 (Tr. 9989; CX 2081 Z12) with ID #20001, and that by the end of Apr. 1970, ID #022972 had been reached (CX 2081 Z16); therefore:

(a) 14 more Masters were recruited from Mt. Prospect during the period May 1969 through Apr. 1970; a total of 9 persons had already been recruited as Masters and Generals as of May 1969.

(b) Seven more Masters and three more Generals were first brought into the program in Skokie during the period May 1967 through Apr. 1970; a total of 31 persons had already been recruited as Masters and Generals as of May 1969.

(c) 14 more Masters and six more Generals were first brought into the program in Des Plaines during the period May 1969 through Apr. 1970; a total of 26 persons had already been recruited as Masters and Generals as of May 1969.

96. Chicago Metropolitan Area:

Approximately 1000 Masters and 600 Generals have been recruited in the Chicago metropolitan area, which for purposes of this finding is defined as including all of Cook County and DuPage County only. The population of these combined counties is approximately 6,000,000 people (RX 156; CX 200AZ177).

As of approximately Dec. 1969, Holiday Magic figures indicate that a total of approximately 809 Masters and Generals had been recruited in the State of Michigan (Tr. 3892; CX 357BZ52).

A comparison with Census figures for 1970 shows the following (RX 155):

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97. As of approximately Jan. 1971, there were approximately 25,000 Masters and Generals that had been recruited in the country.

(a) This information was relayed to former Holiday Magic President Ben Gay III when he was in charge of Holiday Magic, Ltd. in Canada, by Harold Combs, the man in charge of the Customer Service Department (Tr. 89999900, 9984).

This information is possibly more reliable than the testimony of Sherman Coultas, who testified that since the beginning, 20,000 Masters and Generals had been recruited 'probably' (Tr. 9759).

98. As of approximately the end of 1972, 168,000 Holiday Girls and Organizers had been recruited into the Holiday Magic program (Tr. 9762).

Although this information was also testified to by Mr. Coultas, it is considered more reliable than his estimate of the numbers of Masters and Generals since he at first stated he didn't know what the figure was and only after being shown a document was he able to 'refresh his recollection.' (Tr. 9762).

99. The ratio of Holiday Girls to Organizers, Masters and Generals is approximately 4 to 5 and the ratio of Holiday Girls to Organizers is less than 1 to 1 (CX 457 A). The ratio of Masters to Generals is approximately 2 to 1 (CX 457A).

100. Holiday Magic, Inc. does not know and keeps no records of the number of Masters and Generals that are actively pursuing their business.

(a) George Platsis, Assistant Attorney General, State of Michigan testified that he asked Holiday Magic, Inc. for a list of active and inactive distributors. Holiday Magic's response, in Dec. 1969, was that they have no way of knowing who is active and who is inactive (TR. 3892). The list of Masters and Generals supplied appears in the record as CX 357BZ52 (TR. 3890, 3894).

(b) Sherman Coultas, Holiday Magic's Director of legal service, testified that Holiday Magic, Inc. has no records of turnover of Masters and Generals (TR. 9760).

(c) The only method Holiday Magic uses to determine which distributors are active and which are inactive, is to record as 'active' those distributors who reordered product from Holiday Magic in the preceding six month period (Coultas TR. 9699). However, a study of the lists in question testified to by Mr. Coultas (RX 159, RX 160 and RX 161) indicates that Distributors are considered active if they ordered in the previous 12month periodnot six month period (see RX 159, RX 160, and RX 161; TR. 9699).

(This is an unreliable yardstick, since Distributors can be active and not have reordered from Holiday Magic, or can be purchasing for personal use only and not be active as a Distributor.)

(d) Another method of determining the number of active Masters and Generals today is to assume that active Masters and Generals belong to the CRS distribution centers. Testimony appears in the Record that 95 percent of 'active' people belong to CRS (TR. 9629Pangerl) and that there are 2700 members of CRS (TR. 5881Semling). From this it can be determined that there are 2,842 active Masters and Generals throughout the country today.

101. Distributors whom Holiday Magic, Inc. considers to be 'inactive' continue to receive bulletins and Wands from Holiday Magic, inc. (CoultasTR. 9699; CoultasTR. 974344).

102. Holiday Magic, Inc. has a policy of not providing its distributors with the number of previously recruited Distributors in the geographic or market area in which the Distributors do business or are recruited and Distributors who seek such information are denied it. See following:

(a) CX 1881WandSolution BoxJan. 1967:

Question: Can the company provide me with a list of Master and General Distributors in our area so we can participate in joint projects?

Answer: The company does not compile lists of distributors by area, but suggests that this data could be obtained through the council in your area. A list of councils can be obtained by writing the company.

Question: In the December issue of 'The Wand,' we read that 'Holiday Magic' now has 50,000 distributors. We find this almost as incredible as the monthly sales volume. Are these figures accurate?

Answer: The sales figure is indeed accurate. However, the number of Distributors was a misprint. After some deliberation, we have decided to keep the actual figure as to the number of distributors a well-guarded secret.

(b) TR. 906667At first denied because not in Distributor's interestthen given to Council only when mailing initiated to get membership back up.

(c) GayTR 9970.

103. Attached hereto are bar graphs picturing the Master and General Distributors recruited in the geographic areas noted by calendar year.

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

IX. Release Fee Procedures

104. When the release fee money comes into Holiday Magic, Inc. it is deposited in the Holiday Magic accounts, and when a Master Distributor qualifies for the General position by finding a replacement Master, the money is sent out to the old General. Holiday Magic maintains a record of the fees that are thereby sent out (AlexanderTR. 5540).

105. The release fee sum rose from \$2500 to \$3000 approximately six weeks after the buyin requirement for the Master Order went from \$2500 to \$3000 (AlexanderTR 555960); and the buyin requirement and release fee are both up to \$4500 (CX 2069D; TR. 9574; CX 2000).

106. The Master Distributor who pays the release fee to become a General Distributor receives no additional product or inventory therefor. What he does receive is the right to purchase merchandise from Holiday Magic at a 65 percent discount off of list price rather than 55 percent, and receiving the release fee money from other Master Distributors who become Generals (STIPULATION OF RESPONDENTS AT TR. 247576) as well as to be entitled to obtain the 10 percent and 1 percent overrides available only to General Distributors (CX 79M; CX 90P; TR. 1090; 12281229; 13141315; 48434844; 4935; 49454946; 5199; 6058; 6061; 1232).

107. The release fee is paid automatically and without question when a replacement Master is introduced to Holiday Magic, Inc. by the Master desiring to become a General.

CX 90RS When this replacement Master is brought into the business, an additional \$5,000 in retail product is purchased from Holiday Magic and you, with your 10% override, would be paid another \$5,000 in cash. But since the rules require you to pay out \$200 in cash as a finder's fee to whomever brought in this Master, you net only \$300, on replacement Masters. However, the moment that the replacement Master is officially recorded by the company, the \$2,500 cash, being held in escrow, is released to you, the sponsoring General Distributor. Thus, you have earned a total of \$3,300 cash each time you sponsor a new General Distributor.

X. Inventory Requirement and Draw Account

108. Persons who wish to start out in the Holiday Magic program as Master Distributors must purchase an 'inventory' of cosmetics valued at between \$5,000 and \$7,777.77 (CX 77K; CX 90P; TR. 9603).

109. Persons who are workin/buyin Masters must purchase an 'inventory' to qualify for the Master position equal to the difference between the Master calendar month purchase requirement of from \$5,000 to \$7,777.77 and the amount actually sold to his Organizers, Holiday Girls or retail customers during that same month (CX 78H; CX 79H).

110. Persons who are 'Workin' Masters have no initial inventory requirement since all merchandise purchased from Holiday Magic during the Calendar month in which they are to qualify as Master Distributors are resold to Organizers, Holiday Girls or retail customers (CX 90Q; CX 1842ST).

111. The new Master Distributor who qualifies either as a buyin or work in/buyin may either receive the merchandise ordered from Holiday Magic, Inc. or a credit for same which he may draw upon as he desires (CX 77K; RugglesTR. 651; CX 379).

112. The draw account exists for Master Distributors and General Distributors (GillespieTR. 9440).

113. The draw account device was initiated by Holiday Magic, Inc. in 1965 (GillespieTR. 9441).

114. Some distributors take their entire draw balance on their first order. Some take half, and some take just a small amount LipskaTR. 10410).

115. If a Master Distributor becomes a General with a portion of his initial purchase requirement still on a draw account, he continues to order at the 55 percent discount until the draw balance is zero, even though he is already a General Distributor (CX 1415).

116. Other than the draw account and buyin or workin/buyin requirements, there are no inventory requirements for Master Distributors and there are no inventory requirements for General Distributors imposed by Holiday Magic, Inc. (see CX 1302A, B; CX 90RS; CX 78MO; except when new partners are taken into the businessSee Part XXV).

117. An inventory requirement of the CRS Distribution Center which Master and General Distributors may utilize is \$4,000 in retail value of product for Masters and Generals (See Part XXX).

XI. Finder's Fee

118. Holiday Magic, Inc. requires its General Distributors to pay a finder's fee of \$100 to any Holiday Girl, Organizer or Master distributor who sponsors a 'Buyin' Master Distributor (CX 79Z97, Rule 31); CX 79Z98; CX 78P; CX 79P; CX 78H; CX 104M; CX 78Z100 (Rule 31); CX 81Z52 (Rule 31); CX 82Z52 (Rule 31); CX 83Z52 (Rule 31); CX 104L (Rule 31); CX 105H (Rule 30); CX 404D (Rule 30); at CX 78P AND CX 79P:

This fee of \$100 is a special bonus paid by the General * * * to the person who introduces a new 'BuyIn' Master Distributor to him.

It is paid only once and is paid on or before the fifth of the month. * * * Masters, Organizers and Holiday Girls may receive this special bonus for bringing in a Master Distributor at this initial level of commitment. It is only paid on persons who originally sign in as Master Distributor and is never paid on 'Workin' Masters, who have previously executed an application and agreement as an Organizer or Holiday Girl.

119. In order to receive a finder's fee, the person must have been in the Holiday Magic business either as a Holiday Girl, Organizer or Master Distributor, 'which means they would have had to buy a kit to get started with' or 'the minimum inventory' for an Organizer or 'the Master's inventory.' (PangerlTR. 9542).

120. The finder's fee payment is a requirement of Holiday Magic, Inc. It must be paid by the General Distributor. General Distributors have been terminated by Holiday Magic, Inc. for failure to pay the said fee (GillespieTR. 9364; CX 658B; CX 686GJ; CX 655; CX 659; TR. 6952).

121. A Master Distributor who sponsors another Master Distributor into Holiday Magic, Inc. and who obtains the \$100 finder's fee may also use this 'BuyIn' Master as a replacement Master to enable him to become a General Distributor (CX 1840Z59).

XII. The 2 Percent Override

122. Holiday Magic, Inc. requires its General Distributors to pay a sum of money to Organizers and Master Distributors equal to 2 percent of the retail list price value of products purchased by any Master Distributors, the Organizer Distributors or Master Distributors sponsored into the Holiday Magic program. The Organizer Distributors sponsored into the Holiday Magic program. The Organizer Distributor or Master Distributor receiving a finder's fee continues to be entitled to receive this 2 percent override until such time as the recruited BuyIn Master or the sponsoring distributor becomes a General Distributor (CX 78Z100 (Rule 31); CX 79Z97 (Rule 31); CX 81Z52 (Rule 31); CX 82Z52 (Rule 31); CX 83Z52 (Rule 31); CX 104L (Rule 31); CX 105H (Rule 30); CX 404D (Rule 30); CX 78P; CX 79P; CX 77K).

123. The 2 percent override could amount to a considerable sum each month.

At CX 78Z52:

Suppose that after you have been with the Company for several months you have caused to develop among your directs, five Master Distributors. You will receive 2% from each of their volumes. This 2% could amount to a considerable sum each month.

124. The 2 percent override is required to be paid by the General on or before the fifth day of the following month (CX 78H; CX 78H; CX 78P).

125. Distributors who receive the percent override are not required to sell product to the Masters doing the purchasing from Holiday Magic, Inc. and do not service them in any other way:

(a) at Cx 79Z31:

Now, let's look at the next 30 days in the business your third month.

Each one of these people will do the same thing that Mary had done and for the very same reason they will reproduce themselves five times. And now that that has happened, you have reproduced yourself five times.

Each one of your original five people is now moving the same volume that you moved last month \$9,000. And now we have a bit of a problem.

If you will look back on that chart, [Refund Bonus Schedule] you will find that they are earning 55% and you are at 55% and there is nothing left over. You are not making anything.

Well, there was one thing that I didn't tell you about this plateau that you reached when you went above \$5000 in volume.

At that time you became a Master Distributor. As a Master Distributor you buy directly from Holiday Magic, You receive as their sponsor an override. In this case that override is 2%.

2% of \$9000 is \$180.00. You have five people doing that and that's total of \$900.00.

So, in your third month you have earned a total of \$900.00 from your first five people. Again, all the new people in the business this month were sponsored by someone you sponsored in a prior month. As yet you haven't done anything.

(b) At Physical Exhibit B, TR. 9807:

At this point, you may desire to consider the possibility of working full time in your Holiday Magic cosmetic business. By the end of your third month with Holiday Magic, you will be pleased to discover that your first five outlets have reached the volume of \$9,000 each and, as you have done, they, too, become Master Distributors. At this point, they begin to purchase directly from the company.

Although you are no longer required to service them with product and they no longer need your service or your help, you begin to receive 2 percent of their volume. Two percent of \$9,000 is \$180 times five, which equals \$900. This 2 percent is a perpetual override for you each and every month so long as both remain a part of the Holiday Magic organization or until either of you or they become General Distributors.

Your total profit for the third month is calculated as follows: You receive \$900 as an override from your first five outlets without lifting a finger.

126. The 2 percent override is an absolute requirement of Holiday Magic, Inc. It must be paid by the General Distributor. General Distributors have been terminated by Holiday Magic, Inc. for failure to pay the said money.

See CX 658A, B, where in Holiday Magic, Inc. terminated a Distributor for failure to pay a 2 percent override:

As you know, the payment of this 2% override is a definite requirement of our marketing plan and no deviations will be allowed.

XIII. The Ten Percent Override

127. General Distributors receive directly from Holiday Magic, Inc. a monthly payment equal to 10 percent of the retail list price value of products purchased by Master Distributors (CX 790; Physical Exhibit BTR. 9808; CX 152B; CX 104N; CX 78M; CX 79M; CX 1842U).

128. Along with the 10 percent override, the General Distributor receives a copy of the Master Distributor's official monthly purchase record (CX 790; CX 780; CX 2053AM; CX 2054AL; TR. 52235227).

129. General Distributors also receive directly from Holiday Magic, Inc. a payment equal to 10 percent of the purchase volume of Master Distributors recruited by themselves or by Organizers or Holiday Girls to whom they sell, directly or indirectly:

CX90R:

For just a moment, put yourself in the position of a General Distributor working at 65%. Each time you create a new Master Distributor you receive a cash override of 10% of the total retail value of the merchandise which must be purchased from the company to establish that Master Distributor. Ten percent of \$5,000 will earn you \$500 cash.

When this replacement Master is brought into the business, an additional \$5,000 in retail product is purchased from Holiday Magic and you, with your 10% override, would be paid another \$500 in cash. But since the rules require you to pay out \$200 in cash as a finder's fee to whomever brought in this Master, you net only \$300 on replacement Masters.

130. All Master Distributors are assigned to a General Distributor who receives the 10 percent override on the Master Distributor's purchases. (CX 200AZ177).

131. There are, however, General Distributors who have no Master Distributors assigned to them and over whom they collect a 10 percent override.

(a) Since there are more Masters than Generals this is inevitable. See Part VIII.

(b) Specific Examples at TR 40554069; TR. 13351409; TR. 14851625; TR. 16941822; TR. 4814; TR. 6947).

132. Replacement Masters are included in the group of Master Distributors who are assigned to a General Distributor who receives a 10 percent override on their purchases.

(a) This follows from XIII 3.

(b) For specific examples, See: TR. 9560, 9571).

(c) CX 1842V; CX 90RS).

133. Replacement Masters of replacement Masters are included in the group of Master Distributors who are assigned to a General Distributor who receives a 10 percent override on their purchases.

(a) This follows from XIII 3.

(b) For specific examples, see: TR. 9560; 957172).

(c) At CX 1842: WHOLESale ENROLLMENTFor just a moment * * *, put yourself in the position of a General Distributor working at 65%. Each time you create a new Master Distributor you receive 10% of the total retail volume that must change hands. Ten percent of \$5,000 has just earned you \$500.00 cash!

This newly created Master Distributor that you have just enrolled will want to become a General Distributor like you so that he may earn the kind of money that you are earning here. * * *

* * * This means he must bring in a replacement Master Distributor to you, his Sponsoring General Distributor, before you will release him from Master Distributor to become a General Distributor.

Herein lies the strength of the Holiday Magic marketing plan why Holiday Magic has grown so rapidly because he must always replace himself with a working indian before he can become a chief. Your number of Masters will never decrease you will only grow in number of Generals you have.

This replacement Master was brought into the sponsoring General Distributor which just caused another \$5,000 in retail product to be purchased from the factory and you, with you 10% overruled, have just been paid another your 10% override, have just been paid another

134. Holiday Girls and Organizers who become Master Distributors, who are not themselves replacement Masters, are included in the group of Master Distributors upon which the General Distributor in whose buying organization they had been, gets the 10 percent override (CX 90T).

135. Holiday Girls and Organizers who were in the buying organization of a Master Distributor upon which a General Distributor receives a 10 percent override, when becoming Masters themselves will also

produce the 10 percent override for the General Distributor, unless the first Master became a General Distributor himself prior to the movement to Master. A Master Distributor takes his entire Organization with him when he moves into the General position (Wolfson Stipulation; TR. 4938; CX 9025).

136. Procedure for Paying 10 Percent override

(a) As soon as the Master order comes into Holiday Magic, Inc. checks are cut for the General's override. It is a routine office procedure. (Alexander TR. 553031.)

(b) There is an obligation on the part of Holiday Magic, Inc. to pay this Commission [override] the minute of Recruiter [general] takes a check from a Recruitree [New Master]. (Stipulation of Attorney Wolfson TR. 5659; Alexander TR. 5699.)

(c) Holiday Magic, Inc. asks for no reports requires no reports, and receives no reports with respect to the payment of the 10 percent override in connection with 'services' performed. (Alexander TR. 5531; TR. 553738; 5539.)

(d) However, many reports are received that General Distributors perform no services; the response from Holiday Magic, Inc. is that all purchases are final (Ruggles TR. 555556.)

See also Tr. 5351, 5350, 184244, 158990, 1679, 1546; CX 1342 A, B, CX 1380, CX 1411, CX 1353, CX 1382AB:

(e) General Distributors who in fact perform no services receive the 10 percent override. (Tr. 204647, 8852, 907275, 6978, 7016, 7110, 632021, 6344, 6978, 8962.)

(f) Holiday Magic President Al Pangerl testified that a Master of this went to California when he was the top producing General in the country, residing in New York, but continued to receive the 10 percent override because 'he knew what it was all about as a Master.' (Tr. 9649.)

137. General Distributors can live anywhere in the country and receive the 10 percent override on other Master Distributors living anywhere else in the country.

See Tr. 9649, 103391, 5349, 8852, 9118.

XIV. The One Percent Override

138. General Distributors receive directly from Holiday Magic, Inc. a monthly payment equal to 1% of the retail list price value of products purchased by other General Distributors, and by Master Distributors over whom the second General Distributor is receiving a 10 percent override (CX 79M, CX 790, CX 2053AM, CX 2054AL, CX 90P; Tr. 52235227).

At CX 790

This [1%] override is paid by Holiday Magic to the old General of a Master who has been promoted to the General position. It is paid monthly by the Main Office and is based on the purchases of the new General, plus the purchases of all of this new General's Master Distributors.

139. All General Distributors are assigned to another General Distributor who receives the 1 percent override (CX 200AZ177).

140. There are, however, General Distributors who have no General Distributors assigned to them, and therefore they collect no 1 percent override.

(Since there are Generals without Masters, there are no Masters to become Generals (XIII4).)

141. Since replacement Masters and replacement Masters of replacement Masters may be assigned to a General over whom a 10 percent override is obtained, replacement Masters and replacement Masters of replacement Masters, upon becoming Generals, are assigned to that same General who now receives a 1 percent override instead of the 10 percent override.

(a) See XIII5, 6.

(b) See Tr. 6057, Testimony of Corporate Official Dempsey that Jim Hean was a replacement Master in his organizationsponsored by a man Dempsey brought in the businessand Dempsey received a 1 percent override in 1966 on Jim Hean's \$300,000 volume, amounting to \$3,000.

(c) See Tr. 6483.

142. The General receiving a 1 percent override on the purchase volume of another General is not required to have any business relationship with the second General, has no business relationship with the second General, and performs no services for either the second General or Holiday Magic, Inc. To this effect are the following sources:

(a) Stipulation of Attorney Wolfson at Tr. 4613: 'This man as a General doesn't have to have any business relationship with the General from whom he receives the one percent. That's a contractsettlement sum, Judge. He's not supposed to supervise the old General.'

(b) Instructor General and former National Field Director Christie, at Tr. 5955'A General Distributor should be able to run the business on his own.'

Mr. Christie continues to receive overrides from his New York Distributor Although no longer there (Tr. 5979).

(c) Tr. 69916992 of Respondent's witness Kobayaski; a General Distributor from California since 1965:

Q. Who was the General before you in your organization?

A. General before me, Keoshi Hagashi.

Q. Where is he?

A. He travels all over.

Q. When was the last time you saw him?

A. I haven't seen him recently.

Q. Well, when was the last time that you saw him?

A. I saw him last year. I saw him once.

Q. Let's take the calendar year 1971. How often did you see him in 1971?

A. I didn't see him. What for?

(d) Testimony of Holiday Magic president Al Pangerl at Tr. 955657:

Q. * * * Were you assigned another sponsoring General after [Mr. Birni] left [Holiday Magic]?

A. Yes.

Q. Who was he?

A. Tony Rubio.

Q. So Mr. Rubio had been Mr. Birni's sponsoring General?

A. Yes.

Q. Where did this Rubio conduct his business?

A. In California.

Q. Did you have any business relationship with this man?

A. No.

Q. As far as you know he received one percent override on all of your business?

A. Yes.

And at Tr. 9621:

Q. I ask you if Tony Rubio's profit from his business, namely the one percent he received from your volume, was determined by the effort that he, Mr. Rubio, put into the business.

A. If he was working with me then the answer to that would be 'yes.'

Q. And if the answer to that was that he was not working with you, the answer would be 'no'?

A. The answer would be 'no.'

Q. And he was not working with you?

A. No. I saw him on occasion when I was in California and he called me. I knew more than he did, so he couldn't help me much.

Mr. Pangerl's Sponsoring General received 1 percent of \$400,000(Tr. 9557).

(e) A distributorship and the 1 percent override is inheritable, and in effect [Aug. 1967] is included in the estate of the deceased distributor (CX 25GWand, Solution Box867).

(f) See also Tr. 960102, 6072, 6481, 6482, 9420, 9647, 715860.

General Distributors can live anywhere in the country and receive the 1 percent override on other General Distributors living anywhere else in the country (Tr. 9621, 5349, 8963, 8199, 8352, 8685).

XV. Distributor Contracts

143. The Holiday Magic Contract or 'Application and Agreement' is entered into by all three entering levels of distributorsHoliday Girls, Organizers and Masters (RugglesTr. 667; PangerlTr. 9514; Tr. 1929).

144. Contract forms appear in the record at CX 403, CX 402; CX 1925; CX 1880 A, C; CX 1887).

145. All Holiday Magic rules and regulations either appear on the document itself, or the contract embraces all the rules and regulations of Holiday Magic, Inc. (PangerlTr. 9514; CX 404; WolfsonTr. 5658, stipulation); or are specifically referred to in the face of the contract as being an integral part of the contract as set forth in the Holiday Magic Sales Manuals, and distributors agree to abide by all of rules and regulations of Holiday Magic, Inc. (CX 403).

146. Holiday Magic, Inc. maintains in its files a copy of contracts entered into with all levels of distributors (Tr. 9368; CX 405) and requires that this be done. See also the following sources:

(a) At CX 405, bulletin from Holiday Magic, Inc. to all Masters and General Distributors.

Company policy dictates that a distributor to be recognized by the company as an authorized distributor, his application and agreement must be on file in this office.

You Master and General Distributors * * * should forward to this office any such applications you may now be holding.

(b) CX 78Z98, Rule 17, CX 79Z94, CX 81Z48, CX82Z48, CX 83Z48:

For a person to have status with the company as an authorized Distributor, the Company must have in its records an Application and Agreement form signed by the Distributor.

147. The Holiday Magic rules and regulations apply to all four levels of distributor, i.e., Holiday Girls, Organizers, Masters and Generals, except to the extent that a rule may relate to a specific distributor level only (GillespieTr. 93579364).

148. In 1967, Holiday Magic, Inc. paid out \$2,721,092.19 in overrides to General Distributors (Tr. 9251) or approximately 9 percent of the company's gross sales at retail list price value. Since 1 percent of all the gross sales at retail list price value is payable to General Distributors, it can be determined that for 1967, \$303,608.13 went to Generals on the 1 percent override, and the remainder, or \$2,417,394 was based upon the 10 percent override, or purchases of Masters. Approximately 12 1/2 percent of the total override payments is based upon the 1 percent override.

149. The override payments for the years ending Sept. 1968, 1970, and 1971 can be determined in the same manner. Nine percent of the total of the figures appearing in RX 16 is the override payment to all Generals, and 12 1/2 percent of that figure is the 1 percent override payment 87 1/2 percent is the 10 percent override payment.

150. For the fiscal year ending Sept. 1970, Holiday Magic's gross sales at retail list price value was \$15,334,830 (RX 16). Nine percent of this figure, or approximately \$1,380,000 was the override payment, of which \$172,500 was a payment on the 1 percent override and \$1,207,500 on the 10 percent override.

151. For the month of June 1970, twentynine Holiday Magic General Distributors earned over \$2,000 in overrides, for July 1970, 58 Holiday Magic General Distributors earned at least \$2,000 in overrides, and in Aug. 1970, \$2,000 or more in override checks were mailed out by Holiday Magic, Inc. to 61 General Distributors, some of whom received as much as \$13,000 (CX 61DE; CX 60F).

No applications for Organizers and Holiday Girls are refused (CoultsTr. 9762).

XVI. New Master Distributor Procedures

152. Applications come into the customer service department, accompanied by a certified check made out to Holiday Magic, Inc. (RugglesTr. 653; AlexanderTr. 5512, ,5560).

153. Holiday Magic, Inc. requires that only cashier's checks or certified checks should be sent with the Master orders as well as with all orders (Tr. 1512; Tr. 5654; CX 28B; CX 155H; CX 79Z93 (Rules 7)).

154. A distributor who received the check couldn't cash it since it was made out to Holiday Magic, Inc. and even cash has been refused by recruiting distributors (Tr. 1512).

155. The reason for the certified check policy is that no one could stop payment on the check once it was turned over to the recruiting distributor (AlexanderTr. 5654).

156. Once the check was in the Holiday Magic office, it was deposited (AlexanderTr. 5652).

157. The new Master Distributor was then automatically assigned a number, the contract was time stamped, and a distributor file was set up (RugglesTr. 653 654; AlexanderTr. 5512).

158. New Master Distributor 'Applications' never reached anyone in Holiday Magic, Inc. at the executive level (AlexanderTr. 5313; GayTr. 956).

159. Money is the only 'qualification' to become a distributor in Holiday Magic.

(a) This follows from XVII174.

(b) Witness Jane Alexander, former Executive Secretary to William Penn Patrick, related a story of how she pleaded with Patrick in 1968 or 1969 to refund the money to a boy who had borrowed money from his mother to become a Master, but had been drafted in the interim before the product inventory was shipped.

Patrick asked if product was sent, Mrs. Alexander said 'no' and Patrick replied 'Make sure it gets out of warehouse tonight.' (Tr. 5653, 5697, 5652).

(c) It is Holiday Magic, Inc. policy not to issue refunds on new Master orders (AlexanderTr. 5652; CX 466D; CX 79Z93 (Rule 5)).

(d) At CX 78Z7 and CX 79Z7:

When a Distributor deliberately holds people back, the result is, at best, undesirable. The untrained and/or unthinking Distributor who discourages a person in 'Master' or 'Qualifying' Master from entering into the program until the Distributor is 'ready' will find that this type of greed will ultimately hinder and stop his own growth.

XVII. Inflexibility of Marketing Plan

160. Distributors at all levels, i.e., Holiday Girls, Organizers, Masters and Generals are required to abide by all rules and regulations of Holiday Magic, Inc., as well as all procedure contained in other company

publications such as bulletins and sales manuals (CX 105H, Rule 1; CX 77L, Rule 1; CX 78Z96, Rule 1; CX 79Z93, Rule 1; CX 105H, Rule 1; CX 104HK; CX 81Z4851; CX 82Z4851; GillespieTr. 93579364).

161. Distributors at all levels, i.e., Holiday Girls, Organizers, Masters and Generals agree to abide by all rules and regulations of Holiday Magic, Inc. (CX 105H, Rule 1; CX 77L, Rule 1; CX 78Z96, Rule 1; CX 79Z93, Rule 1; CX 105H, Rule 1; CX 403A, B, Rule 1).

162. Violation of any Holiday Magic rule or regulation subjects the offending distributor to termination by Holiday Magic, Inc. (CX 78K; CX 104D; CX 105D; CX 77L; Rule 13 CX 78Z9, Rule 25; CX 78Z95; Rule 25; CX 81Z48; Rule 25; CX 82Z48; Rule 25; CX 104HK, Rule 25; CX 105H, Rule 25 Tr. 5604).

163. Holiday Magic, inc. has terminated various distributors at all levels for violating certain of its rules, regulations and policies (CX 457 A; CX 656AB; CX 657AB; CX 658AB; CX 659; CX 688AC; CX 689).

164. Termination of any individual in Holiday Magic, Inc. is the responsibility of the Holiday Magic board of directors (CX 78Z8689; CX 79Z89 90; CX 78Z9, Rule 25; CX 105H, Rule 25).

165. Other statements by corporate officials emphasizing the inflexibility of the Holiday Magic marketing plan are the following:

(a) Statement by John Hart, board of directors vice chairman, at CX 15C WandOctober 1966:

It's always amazing, and heartening to observe the rapid rise of members of our family of distributors.

However, this relation is tinged with disappointment when note some of our most successful distributors showing evidence that they feel the marketing planwhich has been highly instrumental in their successis a flexible process.

My friends, such is not the case!

The Marketing process is a rigid plan, evolved after exhausting research, backbreaking experience, detailed analysis and brilliant planning.

The basic strength of the marketing plan lies in its rigidity!

You can find that which we all are seeking only by strick adherence to this most unique plan.

(b) Respondent Jan Gillespie, Holiday Magic administrative vice president and member of the board of directors advised Distributors to 'memorize' all rules and regulations (CX EWandJan. 1967).

(c) At CX 27CWandOct. 1967[H]aving the right to buy and sell the Holiday Magic cosmetics is conditioned on your adhering to the company trade rules and practices.'

(d) At CX 679, letter from respondent and then executive vice president of Holiday Magic, Inc., Fred Pape, dated 1/19/67.

There is absolutely no justification for tampering with any of our rules and regulations.

(e) Stipulation of respondents' counsel that distributors are subject to dismissal for violation of rules and regulations (Tr. 5604).

XVIII. Termination Procedures

166. In late 1969, witness Jackie Ruggles testified that respondent William Penn Patrick told her that it was her job to see to it that the Holiday Magic marketing plan was followed by distributors, and that she was to use the Holiday Magic rules and regulations as a guide (RugglesTr. 673674, 674676; CX 79; CX 112; CX 113; CX 114; AlexanderTr. 5496; RugglesTr. 584588).

167. Mrs Ruggles would receive letters from Master Distributors and General Distributors concerning alleged violation of the marketing plan. She would research the matter and point out to the offending distributor what rules were violated. The distributor in violation of the rules had ten days to respond to a letter asking him if he was in violation of the rules as alleged (RugglesTr. 522, 564, 571).

168. If no response was received from the offending distributor, Mrs. Ruggles would turn the matter over to Mr. Gay, then vice president and later president of Holiday Magic, Inc. (RugglesTr. 564).

169. It was the job of Mrs. Jane Alexander to contact the distributor if he was unhappy with the clarification or interpretation given to him by Mrs. Ruggles. Mrs. Alexander would also have Mr. Patrick talk to the distributor at times (AlexanderTr. 5496).

170. In connection with her responsibilities, Mrs. Ruggles would read the Holiday Magic Wands, Bulletins and Family News as well as the manuals to keep informed (RugglesTr. 590591, 594597).

171. Holiday Magic, Inc. utilizes its General Distributors as an instrumentality in reporting instances of violation of the rules and regulations to Holiday Magic, Inc. and recommendation of termination:

At CX 79Z8990 and CX 79Z8687:

TERMINATION OF A DISTRIBUTOR

To begin with, let us understand very clearly that the only person or persons who may effect the final termination of any individual in Holiday Magic is the Board of Directors of Holiday Magic.

However, anyone may recommend to his General that termination procedures be initiated against any other individual for due cause. The General Distributor is obligated to commence such action based on the written statement of person or persons who make the initial request for cause.

Upon receipt of this request, the company will send an official letter to the party in question stating the accusations and violations and offering a hearing on the matter if return comment and request for consideration is given within ten days. Should no reply be forthcoming, the Distributor will automatically be sent his letter of termination.

See also CX 645C; Tr. 533839; Tr. 390; CX 686A.

XIX. Vertical Price Fixing Wholesale Sales

172. Holiday Magic, Inc., in its rules and regulations, requires that all distributors adhere to the refund bonus schedule in reselling products to Organizers and Holiday Girls (CX 78Z96, Rule 14; CX 79Z93, Rule 14; CX 81Z48, Rule 14; CX 82Z48, Rule 14; CX 83Z48, Rule 14, CX 104H, Rule 14; CX 1051, Rule 12; CX 403B, Rule 12; CX 77L, Rule 2; CX 108K, Rule 14).

(a) Rule 14, which appeared in the manuals at least through Jan. 1969, reads:

Distributor agrees to pay the cash refunds based on sales volume produced during the month (per refund bonus schedule) to his distributors as soon as possible after the end of the month and no later than the fifth day of the succeeding month.

(b) The Jan. 1969 version of the old Rule 14, as Rule 12, reads:

CX 105H, Rule 12 (Jan. 1969):

Distributor agrees to pay cash bonuses on sales volume produced during the month (per bonus schedule) to his directors no later than the fifth day of the succeeding month.

173. The Holiday Magic Wands and Family News continually make reference to the requirements of all distributors or all levels to adhere to the discount schedule.

(a) CX 4CWandSolution BoxNov. 1965:

Question: How do I explain to an Organizer why he doesn't get a bigger percentage in his monthly refund schedule?

Answer: If an Organizer, who is actually a SubWholesaler, buys a Distributor Kit and a One Pack, he has purchased \$120.40 plus applicable taxes in his area. Thus, if his Holiday Girl sells any amount over \$100, this means a 35% on our volume schedule. Obviously, then, the Organizer cannot have any override since they are both in the 35% area * * *

(b) CX 10HWandMay 1966Solution Box:

Question: It is encouraging to observe that Holiday Magic has terminated several distributors who failed to comply with the company marketing plan. However, we are concerned for fear Holiday Magic could take action on short notice to modify its present marketing system. Does the distributor have any assurance that this will not happen?

Answer: Holiday Magic is working for the day when it will become a household word and is thereby committed to continue its present course of retailing. There is no intention of modifying the discount rates, bonus structure or marketing plan. Besides, why change a successful formula?

(c) CX 12FWandJuly 1966Solution Box:

Question: Some of us are confused about the discount in price on products. Could you clarify this?

Answer: The discount with respect to cosmetics is fixed according to the marketing plan; i.e., 65%, 55% or 30% with refund according to the distributor's position * * *

(d) CX 27AWandOctober 1967:

Depending on the amount of her cosmetics sales, the Holiday Girl may receive a bonus. For example, if she sells an average of \$1000 worth of cosmetics per month, she would receive an 11% bonus. Added to her 30% commissions, she would earn a total of \$410 commissions for the month.

(e) See also CX 150B; CX 46A; CX 27A; CX 153H.

174. The Holiday Magic bulletins also clearly require Master and General Distributors to sell at specified discounts to Organizers and Holiday Girls.

See Bulletin #4 from respondent Patrick dated Oct. 1965, identified at Tr. 1233, 1262:

TO ALL MASTERS AND GENERAL DISTRIBUTORS * * *

CLARIFICATION OF POLICY:

There has been some question as to whether or not a Beauty Salon or Health Food Stores can start with an original percentage of 40% off retail.

Beauty Salons and Health Food Stores, and all other outlets, must conform fully to the Marketing Plan. If the Beauty Salon is below the level of Master Distributor, they must purchase at 30% discount during the month and be paid a refund based upon their volume.

HOLIDAY MAGIC has no deal. There is but one Marketing plan.

175. The Holiday Magic sales manuals also require all distributors to adhere to the discount schedule and refund discount schedule in selling to Organizers and Holiday Girls.

(a) CX 79Z87:

One of the most serious offenses a Distributor can be guilty of is not paying refunds by the fifth of the month for the preceding month's business volume. When this offense is committed and is proven, termination occurs immediately. The procedure for paying refunds due is as follows:

Sponsor of the terminated individual may elect to pay the refund and become the new Sponsor of the directs of the individual who was terminated. Should this sponsor be unable to do so within five (5) days after the 5th, the Master of the organization may elect to do so, thereby filling the vacant position. The Master may elect to fill this position with another person of his choice at a price mutually satisfactory. The old Sponsor of the terminated person is still entitled to the volume flow without interruption. Should the Master fail to accept the responsibility, his General may do so. Should the General fail, the Corporation will.

ALL REFUNDS WILL BE PAID. This is a Corporate Guarantee.

(b) CX 104C and CX 105C (Jan. 1969):

Secondly, in the case of a 'Workin' Master, his Master Must pay the 25% Refund Bonus on his purchase volume to date on the day that the new Master decides to purchase the remaining volume that makes up to \$5,000 or on the day on which he reaches total purchases of \$5,000. He is not allowed to wait until the 5th of the following month for his refund.

For this would defeat the whole program of 'Workin' Master Distributors.

(c) CX 78Z33:

Here is how your profit is figured. Everyone earns a basic profit of 30% at least. Then, they receive extra bonuses, based on their monthly volume * * *

(d) CX 78Z61; CX 79Z58; CX 104D; CX 105D (Jan. 1969):

These are the steps that must be taken:

* * * * *

3. That same day, Joe must pay Mary a 25% Refund Bonus on all the product she purchased directly from him that month ($\$3,500 \times 25\% = \875.00). This means that Mary is still ahead \$200.00 (\$875 refund minus \$675 cosmetics cost = \$200.00).

4. Mary now computes the overrides which she will owe her organization the first of April. Five percent of \$500 each means that she must pay at least \$175.00 in bonuses (probably more, since they still have 10 days to go.) [Emphasis in original].

(e) CX 78Z8, CX 79Z8:

* * * She is shown how she can make no less than 30% in the future by entering into the program with her own kit.

(f) See also CX 76Z2; CX 76Z4; CX 76Z5; CX 76Z12; CX 76Z28; CX 77G; CX 107E; CX 108E; CX 109C.

176. The price fixing requirement on wholesale sales applies to Organizers as well as Masters and Generals. See CX 78Z2 and CX 79Z1.

177. Distributors are threatened with termination for failure to pay refunds according to the refund bonus schedule.

(a) CX 78Z90; CX 79Z87:

One of the most serious offenses a Distributor can be guilty of is not paying refunds by the fifth of the month for the preceding month's business volume. When the offense is committed and is proven, termination occurs immediately * * *

(b) See Sections XVII and XVIII.

178. Witness testimony relative to refunds and manufal adherence:

(a) Charles Madden. Witness Charles Madden, appointed senior general of the Kansas City Council by Holiday Magic, Inc. and senior general of the month for Holiday Magic, Inc., testified that he was instructed by the manuals (CX 79) to follow the refund schedule as it appeared on CX 649 (Tr. 5332, 5325, 5323, 5321, 5324). Mr. Madden stated that in Kansas City the manual (CX 79) was followed implicitly at the Holiday Magic Distributors councils (Tr. 5330).

(b) Witness Arrowood. Witness, who was Holiday Magic's vice president of training and education (Tr. 6155, 6168) and Holiday Magic senior trainer general (Tr. 6166) through 1971 (Tr. 6171), and who was also in charge of all Council Training (Tr. 6168) testified for respondents that Holiday Girls and Organizers buy at the same prices and that there is 'never any deviation.' (Tr. 6176).

(c) John Wells. Mr. Wells, a General Distributor who resides in Nevada (Tr. 993), stated that he sold to his Holiday Girls at 30 percent discount off list price 'to stay in good standing with Holiday Magic' (Tr. 1024). The manual he followed is CX 1469 (Tr. 10131016).

(d) Thirftone Jones. Mr. Jones, a Master Distributor (Tr. 5388), who does business in Wash., D.C., testified that he follows the refund discount schedule (CX 649) 'to the letter' (Tr. 5391) for fear of losing his distributorship (Tr. 5390).

(e) Charles C. Spellers. Mr. Spellers, a Master Distributor (Tr. 5403) who engaged in his business activities in Washington, D.C. (Tr. 5389), testified that he followed the refund discount schedule of CX 649 (Tr. 54085410) and that this document was given to him by Holiday Magic Instructor General McKelvey (Tr. 540809), who told him in Instructor General class as well as privately (Tr. 54065409) in the Spring of 1968 (Tr. 5408), to follow the discounts (Tr. 5409) lest Holiday Magic, Inc. take action against him (Tr. 5407).

(f) Lester Small. Mr. Small, a Master Distributor until late 1968 (Tr. 5378, 5382) who engaged in his activities in Wash., D.C. (Tr. 5382), testified that he sold to his Organizer and Holiday Girls at the 'prescribed discount' as described in CX 649 (Tr. 5385).

(g) Judy Hurd. Witness Hurd, a Master Distributor (Tr. 5358) who engaged in her business activities in Kansas City, Kan. (Tr. 5357, 5358, 5361), testified that she followed the rules in CX 81 (Tr. 5361). She followed the refund schedule of CX 649 (Tr. 5362) and sold to her Holiday Girls at 30 percent discount (Tr. 5361).

(h) Deith Janz. Witness Janz, a General Distributor (Tr. 5343) who engaged in business activities in Wichita, Kan. (Tr. 5343), testified that she followed the refund bonus schedule of CX 649 (Tr. 534849) and sold Holiday Magic products to her Holiday Girls at 30 percent discount (Tr. 5348) for fear of being terminated by the company (Tr. 5346).

XX. Vertical Price Fixing Retail Sales

179. Holiday Magic, Inc. entered into agreements with its distributors, and its rules and regulations require that all distributors adhere to the retail list prices of the Holiday Magic products in reselling products to the consuming public.

(a) CX79Z93, Rule 3; CX 81Z48, Rule 3; CX 82Z48, Rule 3:

Distributor agrees to purchase merchandise only from the Company or his Sponsor in accordance with the Holiday Magic marketing plan and to sell merchandise only at those prices established by the Company.

(b) After Oct. 1967 Rule 3 as appearing in manuals in the record at CX 104H, was apparently changed to read as follows;

Distributor agrees to purchase merchandise only from the company or his Sponsor in accordance with the marketing plan and to sell merchandise only at those prices established by the company, in accordance with Fair Trade Statutes in those states having Fair Trade Laws.

Then in the same manual, Rule 8 reads as follows:

Distributor agrees to be responsible for the delivery of product and obtaining of the price from his or her customers.

And again in the same manual at Rule 14:

Distributor agrees to pay the cash refunds based on sales volume produced during the month (per refund bonus schedule) to his directs as soon as possible after the end of the month and no later than the fifth day of the succeeding month.

Also in the same manual at CX 104'3':

UNAUTHORIZED OUTLETS

Drug stores, * * * discount stores * * * are unauthorized outlets.

Also in the same Manual at CX 104C:

* * * must pay the 25% rebate * * *

And at CX 104D:

* * * Joe must pay Mary a 25% Refund * * *

* * * she must pay at least \$175.00 in bonuses * * *

Also in the same manual at CX 104G:

ALL REFUNDS WILL BE PAID. This is a Corporate Guarantee.

(c) Even though the Holiday Magic rule change on its face relates only to the fixing of prices in Fair Trade States and is silent on the rule in nonfair trade states, there is considerable doubt that this rule was other than pro forma.

(1) At CX 645C, a letter from Holiday Magic National Field director on Holiday Magic stationery, dated Mar. 8, 1968, indicates the old rule was not rescinded at all!

Dear Mr. Winge:

We are in receipt of a letter enclosing an advertisement allegedly placed by you in the Decatur Dekalb News which is in violation of rule number three in the Master's and General's Manual which states:

Distributor agrees to purchase merchandise only from the company or his Sponsor in accordance with the Holiday Magic marketing plan and to sell merchandise only at those prices established by the Company.

Mr. Winge was terminated by Holiday Magic President Fred Pape on 7/9/68 (CX 645A).

180. Holiday Magic, Inc. constantly publishes information in its Wands and Family News telling its distributors the retail prices to charge for its products. Neither the words 'suggested' nor 'recommended' appear in conjunction therewith.

(a) CX 155GFamily News1/30/70:

February 128, 1970, your Holiday Girls will be authorized to sell Strawberry Frappe Cleanser for just \$1.99 a jar * * * a savings of 96 cents to their customers!!! More sales in Februarymore profits for everybody!

(b) CX 158AFamily News3/27/70:

BY POPULAR DEMAND: HM XXI Deodorant will remain on the price listCode #580, retail price \$1.50 each.

(c) At CX 122DFamily News10/16/67:

REPLY #2In answer to the many requests (6), the prices for Christmas gift goodies are:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

(d) See also CX 164C; CX 165D; CX 166F; CX 167C; CX 168B; CX 170B; CX 158A; CX 158E.

181. Product brochures put out by Holiday Magic, Inc. contained pictures of the products and the retail prices affixed thereto. No mention of 'suggested' price or 'recommended' price appears in conjunction therewith (CX 631AP; CX 633PW (July 1968); CX 634AD).

182. Holiday Magic, Inc. also distributes retail customer order forms to its distributors containing the resale prices appearing directly on the retail customer's order (CX 635 (May 1967)).

183. Distributor price lists containing the retail price of the Holiday Magic products are also distributed by Holiday Magic, Inc. to its distributors (CX 636A; CX 636B (Nov.Dec. 1968); CX 637; CX 410; CX 413).

184. Discounting Holiday Magic products by distributor is a violation of the Holiday Magic marketing plan, and Holiday Magic, Inc. required its distributors to adhere to the retail prices.

(a) (RugglesTr. 554).

(b) Respondent GillespieTr. 9311 (referring to Holiday Magic, Inc.), who was with the company until June 1968 (Tr. 9293) testified:

JUDGE BUTTLE: They [Holiday Magic] simply told them [distributors] what to charge, is that is?

THE WITNESS: They had a price list.

JUDGE BUTTLE: That they had to charge?

THE WITNESS: Basically, but it was never policed.

JUDGE BUTTLE: Unless they did not follow the price list?

THE WITNESS: Right.

185. Holiday Magic, Inc. entered into agreements with distributors and prohibited its distributors from placing their Holiday Magic merchandise in 'discount' stores (GillespieTr. 9454; CX 104'0').

186. Witness testimony relative to price adherence:

(a) Charles Madden, appointed Senior General of the Kansas City council by Holiday Magic, Inc. (Tr. 5320) and Senior General of the month for Holiday Magic, Inc. (Tr. 5332), testified that he never deviated from Holiday Magic policy with respect to retail prices as expressed in the sales manuals and sales brochures (Tr. 532122). He abided by CX 79AZ103 '100%' (Tr. 5323). He used CX 631 (brochure) in his business (Tr. 5323). The price of the Holiday Magic products was part of the training he gave to his new Holiday Girls (Tr. 5330).

(b) Warren Haskins. Mr. Haskins, the Senior General of Kansas City council from the last part of 1967 to early 1968 (Tr. 5338), and who engaged in business activities in Kansas and Missouri (Tr. 5335), testified that Ben Gay told him at the time that Haskins was Senior General and Gay was vice president of Holiday Magic, Inc. (Tr. 5336, 5338), that he could not cut prices in a fund raising program to Boy Scouts since the Boy Scouts couldn't sell at less than list price and that he would lose his distributorship if he did (Tr. 5337), and on a second occasion in Sept. 1967, Mr. Gay told him that he couldn't run specials and sales on products placed in a retail store in Kansas City, Mo. (Tr. 5338).

On another occasion, Mr. Haskins, as Senior General, reported to Mr. Gay of a distributor discounting; Gay wrote back asking for information and stated that it was against Holiday Magic rules to discount. Mr. Haskins supplied the information (Tr. 533839).

Mr. Haskins has maintained his inventory of Holiday Magic products, and didn't discount same for fear of losing his distributorship.

He used CX 631 in his business, and instructed his Holiday Girls to sell out of it; the selling prices were in there.

(c) Bruce J. Longballa. Mr. Longballa, a Master Distributor (Tr. 1064) doing business in Nevada (Tr. 1064), put product in a store because he wanted to discount it, but removed it because he was told by his Sponsoring General that a Senior General in town would see it and as a consequence he would lose his distributorship (Tr. 10681069).

(d) John Wells. Mr. Wells, a General Distributor (Tr. 988) doing business in Nevada (Tr. 995, 993) who is still active (Tr. 988, 1057) testified that he told his Holiday Girls that they 'had to sell at the prices in the books' (Tr. 1011) because of the Holiday Magic rules (Tr. 1011). Until approximately Sept. 1, 1971, Mr. Wells had had only the rules as appearing in CX 1469, and this was the manual he followed (Tr. 1013-1017). Mr. Wells added that Mr. Percy taught him as part of his training to sell at the Holiday Magic prices (Tr. 1009), and he was not permitted to advertise products as loss leaders (Tr. 1023). The rule in CX 1469 is the same as appears in Part XXI (a) hereof.

Mr. Percy was a Holiday Magic vice president in early 1969 (Tr. 7155), and in the first group of Instructor Generals in Feb. 1967 (CX 19C).

(e) Thriftone Jones. Mr. Jones was a Master Distributor (Tr. 5388) doing business in Wash. D.C. (Tr. 5389) who testified he sold at the prices of Holiday Magic as required by his Sponsor and Holiday Magic (Tr. 5389). His Sponsor told him he would lose his distributorship if he didn't (Tr. 5390). Mr. Jones became a Master in Nov. 1968 (Tr. 5388).

(f) Gelanine Hutchinson. Mr. Hutchinson, a General Distributor and Senior General from Fort Pierce, Fla. who did business in Kansas (Tr. 216162), distributed price lists to his Holiday Girls in Kansas as set forth by Holiday Magic, Inc. and contacted his girls to sell at the specified prices because of Holiday Magic rules (Tr. 216465).

(g) Charles C. Spellers. Witness Spellers, who was a Master Distributor (Tr. 5403) until the latter part of 1968 (Tr. 5403), and who engaged in his business activities in Wash. D.C. (Tr. 5403), testified that it was Holiday Magic's requirement to sell at the list prices as indicated in CX 636AB (Tr. 5403 5404, 5412).

Mr. Spellers also testified that Holiday Magic Instructor General McKelvey taught him that if he didn't follow the prices established by the company (Tr. 5405) the company would take action against him (Tr. 5407). McKelvey told him that at IG school in Arlington, Va. and again in Wash. D.C. (Tr. 5406).

Price lists appeared in cartons of Holiday Magic products (Tr. 5411, 5412).

(h) Lester Small. Mr. Small, who was a Master Distributor (Tr. 5377) operating in Wash D.C. (Tr. 5382, 5384) until the last half of 1968 (Tr. 5382), testified that he retailed at the retail prices indicated in the Holiday Magic catalogs at CX 633 PW (Tr 53795380).

Holiday Magic IG McKelvey (Tr. 5381) told him to stick to the list prices or else he probably would lose his distributorship (Tr. 5381).

(i) Hudy Hurd. Mrs. Hurd, who was a Master Distributor (Tr. 5358) operating from her home in Kansas City, Kan. (Tr. 5357, 5358, 5361), testified that she retailed at the Holiday Magic prices from the retail prices given in the price lists (Tr. 5358). She also testified that Gerry Arrowood, a Holiday Magic Trainer General, gave a course in Kansas City in which she had to memorize the prices of all the products (Tr. 5359).

(NOTE: Gerry Arrowood thereafter testified for respondents and never denied this.) She also heard Ben Gay speak at a hotel in Kansas City in Apr. or May 1967 (Tr. 5363, 5365) and say Holiday Magic products would never go on sale, and that they should 'follow the program or else' (Tr. 5364). At the time Mr. Gay was assistant to Holiday Magic president Fred Pape (Tr. 9823).

She also testified that Senior General Temps of the Kansas City area, who was Senior General after Madden (Tr. 5365), instructed her not to discount the product and to sell at the retail prices (Tr. 5367).

(j) Edith Janz. Mrs. Janz, a General Distributor in Holiday Magic, Inc. (Tr. 5343), who was active through mid1967 (Tr. 5343) and who engaged in her business activities in Wichita, Kan. (Tr. 5343), testified that she sold at retail at the list prices as appearing in the manuals, master order forms and price list as CX 635 (Tr. 5344). She was instructed to do so by her Master's and General's manual (Tr. 53435346, 5347).

At training classes in Kansas City and Dallas she was told to sell at the Holiday Magic prices (Tr. 5346).

XXI. Purchase Restrictions

187. Holiday Magic, Inc. enters into agreements and contracts with its distributors and requires all Organizer and Holiday Girl distributors in its rules and regulations to purchase Holiday Magic merchandise only from their sponsors.

(a) CX 79Z93, Rule 3

Distributor agrees to purchase merchandise only from the Company or his Sponsor in accordance with the Holiday Magic marketing plan and to sell merchandise only at those prices established by the Company. See also CX 104H, Rule 3; CX 77L, Rule 4.

(b) A 'sponsor' is a Distributor who recruits or enlists a new Distributor (CX 79Z100).

(c) CX 7HWandSolution BoxFeb. 1966:

Question: I am an Organizer in the MidWest. My Master is in California. Can I fill my orders from a Master who is close to my area?

Answer: Unfortunately, you cannot. Masters can only fill orders to their own organization. If you find that you cannot obtain merchandise from your own Master you may apply for a transfer to a Master that is close to you. This is but one of the many reasons that we constantly suggest to Distributors that they recruit within an area they can realistically service, not only for cosmetic purchases but also for business guidance, training, etc.

(NOTE: Refers to Masters recruiting Organizers, not Generals recruiting Masters!)

(d) CX 79Z29 (from opportunity meeting script):

Now as you will recall in the film, this is you, and your first 30 days you sponsored five people into the business. Now, because you sponsored them, they must buy their product from you. They cannot buy it anywhere else.

As you saw in the film, these particular people that sponsored could have been * * * health food stores, barber shops, beauty salons, Holiday Girls or other organizers * * *

See also CX 76Z20

(e) Manuals CX 78Z49 and CX 79Z46 state:

Once a distributor reaches a total volume of \$5000 in any one calendar month, he has earned the right to buy permanently at 55% off retail. He is then classified as a Master Distributor, and will buy directly from the Company. Master Distributors supply only their directs and conversely, their directs or recruits must order through their sponsoring distributors.

Manual CX 106C states:

Only Master and General Distributor's orders should be submitted to Holiday Magic. All other distributors purchase through their sponsor.

188. Packaging Changes

(a) Holiday Magic, Inc. has over the years engaged in numerous packaging changes of its products, such as changes in bottle shapes, labels, and colors of caps of the bottles or jars of its cosmetic products.

CX 121D (9/67) (black caps to colored caps)

CX 23B (6/67) (golden caps for all)

CX 26A (9/67) (new shape for bottles and jars)

Tr. 602324 (Kajioka)

(b) The constant packaging changes made it impossible for the distributors to purchase (or sell) their products to other distributors as well as at retail.

Tr. 3723 (Pence);

Tr. 5368 (Hurd);

Tr. 32343235, 3248 (Sharpe);

Tr. 1022 (Wells).

(c) Holiday Magic, Inc. would refuse to take the old packaging back when a change occurred (Wells Tr. 1023; CX 79Z93, Rule 5).

189. Holiday Magic, Inc. enters into contracts and agreements with its distributors and requires all distributors in its rules and regulations to agree not to buy back merchandise from his direct distributors. CX 79Z93, Rule 4:

Distributor agrees not to buy back any merchandise from his direct distributors. \$tSee also CX 78Z96, Rule 4; CX 82Z48, Rule 4; CX 83Z48, Rule 4; CX 104H, Rule 4; CX 105H, Rule 4; CX 77L, Rule 4. Incident to agreement arrangements, Holiday Magic, Inc. requires its sponsoring distributors to file copies of the applications and agreements of distributors they recruit into the business with Holiday Magic, Inc. in order to protect their sponsorship rights.

See CX 427HM bulletin9/23/66.

190. Holiday Magic, Inc. in entering into agreements and contracts with its distributors also requires all distributors in its rules and regulations to agree not to transfer to another organization without a prior release from all distributors above them in the marketing chain. Such transfers are discouraged by Holiday Magic, Inc.

(a) CX 78Z8990 and CX 79Z8586 read:

TRANSFERS OF DISTRIBUTORS

Occasionally you will be approached by a Distributor who wishes to effect a transfer from one sponsor to another. You know that Holiday Magic has promised, by policy, to protect each organization. In 90% of the cases such transfers should be discouraged and/or refused. It is usually due to a supposed personality conflict and social differences which have little place in business.

However, in a small percentage of these cases, it might be agreeable and for the good of all parties if such a transfer is accomplished. In such a case, the following must occur before a voluntary transfer can be accomplished:

All the parties listed below must clearly indicate their consent to the transfer in writing to the Company:

1. The Sponsor stating whether or not he agrees to release the organization of the transferee or keep them himself, according to the Rules and Regulations.
2. All members of the organization between the Sponsor and the first Master, since they too have a financial interest.
3. The Master Distributor above the Distributor requesting transfer.
4. The Organization's General as well as the General who is receiving the 1% override.

Should any one of the above persons fail to give their release, the Company will not approve the transfer. The Distributor who desires the transfer has only one other alternative. He may resign as a distributor upon giving notice to the company, and, after a period of six months inactivity, may then rejoin the company under any other Sponsor he desires. Any subterfuge working as a 'silent partner,' working 'on salary,' etc. will not be tolerated by the Corporation during this inactive six month period.

(b) CX 78Z99, Rule 24 states:

Distributor agrees not to transfer to another organization without a prior release or written consent from all Distributors above him in the marketing chain, including the Company as well as any other person with a financial interest in his organization.

See also CX 79Z96, Rule 24 (word 'organization' substituted for 'chain'); CX 105H, Rule 23.

See CX 1382AE regarding the transfer request from witness Vermilye to Holiday Magic, to seek to get out of the organization of Rick Spranzo. Holiday Magic notes that:

When transferring from one organization to another, you do not automatically take your organization with you * * *

See CX 1382CE for transfer forms.

XXII. Customer Restrictions

191. Holiday Magic, Inc. enters into agreements and contracts with its distributors and requires in its rules and regulations that distributors may resell their Holiday Magic products at wholesale only to Organizers and Holiday Girl distributors whom they have sponsored into the Holiday Magic program.

(a) The distributor agrees to purchase Holiday Magic merchandise from respondent company, or from his sponsor only (Answer, p. 10).

(b) See Part XXI.

(c) Letter from Holiday Magic General Counsel to Mr. Glascock, dated 10/17/67 (CX 686A):

We have just been advised by a distributor in Bartlesville, Oklahoma, that you had made a telephone call to Doris Sanford and Francis Stephenson of the Bartlesville distributors' organization advising them that you had spent a week in Chicago with Fred Pape and that Mr. Pape had told you that you could supply product to anyone you pleased and that he, Mr. Pape, would stand behind you.

As you know, this is contrary to the marketing plan and totally unacceptable to this corporation. Mr. Pape denies having any such conversation with you and we take this opportunity to advise you of the allegations that have thus been made against you. Please respond to these charges within ten days, supporting any denial you may care to make with corroborating evidence and advancing any explanation that you may have of the aforesaid report. Failing to hear from you within ten days in this matter, we will have no alternative but to turn the matter over to the Board of Directors for further action.

Due to the fact that Doris Sanford and Francis Stephenson have received a false impression as a result of your phone call, we request that you immediately contact Miss Sanford and Mr. Stephenson to advise them that they are under a misapprehension and that you do not have corporate authorization to furnish product to just anyone, and assuring them that you intend to operate within the framework of the marketing plan and in no other fashion.

Mr. Glascock was subsequently terminated (CX 686A, F).

(d) Letter from former Miami Senior General Vincent Fechtel (Tr. 2422) to complaint counsel (CX 1470A, B):

Through our telephone conversations, I understand you are filing suit against Holiday Magic because they restrict those distributors who buy their goods to certain limited methods and certain types of retail establishments.

When distributors buy merchandise from Holiday Magic they do so with the agreement to restrict their selling methods and customers.

192. Holiday Magic, Inc. enters into agreements and contracts with its distributors and requires that distributors may not recruit or sponsor other Holiday Magic distributors who have already been sponsored into the business.

(a) See CX 79Z94, Rule 16:

Distributor agrees not to recruit or sponsor other Holiday Magic Distributors. Further, a Distributor is considered sponsored by that individual who first signs him as a Distributor and executes an Application

and Agreement Form. The Individual has the freedom of choice as to which Distributor shall sponsor him.

(b) See also CX 77L, Rule 6; CX 78Z97, Rule 16; CX 105H, Rule 14.

193. Holiday Magic, Inc. instituted a policy requiring all distributors to refrain from selling at the retail level to consumers or retail customers who are being serviced by other Holiday Magic distributors.

(a) Policy of Holiday Magic, Inc. under threat of termination (Tr. 8083, 8612, 8644, 4666).

(b) Taught at Instructor General school (Tr. 833839, 8691).

(c) Taught at Trainer General school (Tr. 8571, 857778, 8722).

(d) Taught in Cosmetic Training Classes at Councils (Tr. 8691, 8037, 8518, 8570, 8577, 8671).

(e) Respondent Holiday Magic, Inc. sent a bulletin out to all Masters and General Distributors 3/27/70 requesting that no distributors contact any DECA Chapter in regard to a fund raising project for sales to that organization, since another distributor had the 'exclusive' (CX 655; CX 1680; CX 170F).

XXIII. Retail Outlet Restriction

194. Holiday Magic, Inc. enters into agreements and contracts with its distributors and requires all distributors in its rules and regulations to refrain from selling or placing Holiday Magic merchandise in retail outlets such as drug stores, department or variety chain stores, grocery stores or discount stores.

(a) Distributors are specifically threatened with termination for placing Holiday Magic merchandise in these restricted retail outlets.

CX 1802EF Holiday Magic Bulletin #4 (Tr. 1233, 1262).

TO ALL MASTERS AND GENERAL DISTRIBUTORS CLARIFICATION OF INFORMATION AND COMPANY POLICY

POLICY GUARANTEE:

This product will not be displayed or sold in drug stores, discount stores, grocery stores, chain stores, or department stores.

Anyone placing Holiday Magic Cosmetics in any of the aforementioned, will be subject to termination.

THIS POLICY WILL NOT CHANGE!

[Signed]

William P. Patrick

Chairman of the Board

(b) CX 6FWandSolution BoxJan. 1966.

Question: I own a retail store and have never displayed or sold cosmetics. I am now in the Holiday Magic program. Am I permitted to display and sell Holiday Magic cosmetics in my own store?

Answer: No. The rules, and Regulations specifically state where Holiday Magic Cosmetics may be displayed and sold and no deviation from these locations can be authorized.

(c) Rules and RegulationsCX 79Z94, Rule 13, reads:

Distributor agrees to restrict the retail sales and display of cosmetics to those authorized retail markets: Home Service Routes (Door to Door), Beauty Salons, Wig Shops, Beauty Schools, Barber Shops, Health Food Stores, Holiday Magic Retail Salons, and TEMPORARY Booths (such as: bazaars, fairs or conventions). No other commercial retail market will be authorized in the interest of protecting the Home Service Route.

See also CX 82Z49, Rule 13; CX 79Z97, Rule 13; CX 81Z49, Rule 13; CX 105H, Rule 11; CX 1071, Rule 11; CX 108K, Rule 13; CX 105H, Rule 11.

(d) Statements in sales manuals.

CX 1055 (Jan. 1969) reads:

UNAUTHORIZED OUTLETS. Drug stores, grocery stores, chain stores (Department or variety), discount stores, or any store not related to cosmetic or Home Magic product sales such as real estate, camera, stationery, etc. are unauthorized outlets.

See also CX 104'0'.

(e) As of Jan. 1969, Holiday Magic had in its records '574 authorized retail outlets in the United States now stocking Holiday Magic Products.' (CX 517).

(f) Witness testimony confirms enforcement policy:

1. Vincent Fechtel, former Miami Senior General (Tr. 2422), testified that according to Holiday Magic's rules he could not have Holiday Magic products in a retail store (Tr. 2384), and when he placed said products in a store in Leesburg, Fla., in Nov. or Dec. 1967 (Tr. 2382), he removed these products after

receiving a letter from Holiday Magic asking him if he had products there (Tr. 2383) See also CX 1470A, B.

2. Witness Sowinski, former Holiday Magic Instructor General, taught his students in IG class that drug stores were not in the scope of retailing as specified in the manuals (Tr. 2022).

3. Witness Norma Wegner, a Master Distributor in 1969 (Tr. 4074) testified that she was told by the manuals, by her General, and by her Holiday Magic Trainer General that she could not place product on sale in chain stores or places like that (Tr. 40554087).

4. Witness Sharpe testified that Bill Dempsey told him not to sell product in drug stores, grocery stores and other outlets (Tr. 3242), when he first joined as well as on subsequent occasions. Dempsey said it was against company rules (Tr. 3242).

Dempsey, who testified for respondents, was Holiday Magic Eastern Regional Vice President in 1966 (Tr. 6043), and failed to deny the said charge, although he testified after Mr. Sharpe did.

5. Witness John Wells was told he couldn't have product placed in chain stores by Holiday Magic (Tr. 1047).

6. Witness Longballa testified that he put product in his store but was told by his General that he would be in jeopardy of losing his distributorship if he didn't remove it (Tr. 1066) and was similarly warned by his General distributor that he might lose his distributorship by the mere display of products in his store because a Senior General was in town (Tr. 1068).

XXIV. Advertising Restriction

195. Holiday Magic, Inc. enters into agreements and contracts with its distributors and requires in its rules and regulations that prior company approval must be obtained for advertising or promotion of Holiday Magic products.

(a) Manuals: CX 1800Z1 (Nov. or Dec. 1965, Tr. 835):

3. All consumer advertising copy must be approved by the corporation.

4. All advertising for recruitment must be submitted and approved in each area to the Senior General in that area. All Senior Generals are appointed by the corporation. Poor advertising can be destructive.

(b) CX 2GWand 9/65.

(c) Rules and regulationsCX 78Z99, Rule 22:

Distributor agrees to obtain prior Company approval for any advertising or promotion of the product or his Distributorship.

See also CX 79Z95, Rule 22; CX 83Z50, Rule 22; CX 104J, Rule 22; CX 195H, Rule 21; Answer pp. 1415.

196. The device of requiring Holiday Magic distributors to supply in advance prospective advertising to Holiday Magic, Inc. is a device which enables Holiday Magic, Inc. to control and supervise by prior restraint the price fixing and retail outlet restriction requirements of Holiday Magic, Inc. although, of course, it may also serve as a medium to protect against deceptive advertising if so utilized.

See Part XVII 6.

XXV. Private Arrangements

197. Holiday Magic, Inc. enters into agreements and contracts with its distributors, and requires all distributors in its rules and regulations that in the event a partnership distributorship dissolves, the departing partner is required to revert back to his original sponsor. (CX 78Z99100, Rule 27; CX 79Z96, Rule 27; CX 104KL, Rule 27; CX 105H, Rule 26; Answer, p. 15.)

198. Holiday Magic, Inc. enters into agreements and contracts with its General Distributors and requires all General Distributors in its rules and regulations that in the event a General Distributorship dissolves, the principal or partner who is departing, should he continue with Holiday Magic, must requalify as a new Master Distributor under his original sponsor, create a Replacement Master, and pay the release fee to qualify for the General position again (CX 78Z99 100, Rule 27; CX 79Z96, Rule 27; CX 104KL, Rule 27; CX 105H, Rule 26; Answer, p. 15).

199. Holiday Magic, Inc. enters into agreements and contracts with its Master Distributors and General Distributors and requires all Master Distributors and General Distributors in its rules and regulations that the addition of partners to an existing General or Master distributorship or the sale of a General or Master Distributorship must meet the same retail list price value purchase requirement as do work in Masters (GayTr. 1002526; Answer p. 15; CX 2078; PorstTr. 3116).

200. Holiday Magic, Inc. enters into agreements and contracts with its distributors and requires all distributors in its rules and regulations that they may only have a financial interest in one Holiday Magic distributorship at a time, and may not simultaneously be a part of two separate distributorships (CX 78Z100, Rule 29; CX 79Z97, Rule 29; CX 104L, Rule 29; CX 105H, Rule 28; Answer, pp. 1516; CX 677 (enforcement of Rule as of 6/22/70).

201. Holiday Magic, Inc. enters into agreements and contracts with its Distributors and requires all Distributors in its rules and regulations that they must not enter into any agreement with a distributor in another Holiday Magic organization to make a division of profits, assets or new recruits in violation of the marketing plan.

(a) CX 78Z100, Rule 32; CX 79Z97, Rule 32; CX 104L, Rule 32; CX 105H, Rule 31; Answer, p. 16.

(b) Tr. 5901 Holiday Magic Vice President Semling Violation of Holiday Magic marketing plan for distributors to pool inventories (except through CRS).

(c) CX 672 (Bulletin from Holiday Magic to Master and General Distributor, dated 6/9/67):

We have not, are not, and will not approve of individual marketing plans within 'The Marketing Plan.'

202. Holiday Magic, Inc. enters into agreements and contracts with its Distributors and requires all Distributors in its rules and regulations that they must not make any consignment of the merchandise to any person (CX 79Z93, Rule 6; CX 78Z96, Rule 6; CX 104H, Rule 6; CX 81Z48, Rule 6; CX 82Z48, Rule 6; CX 83Z48, Rule 6; CX 104H, Rule 6 (Oct. 1967)).

XXVI. Contacts And Controls By Holiday Magic, Inc. Over Organizers And Holiday

Girls

203. See Chapters V, VII, XI, XII, XV, XVI, XVII, XVIII, XIX, XX, XXI, XXII, XXIII, XXIV, XXV to this effect.

204. CX 40W and 11/65 Solution box where an additional rule prohibits organizers from combining and also reflects required adherence to controls:

Question: Can a Master combine the monthly volume of two or three of his Organizers and give this total to one of them to help him qualify for the Master Distributor position?

Answer: Absolutely, positively, definitely, emphatically No!

205. CX 76Z26, CX 79Z26 reflects dues assessment regulation:

The Corporation feels that no Distributor below the rank of Master should ever be assessed dues for his attendance or the attendance of his prospects at any Opportunity Meeting.

206. All Holiday Girls are in business for themselves, and are never allowed to go on salary or be hired (Gillespie Tr. 9307).

But a Holiday Girl may be given a guaranteed weekly draw, in which case certain requirements must be met such as attending all sales meetings, and having a minimum number of sales.

At CX 91V (Instructor Manual):

You may give your Holiday Girls a guaranteed weekly draw if you wish. As a matter of fact, it is recommended. However, if a girl is to qualify for a draw of \$90.00 per week (gear your guarantee towards the wage scale in your area. It varies around the country) she must fulfill certain requirements.

1. She must attend every sales meeting. This means all your daily meetings as well as the Monday morning enthusiasm meeting.
2. She must put on 4 demonstrations per day, five days per week and establish proof to you that she has done this. (If you have a parttime girl on guarantee, she must give two demonstrations per day.)
3. She must give one Block Seminar per week, whether she is full or part time. Five ladies must be in attendance at this Seminar.
4. She must have at least 60% of her route covered within 60 days.
5. She must have automatic sales on at least 75% of her customers.
6. After her route is established, she must service her customers each month.

If you are to use this guarantee system, which is very effective, two things should be kept in mind. No 1, the draw does not start until the second week. (The Holiday Girl is basically in training the first week although she will be selling, but you should know after a week's probation if she will work out.)

(NOTE: Earnings of \$90 per week presupposes that the Holiday Girls monthly volume will total approximately \$900 per month. (\$900 volume at 30 percent discount plus 10 percent refund equals \$360 per month.)

207. Holiday Magic, Inc. has a consumer customer refund policy whereby merchandise can be returned to the Holiday Girl or other retailing distributor for refund for any reason (GillespieTr. 9324; PangerlTr. 9523; RX 134D).

208. Failure to forward an application and agreement of a Holiday Girl or Organizer is a violation of the Holiday Magic marketing plan (CX 688B; CX 79Z94, Rule 17).

XXVII. Instructor General Program

209. Effective Feb. 1, 1967, Holiday Magic, Inc. initiated its Instructor General program, the purpose of which was to train General Distributors so that they will have 'proper knowledge' and tools no one else will have who hasn't taken the course (CX 18AWandJan. 1967; SowinskiTr. 2017).

210. Effective midnight Apr. 30, 1970, Holiday Magic, Inc. imposed a requirement that to become a Master Distributor, a person must have a paid reservation in Instructor General school (and Trainer General school) (CX 159FFamily NewsApr. 10, 1970.)

211. Although a specific requirement for Generals as of Feb. 1, 1967 and for Masters (and therefore Generals also) as of Apr. 10, 1970, Holiday Magic, Inc. recommends the course 'to ALL distributors regardless of position' and states that 'it is extremely vital to those just coming into the business.' (Quoted from IG manual, CX 90N.)

(a) IG Sowinski testified that IG school is for Organizers also (SowinskiTr. 2017).

(b) And Holiday Girls (SowinskiTr. 2021).

212. Before Feb. 1, 1967, Holiday Magic, Inc. conceded in its Wand that 'Heretofore, qualification for a Generalship has been primarily on a financial basis.' (CX 18AWandJan. 1967).

213. Prior to Feb. 1, 1967, the Holiday Magic corporate team covered the 'councils' of every state making special training classes available (CX 18A WandJan. 1967).

214. The Holiday Magic Instructor Generals became available to provide the necessary and valuable training formerly conducted by the corporate team (CX 18AWandJan. 1967).

215. The 'Instructor Generals are outstanding distributors who have been singled out because of their individual successful field achievements, and further trained by Holiday Magic, Inc. to insure that they are fully qualified to instruct other distributors in the total Holiday Magic marketing concept, principles and philosophy.' (Quoted from CX 90NIG manual.)

216. 'Every detail necessary for the proper and effective conduct of Holiday Magic business is included in the [Instructor General course].' (Quoted from CX 19CWandAug. 1967; CX 20MWandMar. 1967.)

217. Instructor General school teaches procedures of an opportunity meeting, business training, the general operation of a distributorship (SowinskiTr. 2017) and the background and history of the company (BeltonTr. 496465) and supervisory information and sales and motivational techniques (CX 508).

218. The Instructor General training would in turn enable distributors taking the course to be better able to train their own people (SowinskiTr. 2017).

219. The Instructor Generals are all appointed to their positions by Holiday Magic, Inc. (AlexanderTr. 5523, 5524; NapoletanoTr. 3493).

220. Among the group of Instructor Generals appointed in Feb. 1967, were Bill Dempsey, Mark Evans, Ben Gay, Jim Hearn, Ed Persey and Jim Sowinski (CX 19C WandAug. 1967).

221. CX 1840AZ114 is the Instructor General manual which Mr. Sowinski received from Holiday Magic, Inc. (SowinskiTr. 2040). It states 'You, as an Instructor [General] are the representative of a multimillion dollar corporation, therefore, you physically reflect the corporation's image as well as does your own

business conduct.' (CX 1840P). '[I]nstructor Generals reflect the total knowledge and philosophy of the founder of Holiday Magic.' (CX 1840H.)

222. Holiday Magic, Inc. imposes rules and regulations upon the Instructor Generals. They are:

1. Instructor General agrees to abide by all rules and regulations established by the Company and to all subsequent changes.
2. Instructor General is responsible for all specific rules and procedures not enumerated here, but which are contained in other Company publications, i.e. bulletins and sales manuals.
3. This manual may not be reproduced for any reason, and is the sole property of Holiday Magic, Inc.
4. Upon receipt of additional pages from the Corporation, Instructor General agrees to insert them into the appropriate section of this manual.
5. Upon receipt of superseding pages from the Corporation, Instructor General agrees to return immediately the obsolete pages to the Corporation.
6. Each Instructor General will conduct one regular sixday class per month during their designated week.
7. Instructor General will teach the class in accordance with the lesson plan in this manual without exception.
8. Each class will be limited to 15 students.
9. The fee for each student is \$200, paid to Instructor General by student by cash, money order, certified check or cashier's check.
10. Reservations for class are valid only upon receipt of \$200 fee.
11. All regular classes in Instructor General's designated week must be held in Instructor General's home town.
12. Additional classes may be held only upon the personal approval of Fred Pape. There must be 15 students booked in before this will be allowed.
13. Instructor General's total expenses (travel, meals, lodging, training facility) are to be paid by students for outoftown classes.
14. Instructor General will not use their position as a recruiting tool.

15. Instructor General will be paid \$300 per week plus expenses on a per diem basis when working with or for the Corporation.

16. Effective February 1, 1967, one of the qualifications for the appointment to the position of General Distributor will be the completion of the Instructor General course or a paid reservation for a class to be attended by student within 60 days of reservation booking.

17. Instructor General will issue two (2) receipts to each student for the \$200 fee, so that the student can forward one copy of the receipt to the Corporation in order to qualify for the position of General.

18. Only those who successfully complete an Instructor General course will be permitted to conduct an Opportunity Meeting, and this Opportunity Meeting must follow verbatim the script provided in the Instructor General course. (CX 1840Z111Z113.)

223. In addition, no tape recordings are permitted by Holiday Magic, Inc. in the courses taught by its Instructor Generals.

CX 1840Q Under no circumstances will tape recorders be allowed during these [Instructor General] training sessions. Repeat NO TAPE RECORDERS.

224. Another Instructor General duty is to see to it that all distributors followed the rules of Holiday Magic, Inc. (Napoletano Tr. 3497). This Mr. Gay, when he was president or senior vice president informed Mr. Napoletano when he was Instructor General (Napoletano Tr. 3497).

225. Instructor Generals would receive reports of distributor complaints because of their position as Instructor Generals (Napoletano Tr. 3513, 3517).

226. Instructor Generals are also utilized by Holiday Magic to distribute corporate literature (CX 30C).

227. Holiday Magic, Inc. lists the following items which an Instructor General must make certain are available in his training classes: WPP records; phonograph; Instructor General manual; 15 general workbooks; Distributor's manual; Masters' and Generals' manual; blackboard; chalk; eraser; yellow note pads; extra pencils; ashtrays; water; coffee arrangements if desired (CX 1840P Q).

228. Instructor General manuals appear in the record at CX 1840AZ114; CX 90A Z8 (Tr. 1710, 2040).

229. Instructor Generals were given uniforms consisting of an 'HM' crest, which were owned by Holiday Magic. It was a Holiday Magic rule that the uniform be worn by Instructor Generals when attending council functions (Napoletano Tr. 35073511).

230. To the distributors, Instructor Generals were representatives of Holiday Magic, Inc. (Tr. 8378, 8532).

231. The fee for the Instructor General program was paid for by the person taking the course (Tr. 6340; 4965; CX 1856C; Tr. 8160, 8211, 737576, 7681, 5134, 3052).

232. Holiday Magic, Inc. has the following policy issued to distributors with respect to the Instructor General school fees:

POLICY CLARIFICATION

The only way you can make a reservation in an Instructor General or Trainer General class is to give the IG or TG a certified check to reserve your seat. This check is NOT REFUNDABLE. You have purchased a piece of real estate you may sell it to someone else, use it yourself, or leave it vacant. But the seat is your property (CX 151K Family News Sept. 5, 1969).

Cost for the newly revised course will be \$260, after February 15, 1970. However, all Instructor Generals are authorized to accept students who present a receipt for \$225, paid before February 15 (CX 508-Bulletin Dec. 24, 1969).

233. According to Holiday Magic, Inc. 'Once individuals are graduated from Instructor General and Trainer General Schools they are then truly qualified and able to function as independent business people.' (CX 90N Instructor General Manual).

XXVIII. Trainer General Program

234. The Trainer General school is made available by Holiday Magic, Inc. to 'distributors who desire a greater depth of understanding of the customer benefits and practical retail sales techniques.' (CX 90N.)

235. The Holiday Magic Trainer Generals are trained by Holiday Magic, Inc. at its main offices (Alexander Tr. 5526).

236. The Trainer General class is available to all distributors at all levels, i.e., Generals, Masters, Organizers or Holiday Girls, for a fee of \$25 (Baehlein Tr. 50855086).

237. 'Holiday Girls, Organizers, Masters, Generals and even prospects have flocked by the thousands to attend the [Trainer General] School.' (CX 609 Holiday Magic Bulletin Mar. 14, 1969.)

238. The fee for the TG school was paid by the person taking the course (Baehlein Tr. 5087; Tr. 2837, 8212, 8160, 4114, 5141; CX 2062; CX 1926A; Tr. 5352, 7787, 8002).

239. The Trainer General training program was set up by Holiday Magic, Inc. (Baehlein Tr. 5086; CX 90N).

240. The Holiday Magic Trainer Generals taught their students about makeup techniques, how to build a retail organization, how to sell cosmetics, and how to work with the people in their organizations (Arrowood Tr. 6161; Alexander Tr. 5526; Baehlein Tr. 5081; CX 133A).

241. Effective midnight Apr. 30, 1970, Holiday Magic, Inc. imposed a requirement that to become a Master Distributor, a person must have a paid reservation in Trainer General school (and Instructor General school). (CX 159F.)

242. It is the duty of the Trainer General to see to it that training is held at councils throughout the United States (NapoletanoTr. 3557).

243. Only 'Instructors' who have been trained by Holiday Magic Trainer Generals are authorized to instruct Holiday Girls effective Jan. 1967 (CX 19E WandJan. 1967; CX 17E).

244. Examples of Trainer General manuals appear in the record at CX 91AZ90; CX 92AZ55.

245. According to Holiday Magic, Inc. 'Once individuals are graduated from Instructor General and Trainer General schools they are then truly qualified and able to function as independent business people.' (CX 90NIG Manual.)

XXIX. Other Corporate Training for Distributors

246. Holiday Magic, Inc. sells records to its Master and General Distributors for purposes of self-motivation (CX 136E; CX 136B; CX 130D; CX 129F; CX 28H; CX 32A). Cost of the series of records is \$75 (CX 28H).

247. In May 1970, Mr. Patrick and Mr. Gay led a corporate team into various cities to provide 'intensive motivational and sales training.' The program was open to Masters and Generals, for the cost of \$20 by certified check (CX 56C WandMay 1970).

248. Leadership Dynamics Institute

(a) At a cost of \$1,000 distributors are invited to attend this self improvement type session (CX 60C; CX 62C; CX 63C; CX 59D, E; CX 151L).

(b) Although not a requirement for distributors, it is recommended by Holiday Magic, Inc., and is required for the positions of Instructor General, Trainer General, and Senior General (CX 163H; CX 164C; CX 153A; CX 154B; CX 60C; CX 62C; CX 63C; CX 57C; CX 50G; CX 54I; CX 155F; CX 157B; CX 171D; CX 47B; AlexanderTr. 56325635; Tr. 6343).

(c) Holiday Magic distributors have taken the LDI course and have considered it as a Holiday Magic business expense (Tr. 6918, 6924, 6343; CX 2057; Tr. 8211, 8680).

(d) Respondent William Penn Patrick is chairman of the board of directors of Leadership Dynamics Institute, and Holiday Magic secretary and comptroller, Harold Lipska, a secretary and director (CX 57C); formed by Mr. Patrick (AlexanderTr. 5635).

249. Mind Dynamics

(a) Another course formed by respondent Patrick and made available to distributors for a fee is Mind Dynamics (AlexanderTr. 56375639; CX 57H; CX 60B; CX 69B; CX 163D; CX 165C).

This course, of which Mr. Patrick is chairman of the board of directors (CX 57H) is a 'means of achieving personal success through the conscious use of the subconscious mind.' (CX 57H.)

(b) Holiday Magic Distributors have taken the Mind Dynamics course and have considered it as a Holiday Magic Business expense (Tr. 6919; CX 2007; CX 2062; Tr. 8680).

250. Another program of instruction for pay available to Holiday Magic Distributors to help them in their business activities is Sales Dynamics (CX 68A).

XXX. Distribution Centers

251. Ninetyfive percent of Distributors who are in business today (as of Jan. 1973) belong to the CRS distribution centers (PangerlTr. 9629). Not all Masters and Generals belong to CRS (Tr. 5828).

252. Approximately 2700 Master and General Distributors today belong to the CRS Distribution Centers (Tr. 5881), and pay the same dues of approximately \$50 to \$60 per month (Tr. 5825; Tr. 10368) with an additional assessment of 5 percent of the retail value of products taken from CRS inventories by Distributors (Tr. 5829, 5877).

253. There are approximately 36 such centers nationwide (Tr. 5825).

254. CRS requires that its Master and General members maintain an inventory account at \$4,000 worth of merchandise (Tr. 5884) and CRS orders product from Holiday Magic, Inc. in the Distributor's name and account (Tr. 5884) at 55 percent off list for Masters and at 65 percent discount for Generals (Tr. 5885) CRS members can also buy directly from Holiday Magic (Tr. 5898).

255. CRS performs the same services for Master Distributors and for General Distributors (Tr. 5881, 5882). These services are product warehousing, additional training, supervision of retail activities, collection of sales tax, and immediate delivery of product (Tr. 6827).

256. The CRS's operate in the following manner: Holiday Girls of a member's organization come to the CRS center to pick up merchandise and pay for the product at 30 percent discount as per the refund schedule (Tr. 5882, 5826). A sale is thereby recorded on the member's card file, and he is entitled to the difference in price between the discount at which he (or CRS for him) buys and the price that the Holiday Girl paid for the product (Tr. 5826). The Holiday Girls are given cards by the CRS members to show when they pick up their merchandise (Tr. 5880).

257. Holiday Magic, Inc. has a controlling interest in CRS (Tr. 5827).

258. CDC, which was the forerunner of CRS, served the same functions that CRS now serves (Tr. 5883, 45004511); CDC was not owned by Holiday Magic, Inc.

259. As in CRS, CDC members were Masters and Generals (Tr. 4500) who paid the same dues (Tr. 4511).

260. CDC, which stands for Combined Distributors Centers, was first promoted by Holiday Magic for its distributors in July 1969 (CX 46A).

261. The CRS and CDC distribution centers were and are highly recommended by Holiday Magic, Inc.

CX 49E, 50C, 42E, 55F, 58C, 59B, 59F, 64B, 65A, 150D, 151C, 151H, 151P, 152E, 153A, 153C, 62F, 63L, 65E.

XXI. Councils

262. A council is an association of General and Master distributors formed in a given geographical area to share in the costs of retailing, business training, recruiting, and participating jointly in any Holiday Magic activity of mutual interest (CX 78Z73, CX 79Z70, CX 93B).

263. The combined efforts of the distributors thereby reduce the costs to the individual distributor members who might otherwise be required to expend additional monies were they to be acting alone (CX 78Z74, 78; CX 79Z75; CX 93C, G).

264. The combined efforts of the local Master and General distributors in providing for a single establishment means an improved physical facility in furthering the Holiday Magic image (CX 78Z74, CX 79Z71, CX 93C).

265. Although the specific amount of the dues is fixed at the discretion of the council members, Holiday Magic requires of the councils that Masters and Generals pay the same dues (CX 78Z74, CX 79Z72, CX 93D, CX 95C).

All distributor witnesses who testified with respect to council membership consistently testified that Masters and Generals paid the same dues at the council to which they belonged (Tr. 2279, 2598, 2411, 2071, 5119, 3068). Council dues today, Jan. 1973, on the average are approximately \$60 per month (PangerlTr. 10368).

266. Holiday Magic, Inc. requires that a council must provide for:

1. Approved company business training.
2. Approved retail sales training.
3. Regular opportunity meetings.

4. Training classes for Holiday Girls.

5. Weekly meetings to discuss questions of mutual interest and to conduct sales and motivation seminars.

(CX 78Z7677, CX 79Z7374, CX 93EF.)

267. Masters and General Distributors join the councils in order to have a place to have their Holiday Girls trained (ChristieTr. 5985; Tr. 616869, 5126, 5092, 4968, 439192 (stipulation)) have the business explained (Christie Tr. 5985); and to bring prospects to opportunity meetings (ChristieTr. 5985; Tr. 4689).

268. Holiday Magic, Inc. has a reciprocal training policy for its councils whereby a reasonable amount of training will be given by a council in another area for members who send their recruits there. This policy of Holiday Magic, Inc. was established to save Master and General distributors the traveling expenses which would otherwise be necessary if their recruits were in an area some distance from the recruiting distributor's base of operation (CX 78Z78, CX 79Z75, CX 93G, CX 75L, CX 1394).

269. [The Councils'] Master and General Retail Route Training class is designed to prepare the Masters and Generals for their responsibilities in the retail field and to teach them how to run a retail organization (CX 91C).

270. Holiday Girl Council Training is designed to provide fundamental education of product, its application, block seminars, retail sales and closing. (CX 91D.)

271. Council training classes are taught by instructors (CX 27A; CX 35E, G, H; CX 49B; CX 131A; CX 171C) who have been trained by Trainer Generals (See XXVIII 8).

272. The councils render the same services to Masters and Generals and treat all members alike (ChristieTr. 598485; CX 94AT; CX 93AH; CX 95AH; CX 96A H).

273. The council formation is subject to the approval of Holiday Magic, Inc. (CX 78Z74, CX 79Z71, CX 93D) and once a council is formed and receives confirmation from Holiday Magic, Inc., the council and each member therein automatically assume responsibility for enforcing and complying with the rules, regulations and directions stated in the Masters' and Generals' council manual (CX 95C).

274. The councils are highly recommended by Holiday Magic, Inc. for Master and General Distributors to join.

(a) CX 630A (Bulletin to Masters and Generals 7/7/67: 'Remember! To have a voice in the operation of your area and to insure your own success you should belong to and take an active part in, your local Council!')

(b) The desirable and advantageous CDC is available only to council members (CX 46AWand 7/69).

(c) CX 483 and CX 1382B (Letter from Holiday Magic, Inc. to distributors requesting a transfer from their Generals dated 2/16/70 and 11/19/69board of directors) 'feeling is that since you are a Master distributor, you deal directly with the company. You promote your own programs, and you service the interests of those in your organization. If you do not belong to a Council, we suggest you join a Council in your area. This action will keep you in the center of business and promotional activities.'

(d) Leads from Holiday Magic advertising activities go to the councils (CX 29H) by way of the Senior General (CX 122C).

(e) PangerlTr. 10370.

275. Holiday Magic field directors help local distributors establish councils in every area, working to create a synergistic effect (CX 42BWand 3/69).

276. Holiday Magic, Inc. exercises such controls over the councils as requiring all council meetings to begin with the pledge of allegiance (CX 162C), prohibiting councils from holding special classes on eye makeup or corrective makeup (CX 493) and requires the councils to abide by Holiday Magic Rules (CX 94C; CX 95F). Other controls with respect to opportunity meetings appear in part XXXII.

277. Holiday Magic, Inc. recognizes 'only one council per city or market area' with the exceptions of New York and Los Angeles (CX 630A).

278. The material in the council manuals are 'obligations' of a council (CX 622).

279. Council manuals appear in the record at CX 78Z76; CX 79Z73; CX 93, CX 94, CX 95.

280. Holiday Magic, Inc. determines the membership requirements of councils in membership disputes (CX 621) and has required councils to admit certain persons to council functions whom the councils sought to terminate (CX 1126).

281. Holiday Magic, Inc. has also required councils to turn over their financial statements to Holiday Magic, Inc. (CX 1123A6/15/70).

282. The council head is termed the 'Senior General' (CX 78Z74; CX 79Z71; CX 93D; Tr. 4688, 334748, 4683, 2069).

283. Holiday Magic, Inc. appoints the Senior General to his position as council leader (CX 1155; CX 1156; CX 619; GayTr. 10009; CX 79Z72; CX 78Z69; CX 93D) and even has had corporate officials run councils (Tr. 5937).

284. Holiday Magic, Inc. has described the Senior General 'as a representative of the Corporation.' (CX 29GWandJan. 1968.)

285. As compensation for his various duties and functions as council leader, the Senior General receives a 1 percent override on new Master orders sponsored by his Member Masters and Generals (CX 94M, CX 95F) as well as a 1 percent override on all business produced by purchases from Holiday Magic by council members (CX 78Z74, CX 79Z77, CX 93I, CX 95F). This override is based on direct sponsorship only and the sponsor must be a member of the council in order for the override to be paid by Holiday Magic, Inc. (CX 512).

286. As of 1/23/69, there were approximately 66 active councils throughout the United States, with a total membership of 1,459 for 44 of them (CX 616).

XXXII. Opportunity Meetings

287. A Holiday Magic 'companyapproved' opportunity meeting is really an opportunity procedure consisting of at least three parts: the films shown thereat, an 'on script' blackboard presentation or 'chalktalk' of the opportunity meeting script, and a discussion of the 'prospect's qualification' which is a thorough explanation of the advantages of the distributorship levels by an 'on script' presentation of 'the Six Enrollments' (CX 136CFamily News 5/24/68; CX 90K; GayTr. 987879).

288. The films shown at the opportunity meetings appear in the record as Physical Exhibits A and B; and a transcript thereof at Tr. 97829808; the 'opportunity meeting scripts' appear in the record at CX 78Z27-37; CX 79Z27 z40; cx 96an; cx 97ap; cx 98an; cx 99ao; cx 100ap; cx 1468ap; cx 102ap; CX 103AK; and the 'Six Enrollments' appear in the record at 1840; CX 90PW; CX 85P; CX 86; CX 1842).

289. Physical Exhibits A and B are shown at opportunity meetings presented by councils, since at least 1967 or 1968. They are films sent to the councils by Holiday Magic, Inc. (AlexanderTr. 55995600; CX 166D (cost of film regularly \$135Family News8/4/70)).

290. Opportunity meetings are held throughout the country, and are often attended by hundreds and sometimes thousands of persons (CX 1C (250); CX 11E (452); CX 14A (600); CX 15B (1,000); CX 15C (400); CX 21A (2,300); CX 13C (300)).

291. Holiday Magic, Inc. advises its directors that 'the attendance at the Opportunity Meeting should be as large as you can make it' (CX 90EInstructor General manual; CX 1840U).

292. The opportunity meeting is the only place where all the facts are given to prospects (CX 90I).

293. Holiday Magic advises its distributors not to go into details with the prospects over the Holiday Magic marketing plan: 'if you could explain it correctly and easily over a 10 cents cup of coffee or a 15 minute telephone call or amidst the confusion and distractions of the normal situation, why do you think thousands of dollars are being spent setting up and conducting these meetings.' (CX 78Z39.)

294. Holiday Magic relies heavily on the emotional impact of these carefully staged meetings:

(a) CX 90G: Our objective is to bring our prospect to the point where he feels excited at the end of the meetinghe feels a ray of hope and an inkling that this may be his way out of his financial problemshe can think of only three thingshimself, Money and Holiday Magic. See also CX 1840Z62; CX 1840B; Tr. 2060.

(b) See witness descriptions of opportunity meetings at Tr. 405: 'Jesus, it looks unreal. How can it be possible? Gee, if a guy could just make half that. It really looks easy.' And at Tr. 4058: 'I see where I can make \$100,000 a year. See also Tr. 10941095, Tr. 22592261, 1990, 2132, 2137, 2270, 3050, 1996.

295. Holiday Magic, Inc. in the Instructor General manual provided to its first group of Instructor Generals, explains the purpose of the opportunity meetings as follows:

The opportunity meeting is designed primarily to aid in the recruiting of new Organizers and Master Distributors. It is not really designed to help recruit retailers.

We explain how a great deal of money can be earned by using the Holiday Magic concept.

We talk of earning in excess of \$100,000 a year. Anyone should be able to expect, therefore, that your meetings are being held by men capable of earning more than \$100,000 a year and would run smoothly and with much polish.

A hundred thousand dollars a year is a great deal for any prospect to accept. We tell our prospects that we will teach them, show them and supply them with everything they need to be successful in this business. Unless they feel you can actually do this they will not accept the idea.

The Opportunity Meeting may be the only contact they have had with the Company. We will therefore rely heavily on any and all impressions given. The product presented at these opportunity meetings is not truly cosmetics, but actually a fantastic financial opportunity (money) (CX 1840TV); see also CX 78Z39, CX 79Z29).

296. Holiday Magic tells its distributors that the 'Product' at the Opportunity Meetings is not cosmetics, but 'money' (CX 1840U; CX 90E).

297. Holiday Magic, Inc. controls the Opportunity Meeting presentations and attains in it the appearance of a corporate presentation.

(a) Holiday Magic, Inc. instructs its people in the Instructor General manual that the Opportunity Meeting room 'should be draped with our banners, as to take on an appearance of a Holiday Magic Opportunity Meeting and note a Hotel meeting room' (CX 1840Z2; CX 90F; CX 95DE) with 'a 20" by 40" framed photograph of William Penn Patrick' (CX 90F; Tr. 3898).

(b) The 'tools' required by Holiday Magic, Inc. to present a Holiday Magic Opportunity Meeting are stated in its Instructor General Manual:

With the proper tools to enroll, the proper setting for the presentation, the proper speakers for your guests and with the right prospects, your Opportunity Meetings and your business will be successful.

The tools needed to present Holiday Magic Opportunity Meetings:

1. 'Formula for Happy Living' and the 'Story of Holiday Magic' films
2. A 16mm projector
3. Extra lamps and fuses for the projector, splicing tape for the film
4. A portable projection screen (approximately 4' x 5')
5. A large black board, chalk and eraser
6. Product display and sales aid display
7. Distributor kits and minikits
8. Recruiting kits
9. One packs
10. Applications
11. Refund investment schedule
12. Banners
13. Guest register

(c) Holiday Magic, Inc. prescribes the details for an opportunity meeting down to the last ash tray, to wit:

Before the meeting he will check the sound projector to be absolutely sure it is in working order. He will locate the light switches so there will be no running at the time the film is to be shown. He will see that there is a riser at the front of the room upon which there will be a projection screen and a speaker's stand. To one side of the projection screen will be the large blackboard; he has to make sure of the availability of chalk and eraser. The product display will be set up to the left of the riser, and the sales aids display will be set up to the right of the riser. Refund investment schedule cards will be placed on

each chair and ash trays on every second or third chair. One table will be set up with glasses and water and one will be set up at the door for the registering of guests.

It is imperative that the Opportunity Meeting leader be responsible for the setting up of this room with the tools prescribed.

The room should be a large conference or meeting room, preferably in an outstanding hotel or motel. It will add prestige to the meeting if the room is carpeted and draped.

Acquire a room that is away from any dining room or dance area to insure quiet. The room may be set up in either classroom or theater style. If set up classroom style, the long rectangular tables are preferable. An alternative would be to set up the front of the room classroom style and the back of the room theater style, insuring those who arrive on time a table on which to write. The location of the meeting should be posted in the hotel with signs directing distributors and guests to the room.

A Holiday Magic Opportunity Meeting will start at 7:59 p.m. sharp and the Opportunity Meeting leader and speakers will be there at 7:30 p.m. to set up the room with the prescribed tools.

Attempt to make your meeting place a permanent one. This creates a feeling of security much preferable to the confusion created by moving from one place to another. Meeting dates should be posted 30 days in advance, and you should try to make them on the same days each week.

Make sure everyone is informed of any changes in the meeting place, date or time far enough in advance to prevent embarrassment, either to you, the distributors or their guests.

Your speaker for the evening should be at the prescribed place at 7:30 p.m. to greet guests on their arrival. The guests will be more at ease while he gives his speech if they have met him a few minutes earlier.

Next, we suggest what the Corporation feels should be the tools and setting for the 'ideal' Holiday Magic Opportunity Meeting.

The basic tools would remain the same except for a few additions. These would include a 20" x 40" framed photograph of William Patrick set up on the product display table.

Add at least two girls in uniformed dress, one to help the guests sign in and the other to usher. We say at least two you may have more.

The speaker's area could be illuminated with two spotlights approximately 300 to 500 watts each. These should be placed on either side of the speaker's area at approximately a 45 degree angle, eliminating any glare on the blackboard. The latest issue of 'The Wand' could be placed on each chair or on the table in front of each chair if the body of the room were set up schoolroom style. A dimmer switch should be used as follows: Instead of switching off the lights completely, just before the film the light should be

dimmed slightly but not all the way into blackness. At the end of the film, the reverse procedure should take place. Bring the lights up slowly but not all the way. At this time your two spots should be turned on the speaker. As he is speaking, the lights are brought up very slowly so those in the audience will not notice the change.

The room should be draped with Holiday Magic banners to give the appearance of a Holiday Magic Opportunity Meeting and not a bare meeting room.

Slate blackboards are the best for use in the Opportunity Meeting presentation. Unfortunately, slate boards are very difficult to obtain. As a second choice, use a Duracite board in green. This is usually a standard item at most hotels so there should not be too much difficulty in obtaining one.

We suggest using a florescent, light green chalk. If white chalk is the only thing available, use a dustless brand that is not too heavily enamelled or laminated. (CX 90F; see also CX 95DE.)

(d) Holiday Magic, Inc. coaches its distributors in techniques of bringing prospects to opportunity meetings down to the finest details. Distributors are told not to discuss any details of the business with their prospects before the meeting (CX 1840Z45; CX 78Z39) and that the word 'cosmetics' should be deleted from their recruiting business cards (CX 90I) or in talking to a man (CX 1840Z51).

(e) Distributors are also told by Holiday Magic, Inc. that they 'have' to pick up their prospects and bring them to the opportunity meetings (CX 1840Z; CX 78Z39).

(f) Distributors are advised always to carry blank checks in the event the new distributorprospect does not have cash or his checkbook with him (CX 1840A68).

298. Distributors are told to use the following methods to invite a 'suspect' to an opportunity meeting:

(a) I have discovered a business opportunity that is really great! And there is more money in it than anything I have ever seen and I would like to invite you to come with me and look at a real money tree! (CX 1840Z44.)

(b) I would like to have your personal opinion on a business opportunity! Could you please come with me this evening? (CX 1840Z44.)

(c) Joe, I've discovered something that is really great! There's more money in it than anything I've seen and I'd like to show it to you, too. I think it would fit you like a glove. (CX 78Z38.)

299. The formal Opportunity Meetings are required by Holiday Magic, Inc. to be given 'on script' and only by those distributors who are holders of socalled 'Black Certificates' given out by Instructor Generals in Instructor General school (CX 90K; CX 95D).

300. Holiday Magic, Inc. threatens distributors with termination for not presenting the formal opportunity meetings on script, which script first appeared approximately Mar. 1967 (CX 79Z27, CX95D, CX 136C, CX 90K).

301. However, the threatened termination by Holiday Magic, Inc. for an off script presentation of the Opportunity Meeting relates only to 'public' meetings and 'company' meetings at 'Council or CRS' places (PangerlTr. 9650).

Holiday Magic policies the Opportunity Meetings to insure that it is given 'on script' (Tr. 6043; Tr. 6163).

302. Every Opportunity Meeting speaker closes with 'At this time I would like you to turn to the person who invited you and ask him to help you select one of the four portions for you in Holiday Magic. Thank you.' At this point it is the job of the wouldbe distributorrecruiter to enroll his prospect and he attempts to do so by presenting 'The Six Enrollments' (CX 90K; CX 1842Z29).

303. Holiday Magic, Inc. tells its distributors that following the Opportunity Meeting they are to train their people to 'applaud the final speaker' and to 'sign up their prospects on the spot.' (CX 1800Q-Masters and Generals manuals; CX 90E.) 'Prospect should be able to make a decision at the time he attends the meeting. If both husband and wife are necessary to the decision, then both should be present at the meeting.'

304. Distributors are advised by Holiday Magic, Inc. to show up at Opportunity Meetings with Holiday Magic application forms and distributors lists (CX 78Z30; CX 90K).

305. The 'Six Enrollments' which is utilized on an individual basis with prospect after the formal opportunity meeting (Tr. 599697) is an explanation of what can be done using the Holiday Magic marketing plan (ChristieTr. 5999; CX 90K).

306. Holiday Magic, Inc. states in its Instructor General manuals that 'The Six Enrollments factually present the advantages of the four positions [and] totally explains the entire marketing program in a most concise manner.' (CX 90K.)

307. The 'Wholesale Enrollment' for example, explains how to become a General Distributor (ChristieTr. 5997).

308. The format of the six enrollments actually appears in current versions of the Holiday Magic Opportunity Meeting scripts. The words are different, but the presentation and impact is the same (See RX 29AM; CX 103AK; CX 102AP).

309. The psychological hard sell of the six enrollments takes over the emotionalism of the Opportunity Meeting at which point the 'scripts' are no longer policed. Prospects are urged to sign up during the six enrollments presentations.

(a) See CX 90K.

Holiday Magic Instructor General manuals further describe the six enrollments procedure:

Each [of the Six Enrollment presentation] ends with an obligating question, so that when your prospect qualifies himself by giving an affirmative reply, you can start filling out the application.

When the application is completed make the cash arrangements. This is accomplished by merely pointing to the amount equivalent to the position selected and ask 'How would you prefer to handle this, by cash or by check?' (CX 90K.)

(b) See McKinnanTr. 4060: I am naive. All I can see is a whole lot of money. I knew if you got to be a General you had it made.

310. Holiday Magic requires that all council opportunity Meetings be open and free to any other Holiday Magic distributor or his prospects, regardless of who is conducting them (CX 79F26). Nor should any distributor below the rank of Master be assessed dues for his attendance at an opportunity meeting (CX 79Z26).

Any Holiday Magic distributor who is a member of some 'company recognized council' shall have the right to take his prospects to another council's Opportunity Meetings (CX 79Z75, CX 79Z78, CX 93G).

311. Holiday Magic, Inc. utilizes the opportunity meetings in order to obtain persons to come into the program based upon emotional rather than logical considerations (SowinskiTr. 2060; DavisTr. 6282), to the point that they 'lusted over money' and thought they could become rich overnight (SowinskiTr. 2060).

312. Holiday Magic, Inc. in its Instructor General manuals, highlights the emotional aspects of the opportunity meetings:

Our objective is to bring our prospect to the point where he feels excited at the end of the meeting, he feels a ray of hope and an inkling that this may be his way out of his financial problemshe can think of only three things: himself, money and Holiday Magiche likes the way he feels, so his thoughts must be compatibleHIMSELF AND MONEY THROUGH HOLIDAY MAGIC!

He feels, he feels, he feelsherein lie's the key. FEELING is an emotional reaction. It is obvious that to achieve our objective with our prospect good feelings associated about Holiday Magicwe will be dealing on an emotional basis constantly.

If this emotional tone could be charted, it would look like this:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

And at CX 1840Z5:

What are some of the techniques we are using to bring this about? Remember:

(1) We are all 'Happy birds'. We know where we are going and we like it because it's where we want to go. Everyone wants on a team that obviously knows where it's going and is excited about it. There is a wonderful feeling of comradery shown among the Holiday Magic Family members.

(2) We know what we are doing. It is obvious because we show confidence and planning perfection. We are living proof that the program is successful.

(3) The film is loaded with emotionstimulating thoughts. '* * * my income and my bills just didn't match up * * * it may be charity * * * children * * * these four walls * * * future didn't look too bright * * * I'd hate to think it passed me by * * * your chance, your choice and your challenge * * *' and literally hundreds more.

(4) Our speakers are outstanding and obviously successful.

(5) We are excitedly enthusiastic.

Never forget, emotional selling is what we are doing. Our propects are going to make their decisions to join us because they 'feel' right about it in 99 cases out of 100. The remaining 1% will come in because he has 'logically reasoned' that it is the proper thing to do.

313. Holiday Magic Opportunity Meetings are difficult to impossible to comprehend to prospects attending same, and are so intended to be by Holiday Magic, Inc. (CX 97AP, CX 98AN, CX 99AD, CX 100A-P, CX 101AP, CX 102AP, CX 103AK).

See Opportunity Meeting scripts (CX 18420, Tr. 3969).

314. The atmosphere at Opportunity Meetings is one of potential overwhelming financial gains, dramatized by stories of great riches, and a parade of toys as in the movies. The unusual incomes are described as earned by ordinary people, so that the prospect can easily put himself in the shoes of the spender (Tr. 2281, CX 97AP, CX 98, CX 99, CX 100AP, CX 101AP, CX 102AP, CX 103AK).

See opportunity meeting scripts.

315. The major emphasis of the Opportunity Meeting is on earning 'big money' by becoming a master and then general distributor in Holiday Magic.

See Opportunity Meeting scripts (CX 97AP, CX 98AN, CX 99AD, CX 100AP, CX 101AP, CX 102AP, CX 103A-K).

316. With a changing in the language but not the impact of the Opportunity Meeting script, respondents have resorted to unrealistic 'hypothetical' examples of spectacular profits which replaced the non-hypothetical blatantly fraudulent misrepresentations of earlier opportunity meeting scripts.

See Opportunity Meeting scripts (Tr. 7328, Tr. 88898890, CX 97AP, CX 98AN, CX 99AD, CX 100AP, CX 101AP, CX 102AP, CX 103AK).

317. The opportunity Meetings and six enrollments or closing formats have not been altered by Holiday Magic in any significant respects.

See above cited Opportunity Meeting scripts (Tr. 7334, CX 86AF, CX 1840A Z114).

XXXIII. Emotional Lure to Selling

318. Holiday Magic, Inc. utilizes emotional keys to selling distributorships and tells its distributor to do likewise. As they appear in the Instructor General manual, they are:

(a) The Assumptive Attitude Assume at all times your prospect is going to enroll (CX 1840Z6566).

(b) Using Subordinate Questions This is getting your prospect to agree on minor issues so that he is in the habit pattern of saying yes and will not be able to refuse you (CX 1840Z60).

(c) The Impending Event This is a PowerHouse method of enrolling your prospect though presenting to him a situation which he can take advantage of only today and which will not be available tomorrow (CX 1840Z66).

(d) The Inducement Give something to your prospect that is and have the normal program which will induce him to make a decision right now (CX 1840Z66).

(e) Physical Action Assist your prospect in filling out the paper work or demonstrating the product (CX 1840Z66).

(f) The Narrative Key Tell short positive or negative story. Enroll prospect through 'Hope of reward' or 'fear of Loss' (CX 1840Z67).

(g) The Persistence Key Be stronger than your prospect at all times by continually asking him to buy from you (CX 1840Z67, CX 79U).

319. Holiday Magic Inc. also informs its distributors through their Instructor Generals in connection with seeking to enroll prospect that 'Many people have a desire to be misunderstood' (CX 1842E).

320. The Holiday Magic enrollment keys to selling were utilized throughout by corporate officers and Holiday Magic distributors in recruitment efforts. For example, the record is replete with instances of the 'Impending Event' technique:

(a) Holiday Magic President Al Pangerl testified that RX 137, which discontinued a 1 percent override for new Generals only, as well as an additioned requirement of \$1,000 per month in override purchases (Tr. 9526) was mailed to distributors in October even though it was effective Nov. 30, 1972, to give distributors an opportunity to become General prior to the deadline (Tr. 9191).

(b) 1. CX 2067A:

EFFECTIVE FEBRUARY 1, 1972, THE REQUIREMENT FOR A GENERAL DISTRIBUTORSHIP OF HOLIDAY MAGIC PRODUCTS WILL INCREASE TO \$4,000.

We're telling you this in advance so that you will have these remaining weeks to take advantage of the present requirement of \$3,000 before the deadline. That means that all applications postmarked after 12:01 A.M. on February 1, 1972, will be approved only if the new requirement of \$4,000 is paid.

Sincerely,

Roland R. Nocera, President

2. CX 2067B:

THE GENERAL DISTRIBUTOR NEW REQUIREMENT OF \$4,000 WILL BE EXTENDED TO BEGIN MARCH 1, 1972 * * * instead of becoming effective on February 1, 1972, as previously announced.

This 20 day postponement is required to give Distributors more time, since there seems to be confusion in the field regarding the program.

All applications for General Distributorship will be honored when accompanied by payment of \$3,000 to be placed in escrow, if postmarked before 12 midnight on February 29th. It is not necessary to have a replacement Master by that deadline date, the replacement Master may be submitted at a later date.

I give you my word that there will be no further extension of this deadline. Don't waste one minute of this extra month. You'll be very glad you didn't.

Sincerely,

Roland R. Nocera,

President.

(c) 1. CX 2068A:

MASTER REQUIREMENT\$4500

STARTING ON MARCH 1, 1972, THE REQUIREMENT TO BECOME A MASTER DISTRIBUTOR WILL INCREASE FROM \$3,000 TO \$4,500. THAT MEANS THAT FEBRUARY WILL BE THE LAST MONTH TO BECOME A MASTER DISTRIBUTOR FOR \$3,000. ALL APPLICATIONS RECEIVED FOR MASTER DISTRIBUTORSHIPS POSTMARKED AFTER 12:01 A.M. ON MARCH 1, 1972 WILL BE APPROVED ONLY IF THE NEW \$4,500 REQUIREMENT IS PAID.

CANDIDLY,

ROLAND R. NOCERA,

PRESIDENT.

2. CX 2068B:

FOR YOUR IMMEDIATE ATTENTION!

THE MASTER REQUIREMENT WILL POSITIVELY INCREASE TO \$4,500 ON MARCH 29

I give you my word there will be no further extension of the old \$3,000 price beyond that date. We are determined that every new Master Distributor has all the help possible to become an outstanding success in the Holiday Magic program. To do this, we have made certain adjustments in the required Master training and product and sales aids inventory. These changes mean increasing the Master cash requirement to \$4,500. We strongly feel that, as a result of these changes, every new Master will be more fully prepared than at any time in the past to achieve total success with his distributorship.

The \$4,500 cash requirement will cover the cost of a greater amount of product at retail; a standardized, special assortment of sales aids for Masters, and the finest professional management and sales training anyone can get anywhere.

As you know, the true value of a Holiday Magic Distributorship is growing by leaps and bounds. Thus, I have no way of predicting how long we can hold the line at \$4,500. I advise you to take advantage of the current situation.

Every day you wait can cost you money instead of making you some.

We're on our way.

Roland R. Nocera

President.

3. CX 2060A:

FOR YOUR IMMEDIATE ATTENTION!

MASTER REQUIREMENT TO INCREASE TO \$6,000 ON JULY 6

Effective July 6, 1972, the cost of a Holiday Magic Master Distributorship will rise from \$4,500 to \$6,000.

This rise reflects the enormous growth in value of every Holiday Magic Distributorship. You all see evidence of this in the large numbers of Distributors who appear in each month's 'Wand as Money-makers and in the rapid upsurge in retail business at every CRS facility in the country.

This means that all applications received for Master Distributorships postmarked after 12:01 A.M. on July 6, 1972 will be approved only if the new \$6,000 cost is paid.

The Holiday Magic opportunity continues to reach outward on all sides toward the distant horizon. Reach with it and you may be richly rewarded. Every day you wait is money you aren't earning.

Yours for the future,

Roland R. Nocera

President.

4. CX 2069B:

FOR THE IMMEDIATE ATTENTION OF ALL DISTRIBUTORS

WE ARE EXTENDING THE MASTER REQUIREMENT!

The deadline for the \$4500 requirement has been extended to July 28, 1972. This means that all applications received for Master Distributorships postmarked after 12:01 A.M. on July 28, 1972 will be approved only if the new \$6,000 requirement is paid.

I advise you to take advantage of the limited time remaining now.

Cordially,

Roland R. Nocera,

President.

5. CX 2069C:

FOR YOUR IMMEDIATE ATTENTION

MASTER REQUIREMENT EXTENSION

We have decided to extend the current Master Distributor price requirement of \$4,500 to August 23, 1972. Applications received after 12:01 a.m. on this date must be accompanied by the new price requirement of \$6,000.

Take this opportunity while you may.

Cordially,

Roland R. Nocera,

Chairman of the Board.

6. CX 2069D:

FOR YOUR IMMEDIATE ATTENTION!

MASTER REQUIREMENT TO REMAIN AT \$4,500

We will be taking major steps in improving distributor sales training and sales aidstools with which a Master can achieve greater success than at any time in the past, but we have decided to let the Master requirement cost remain at just \$4,500.

Holiday Magic believes in its people, and has faith in their ability to continue to work hard towards personal achievement which in turn contributes to the success of the company and to the success of the American economy.

The Master requirement will remain, for the time being at \$4,500.

Sincerely,

Alfred W. Pangerl,

Senior Vice President.

(d) 1. CX 207AC:

A NEW FINANCE PLAN FOR YOUR NEW MASTERS

Effective October 1 through October 31, 1971, we're offering to finance up to \$1500 of the purchase price of a Master Distributor * * * at an interest rate of 6% on the declining balance.

2. CX 2071:

You only have a few more days to take advantage of the Finance Plan for New Masters that ends January 31st * * * THERE WILL BE NO FURTHER EXTENSIONS OF THE DATE.

If you've heard any rumors to the contrary, don't believe them. If you're counting on an extension for any reason, you're going to be disappointed. Even though this program has been very successful for all of us * * * and we did extend it from the original December 31st date * * * there will be no further extension! I'm advising you of this now, so you will take full advantage of the time remaining and you have my word for it * * * there will be no further extension beyond the January 31st deadline.

Sincerely,

Roland R. Nocera

President.

3. CX 2072AD:

A NEW FINANCE PLAN FOR YOUR NEW MASTERS!

New effective through April 19, 1972, we're offering to finance up to \$2500 of the purchase price of a Master Distributor order * * * at an interest rate of 6% on the declining balance.

4. CX 2073AC:

A NEW FINANCE PLAN FOR YOUR MASTERS!

Effective now through June 13, 1972, we're offering to finance up to \$2000 of purchase price of a Master Distributor order * * * at an interest rate of 6% on the declining balance.

5. CX 2074AC:

A NEW FINANCE PLAN FOR YOUR NEW MASTERS!

Effective December 10th through December 31st, we're offering to finance up to \$1500 of purchase price of a Master Distributor order * * * at an interest rate of 6% on the declining balance.

6. CX 2076AC:

A PRESENT FOR THE NEW YEARA SPECIAL MASTER TOTAL PRICE OF \$3000 PLUS THE NEW FINANCE PLAN FOR NEW MASTERS

Effective through January 31st, we're offering to finance up to \$500 of purchase price of a Master Distributor order * * * at an interest rate of 6% of the declining balance.

(e) See GayTr. 1001010011 describing the impending event as utilized by Holiday Magic, Inc.

(f) See also CX 1395A.

321. Holiday Magic, Inc. has utilized as an 'impending event' the fear of distributors that limitations in their recruiting activities may at some future date occur.

CX 90Z3, opportunity meeting statement dated Jan. 1970, for example, states:

There are only a limited number of Generalships in any given area. Achieving this level depends in part on your own abilities to produce and in part on how many have gotten there before you. As in any other test of achievement, the race goes to the swift.

322. There is considerable doubt that any such limitation has actually been imposed; and this doubt is generated by the following:

(a) RX 84 purports to be an interoffice memorandum distributed to all Senior Generals and Instructor Generals some time after Roland Nocera became Holiday Magic President which was in Nov. 1970 (Tr. 10016; Tr. 9655). RX 84 states that on Mar. 22, 1967, the Holiday Magic Board of Directors adopted a policy of one General Distributor per 10,000 population in a given market area.

(b) RX, 163AO, which is the minutes of the meeting of Mar. 22, 1967, contains no such statement.

(c) Two Holiday Magic officials, Coultas and Pangerl, testified with respect to the alleged limitation of Generalships, and their testimony indicates an incredible lack of knowledge by these two officials the president and the director of legal service, about such 'limitation.'

For example, we learned that a limitation was placed in recruiting Generals in Red Lion, Pa. (Tr. 9701) but we are not told, and corporate officials do not know Red Lion's population, geographic area, size or number of Generals there (Tr. 972930, 10331) or the number of Masters or Generals operating out of Red Lion (Tr. 10331).

See Tr. 1033110339 and Tr. 1035610374, which is president Pangerl's entire testimony on the subject.

(d) At least through June 1968, the time that respondent Jan Gillespie, a member of the board of directors, left Holiday Magic, Inc. (Tr. 9293), she testified that the company had no filing for Masters and Generals by geographic area (Tr. 9557 Gillespie).

XXXIV. Business Training

,323. The term 'Business Training' as used throughout the Holiday Magic program is really nothing more than the 'Six Enrollments' being taught and given at the various councils (FechtalTr. 238991, PenceTr. 3674, GayTr. 9940, CX 1840Z8586) and is given to educate newly enrolled people and to motivate individuals at lower levels to move up (SowinskiTr. 2017, CX 1842Z29). For this reason, business training II and III is referred to by Holiday Magic, Inc. as opportunity meeting II and III (NapoletanoTr. 3609, GayTr. 9857).

324. The purpose and design of 'Business Training' was to 'close' prospects and to teach others how to recruit and close prospects (NapoletanoTr. 3611, FechtalTr. 2391, CX 1840Z8586).

The Instructor General manual states:

Business training is provided by functioning councilsMasters and Generals who belong to these Councils pay small monthly fees to support them. When your guest is invited to a council training meeting he will have to sign into the guest register and you're going to try to use the training facilities to sponsor your guests into the program. (CX 1840Z8586).

See also CX 1842Z2728; CX 1842Z29.

325. The closing techniques for prospective distributors, not for the sale of cosmetics, as described by Holiday Magic, Inc. to the Instructor Generals, contained in the material of CX 1844AN and CX 1842AZ30 (SowinskiTr. 203536, 2053) are all psychological hardsell techniques, as follows:

(a) Application EnrollmentThe filling out of the application by asking your prospects questions and writing down the answers. Prospect is asked to 'O.K.' the form (Z18).

(b) Enrollment QuestionsIs the use of questions the answers to which will confirm the fact of enrollment. Example'What is your correct mailing address?' (Z18).

(c) Alternates of Choice EnrollmentExample'Do you want to handle this by cash or by check?' (Z18).

(d) Call Back EnrollmentDon't ever ask your guest if he has thought it over because he will normally tell you the answer is 'no.' Use standard enrollment procedure all over again (CX 1842Z19).

(e) Summary Question EnrollmentOral method of enrolling your guest through using a negative yes enrollment each time he says no. Example'Is it the integrity of the company that is keeping you from enrolling?' (CX 1842Z19).

(f) Lost Sale EnrollmentTo be used when your guest has been lost and is starting to leave. Ask prospect to excuse his 'ineptness' and ask where he has gone wrong. When guest answers, go back into the presentation. Apologize to your guest for not enrolling him (CX 1842Z19).

(g) secondary Question EnrollmentUse minor question following an alternate of choice enrollment (Z20).

(h) Sharp Angle EnrollmentWhen prospect asks 'Can it earn money?' 'Do you want to enroll if you can make money?' (Z20).

(i) I'll Think It over EnrollmentAsk what phase of the program you want to think overthen you have a final objection enrollment (Z 20).

(j) Final Objection EnrollmentMake guest explain his objection until he feels 'stupid' (Z2021).

(k) The Puppy Dog EnrollmentFor skeptical guests on the try it before you buy it approach. Take the demo kit home and let your wife play with it. Prospect will have to enroll if wife wants to keep kit (Z21).

(1) Ben Franklin Balance Sheet EnrollmentUsed for indecisive prospects. Put down reasons pro and con for joining. Help prospect with pro reasons. Subconscious mind won't be able to switch to the con so fast (Z21).

(m) Similar Situation EnrollmentUse a positive or negative story to influence your prospect's decision.

(1) Positive story 'Oh, boy! am I happy that I made that decision because now I have the world by the tail enrollment.'

(2) Negative'Make them cry enrollment' or the 'back the hearse up to the door and let them smell the flowers enrollment' (Z2122).

(n) Obligatory Question EnrollmentLet prospect answer yes to any question he asks by asking him the same question. Example'Can I have retail girls?' 'Do you want to have retail girls?' (Z22).

(o) The Budget EnrollmentUse when losing your propect due to his lack of available funds. We'll start your training right away so you can become a financial success (Z22).

(p) Trial EnrollmentBook him in training class where you can obtain more information (Z22).

(q) Impending EnrollmentYou should get started with us right now! And reap the cash benefits available by expanding in these new areas before someone else comes along ahead of you and takes home the cash money you could have earned (Z22).

(r) Buddy EnrollmentLet's record your name at the main office so you will be able to sponsor your friend into the program (Z23).

(s) Name EnrollmentAsk prospect to write down names of five people who would like to make an extra \$25,000 a year. Then explain how much money these five people will make for your prospect if he sponsors them into the business. But in order to sponsor you have to enroll. If he doesn't enroll,

threaten him that you will sponsor the people. The moment you enroll one of his contacts you will have leverage to enroll him again (Z23, see also CX 78WX).

(t) Circle Enrollment Can you do it? Product, Industry, Marketing Plan & Company explained already (Z23).

(u) Cash Money Enrollment Used when you have a prospect who is a non believer. Pull roll of \$100 bills out of your pocket and say 'Now, I am not trying to impress you with the money that I'm making, but would earning this kind of money each week interest you? Wonderful' (Z24).

(v) Direct Enrollment 'I believe this program will directly benefit you by increasing your income' (Z24).

(w) Indirect Enrollment 'Now in order to start earning big money right away I think you should start in this position.' When a prospect turns down a position that you select for him just automatically assure that he is selecting the position directly below the one you have just offered him. 'Well, that's all right, we'll start you in this position and you can work your way up' (Z24).

(x) Choice Enrollment Now that I have explained all four positions to you which to you feel will suit your needs best?' (Z24).

(y) Pen Handling Techniques

(1) Pen Circling Always circle pen into your prospect's hand beneath his eye level (between the first finger and thumb) (Z2425).

(2) Pen Snapping Make a mark on the application where you want him to write, then snap the pen down upon the top (indicating you want him to use it). 'Please put your name and mailing address right here' (Z25).

(3) Pen Reaching When you have a wide distance to cover in placing your pen in prospect's hand. Place pen in prospect's hand while keeping your eyes at his level (Z25).

(4) Pen Dropping Should only be used after several unsuccessful attempts have been made to place your pen in your prospect's hand. You must become extremely nervous and accidentally on purpose drop your pen, saying 'Whoops.' When prospect picks up pen, don't thank him, but tell him to put his name on the application (Z25).

(5) Pen Tapping 'Is used to bring about fast signature.' 'Let's go' (Z25).

(6) Pen Borrowing Used when prospect has his own pen close at hand. Borrow his pen to make a mark on application, then give it back to prospect, telling him to finish filling out application (Z25).

(7) Pen Priming TechniquesUsed to get prospect to start writing after pen successfully placed in his hand.

(i) Quick PrimePick up second pen and quickly point to place you want him to sign'Just like a small bird sitting on your prospect's shoulder and softly whispering into his ear 'You forgot to sign your name' (Z26).

(ii) Hot and Cold Pen SwitchPut pen that has started writing into prospect's hand. Clear the negative deception from his conscious mind first.

326. Examples of the utilization of the 'pen' techniques are found in the record at Tr. 3611Napoletano and Tr. 3715Pence. On both occasions, they were demonstrated by either Instructor Generals or corporation team personnel.

Utilization and teaching of the 'Cash Money Enrollment' is very prevalent:

(a) Mark Evans, Holiday Magic's national sales manager, said HM stood for 'Hot Money' and threw 25 \$100 bills in the air (PenceTr. 3711).

(b) Bill Dempsey, V.P. for East Coast of Holiday Magic, Inc., flashed 3 or 4 \$100 bills in the air during his talk (PenceTr. 3710).

(c) See also LangstonTr. 3851.

(d) Jerry Booz at his Instructor General class opened his coat and it was lined with bills of all denomination (NapoletanoTr. 3612). (Mr. Booz testified for respondents after Mr. Napoletano, but never denied the incident.)

XXXV. How Money May Be Made Under The Holiday Magic Program

327. Money can be made in the Holiday Magic marketing plan without moving product to the consumer (Professor LappTr. 6739; SloaneTr. 2119).

328. There are many ways to make money in the Holiday Magic marketing plan. This can be accomplished by either selling product, recruiting people to sell product, or recruiting people to become Masters who in turn will be upgraded to the General position and the money can be made in the release fees (Respondents' Marketing Professor BaumgartenTr. 660809, 6616). See also CX 79Z45:

In other words, the distributor * * * may function as a retailer and/or recruiter of other distributors. What the distributor becomes in Holiday Magic depends mainly on his or her interest and ability.

329. It requires only two Masters going General for the individual General to reach his breakeven point (Professor BaumgartenTr. 6609, 6626).

330. It is clear from the record in this case that there are many ways that Master and General Distributors have worked the Holiday Magic program. They can do so by: (a) Retailing the product directly to the consumer (Tr. 5256, 4481 4482, 5114).

(b) Selling Holiday Magic products directly to Organizers and Holiday Girls at wholesale (Tr. 2452, 2479, 4187, 2525, 2518, 4554).

(c) Recruiting Master Distributors and receiving a 10 percent override if a General (Tr. 4841; CX 2009AB; Tr. 49894990).

(d) As a General, upgrading Master distributors to the General position, and collecting the release fees and subsequent 1 percent overrides (Tr. 5314, 8963, 4612).

331. The record is clear that the most successful Holiday Magic Distributors have made the vast majority of their money in Holiday Magic, Inc. by collecting release fees on upgrading Masters in their organizations to the position of General:

(a) Cf. Al Pangerl, the top producer for 1967, 1968 and 1970 (Tr. 9558 who sold only \$15,000 at retail value at wholesale in 1970 (Tr. 9562) which means approximately a gross income in wholesale business of \$5250 (35 percent differential between selling price of 30 percent undercut to Holiday Girls and 65 percent discount from Holiday Magic) received at least \$15,000 in overrides on his Master Distributors (Tr. 956062) and with 50 Generals totally made at least \$125,000 in release fees since 1967 (Tr. 9570).

(b) Bill Dempsey, the third highest Holiday Magic producer for a six month period in 1966 (Tr. 6062), made between \$40,000\$100,000 every year in Holiday Magic, made at least \$125,000 on release fees (Tr. 605960 Generals) and at least \$50,000 on 10 percent overrides (Tr. 605960 Masters plus 50 Generals who were Masters.

(c) Distributor Ben Gay, who like Pangerl also became president, testified that of \$100,000 he made his first year in Holiday Magic, \$98,500 was from recruiting activities and \$1500 was from wholesale sales (Tr. 9871).

332. Distributors are aware that the big money to be made in Holiday Magic is through recruiting and sponsoring Masters and Generals. Cf. Tr. 2246, 2119, 2288, 371720, 3388, 3784, 5137, 1093, 119495, 5314, 7307, 7309, 7338, 7667, 77247725.

333. Holiday Magic, Inc. tells its distributors and prospects in the six enrollments that the 'big money' is made by recruiting and sponsoring General Distributors, and collecting the release fees. Cf. CX 86BC:

Now for just a moment lets put you in the position of a General Distributor working at 65%. Each time you bring a new Master you receive 10% of the total retail volume that must change hands. 10% of \$5000 is \$500, you have just earned by bringing in a new Master Distributor, this newly created Master will want to become a General Distributor like yourself, so that he may earn the big money.

* * * [T]he moment this replacement Master has been signed in at the factory, the \$2500 that has been sitting there in escrow is released back to you, the General Distributor, for a total of \$3300 each time you bring in a new General Distributor.

If you did this once each month you would earn a total of \$39,009 a year and still have twelve Masters. Now, this is part time because, believe me, anyone who only brings in one Master a month is working part time! But, if you could bring in one distributor a week you would earn in excess of \$150,000 by this time next year.

334. The backbone of the success of Holiday Magic was based upon the Mark Evans lecture notes, which appears in the record at CX 85AZ29 (Quoted by witness Rountree of Fred PapeTr. 941).

335. The Mark Evans Lectures were given when Evans was a member of the Holiday Magic Corporate Team (Tr. 924).

336. A comparison of the Evans notes with the six enrollments scripts utilized by Holiday Magic reveals that the six enrollments follow the Evans lecture notes. Cf. CX 852AZ29, CX 86AF (handed out by Holiday Magic Corporate Team at meeting conducted by EvansTr. 2972) and CX 1842RZ10. Given to all Instructor GeneralsTr. Sowinski).

337. Holiday Magic distributors make money under the Holiday Magic marketing plan off of other people's efforts. Cf. Tr. 1097, Part XIV 5, CX 1800P, Tr. 2276, 6236, 4543; CX 1983, D.E.G.

338. No 'top achievers' in Holiday Magic have made more money in Holiday Magic selling to organizers and Holiday Girls than they have in generating release fees and overrides for themselves (CoultasTr. 9755).

339. Under the Holiday Magic marketing program, according to Robert DePew, Holiday Magic's first vice president, 'a tremendous amount of money could have been earned by many without must regard at all for quality of product or retail sales or repeat orders' (CX 2BWand 9/65).

340. The record establishes that Holiday Magic, Inc. provides the distributor with the marketing plan, and lets the individual distributor decide for himself how he chooses to make his money in the Holiday Magic program (Tr. 1320, CX 79Z45).

341. Because there are so many ways to make money in Holiday Magic, Inc. one cannot properly compare the Holiday Magic business at the Master or General Distributor level with any other business in which release fees and replacements are not present. Respondents' own expert on motivational selling testified that 'there are motivational factors which cause a distributor to go into Holiday Magic which are different from a Salesman going into any other business' (DavisTr. 6306).

342. Because of the nature of the marketing plan, the intent of a distributor in coming into Holiday Magic could be to do so without the desire to resell products, but to just recruit Masters (PangerlTr. 96509651):

Q. You indicated also on redirect examination, Mr. Pangerl, that you knew of no distributor who didn't intend to resale [sic] products he purchased from Holiday Magic. Do you recall saying that?

A. If you bought product from the company, you bought it to sell to someone.

Q. If a distributor in a Holiday Magic Program was interested only in recruiting Master Distributors and not reselling the product and if a requirement was that before he could recruit Master Distributors he had to buy inventories, would this not be a situation where the intent of the distributor would be to come into Holiday Magic not to sell product but instead to recruit Masters?

A. No, the company frowned on headhunting. That would be called headhunting.

Q. It would be called headhunting, but that would not change the intent of the distributor coming into the program, would it?

A. I guess not.

343. Holiday Magic, Inc. did not frown on 'headhunting' but fostered it 100 percent. (All of Holiday Magic's earnings representations in the Record substantiates this.) See CX 82Z47 Holiday Magic Distributor's Manual:

There will be those who join our ranks from greed alone, seeing an opportunity to 'get rich quick.' It is alright that they join with the intent of getting rich quick, for indeed they can * * *

344. One cannot be successful in the Holiday Magic program unless one is competent to sponsor other distributors into the program at the Organizer, Master and General Level.

(a) CX 1800Q (Masters' and Generals' Manual):

The position of Master Distributor has been designed as a leadership position with many responsibilities and rewards commensurate with those responsibilities. A Master Distributor who conducts himself ambitiously in following the Holiday Magic formula for success will have a business which he can enjoy for the balance of his life with an income of \$15,000 to \$24,000 per year. To achieve this income level is not difficult, but there are several things that must be done:

1. RECRUITING: You must maintain a constant Personnel Recruiting Program and encourage your distributors to do likewise.

a. Have no less than one recruiting meeting per week. Evening recruiting meeting should begin at 8:00 p.m. sharp.

(Note: Opportunity Meetings are not designed for Recruiting Holiday Girls See CX 79Z29.)

(b) CX 1800P:

Our job this evening has not been to sell you, but to thoroughly explain our program so that you might see how this opportunity can be used by you. It is obvious that the person who invited you here must have respect for your ability. Further, if you understand the opportunity, it is obvious to you that unless you make progress, he can make none.

345. The sponsorship or recruitment act, of itself, is an income generating event in the Holiday Magic marketing plan and Holiday Magic, Inc. points out to its distributor that money is to be made in the act of recruiting (and not in selling of the product).

(a) CX 1840Z48:

Having personally escorted your prospects to an opportunity meeting it behooves you to remember that it is not only your prospect's opportunity, but your opportunity also.

This is the point of your being there. You are there to present an opportunity to your prospects which will directly affect your financial well being. Because of this you are enthused!

(b) CX 1842U, CX 1840Z74:

[P]ut yourself in the position of a General Distributor working at 65%. Each time you create a new Master Distributor you receive 10% of the total retail volume that must change hands. 10% of \$5000 has just earned you \$500 cash!

This newly created Master Distributor that you have just enrolled will want to become a General Distributor like you so that he may earn the kind of money that you are earning here.

(c) See also CX 1842V, CX 1840Z77.

(d) CX 1842V, CX 1840Z75:

But the moment that the replacement Master is received at the factor the \$2500 cash, being held in escrow, is released to you, the sponsoring General Distributor, for a total of \$3300 cash each time you sponsor in a new General Distributor as a General Distributor.

(e) CX 1395A letter from Holiday Magic to Distributor Davis(9/16/68):

Just a reminder that at midnight, September 30, 1969, as a General you will earn one hundred and sixty-six dollars more for every Master Distributor you bring into the business and three hundred and sixtysix dollars more by the time he becomes a General Distributor!

In the meantime, your prospects will save \$750 by joining the business before the deadline.

See you at the top and at the bank!

346. Holiday Magic, Inc. rewards its General Distributors to the extent of \$300 or \$500 as a result of someone else's activity in merely sponsoring a new Master distributor. The money has been received, yet there has been no training, no supervision and no control:

When this replacement Master is brought into the business, an additional \$5000 in retail product is purchased from Holiday Magic and you [the General], with your 10% override, would be paid another \$500 * * * in cash. But since the rules require you to pay out \$200 in cash as a finder's fee to whomever brought in this Master, you net only \$300 * * * on replacement Masters (CX 90R).

347. Holiday Magic, Inc. rewards General Distributors with release fees of at least \$2500 the moment a replacement Master is recruited by a Master in the General's Organization.

However, the moment that the replacement Master is effectively recorded by the company, the \$2500 cash, being held in escrow, is released to you * * * Thus, you have earned a total of \$3300 each time you sponsor a new General Distributor. (CX 90S).

348. Holiday Magic, Inc. rewards its distributors who recruit Masters by paying a 10 percent override on the retail list price purchase volume of the new Master's order.

(a) See CX 2054AL and CX 2053AM, overrides of Dale Schmidt, who testified that he made the \$25,000 round table five times and that the round table indicates a volume of \$25,000 in one month (Tr. 5229). Schmidt recruited 46 Masters and received between \$500-\$777.77 apiece therefor for a total of \$29,914.04.

(b) CX 1842U, CX 1840Z74, CX 90R.

349. Holiday Magic, Inc. also rewards its distributors for recruiting Masters by so-called 'RoundTable' clubs, and gives prizes to members of the round table:

(a) Witness Barry Toepfer testified that he was a member of the \$25,000 'Round Table' in July 1970, because his 'sales volume' totaled \$25,000 that month. Mr. Toepfer recruited five Masters that month, each of whom purchased \$5000 at retail value for a total volume of \$25,000. Mr. Toepfer stated the \$25,000 was achieved through recruiting (Tr. 4980-4989).

(b) Witness Dale Schmidt was an Instructor General (Tr. 5198) and a member of the round table five times (Tr. 5229). He testified he made the Round Table as a result of recruitment of Masters (Tr. 5231, 5223). See CX 2053AM and CX 2054AL).

350. Another way Holiday Magic, Inc. rewards its distributors who recruit Masters, is in 'Mugs' or trophies.

(a) CX 140D Family News 8/2/68.

MUG YOUR MASTERS

We're getting more and more orders for the mugs which have been used so successfully by successful leaders. These mugs are a humble symbol of achievement in recruiting. Smart people are building a large set.

(b) Reggler Tr. 665, 687.

(c) CX 1634.

351. Holiday Magic, Inc. would also reward its distributors for recruiting Master Distributors by holding so-called 'retail volume' contests, which are nothing more than Master recruiting contests.

(a) Former Instructor General Napoletano testified that contests were based upon retail volume, but a credit of \$5000 volume for each Master recruited was attained (Tr. 3618).

(b) Former Instructor General Sowinski testified that contests depend upon the volume of products that flowed from Holiday Magic, Inc. and gave as an example that if a person brought in 10 Master distributors, this would result in a volume to him of \$50,000 or \$5,000 per Master (Tr. 20442045).

(c) Former Holiday Magic president Ben F. Gay III testified that the retail volume contests were thinly disguised Master recruiting contests (Tr. 9833 9840).

(d) CX 537A(7/15/66) Bulletin from Holiday Magic, Inc. to all Master and General Distributors, announcing the 'GET JIM HEARN' CONTEST.

If you think he's [Jim Hearn] resting on his laurels and counting his money, you're wrong! He's opened up a new office in Miami, stormed the Southland, signing up distributors and his business is better than ever.

See also weekly bulletin announcing the standings of the 'GET JIM HEARN' Contest at CX 538AB, CX 539A, B, CX 540, CX 541A, B, CX 542AB, CX 543AB, CX 544AB, CX 545 AB, CX 546, CX 547, CX 548.

(e) Top producer Pangerl at Tr. 1037677:

Q. Mr. Pangerl, what did you state with respect to Mr. Patrick telling you to concentrate on retailing or not just now?

A. He didn't make any statement.

Q. He didn't tell you not to engage in retail activities?

A. He didn't tell me not to engage in wholesale activities either.

Q. He did reward you for engaging in wholesale activities, didn't he?

A. He rewarded me for my total overall effort in my business.

Q. You had four cars, the use of four automobiles?

A. That is right.

Q. That was because of your wholesale or retail volume?

A. It was the total volume of sales that I had.

Q. And you made the President's \$75,000 Club?

A. That is right.

Q. And that was based on wholesale volume whether to you or to masters in your organization?

A. That was based on total volume of everything.

Q. How much of that was master purchases, and how much of that was sales to you as a general?

A. I state earlier, 90%. [FN3]

Q. All right. 90%. What did you get for the \$75,000 Club?

A. I got a year's lease on Cadillac. I got a ring and pin.

Q. What did you get for the \$50,000 Club?

A. I got a trip to any city anywhere in the world.

Q. Where did you go?

A. Which world?

Q. Where did you go?

A. I never took the trips. I was too busy.

Q. Too busy recruiting?

A. Too busy doing everything there was in my business.

JUDGE BUTTLE: Mr. Gay was considered one of the top recruiters also, wasn't he?

THE WITNESS: Yes, sir.

JUDGE BUTTLE: All right. [FN4]

352. Holiday Magic, Inc. innundates its distributors with news stories of contests and clubs in which they can win prizes such as trips around the world and RollsRoyce automobiles by having the highest 'volume' of all other distributors (Cf. CX 158D, CX 7A, CX 14C, CX 4, CX 155A, 155D, 156C, 30A, 41A, 165A, 166A, 41DI, 45C, 160A, 164A, 163A, 39G, 48A, 49A, 51A, 51C, 47CE, 53A, 54A, 54J, 55D, 57A, 57D, 166E, 60A, 61A, 61C, 63A, 63J, 64B, 64E, 64H, 129D, 129G, 135C, 144A, 147A, 165M, 147M, 148A, 151H, 151'o,' 153C, 172A, 13B, 165H, 46A, 167C, 56A, 57D, 59A, 59H, 60F, 61D, 62A, 63C, 64G, 68C, 133B, 136G, 156A, 172B, CX 47A, CX 63C, CX 65C, CX 165H, CX 167A, CX 36E, CX 53A).

XXXVI. The Geometry of the Marketing Plan

353. The Holiday Magic marketing program is designed and intended to increase the number of distributors geometrically, that is, it is designed to produce an even broadening base of new distributors at the same functional levels:

(a) CX 1800Z8:

It is important that you make your Opportunity and Training meetings open to everyone and members of their organizations. Since your organization will grow beyond your local area and spread across the country, it is important that full cooperation be extended to everyone in the Holiday Magic organizations.

(b) CX 278:

Between your associates and their associates you can easily reach 2500 people. If you are diligent you can easily affect one half of the people or 1250 over a period of one year. If you are not so diligent you can at least affect 400 to 500 individuals. Do you realize what this could mean for you?

(c) At CX 76L, Holiday Magic explains that everyone has the 'same opportunity.'

(d) Witness S. Price Holton, former Secretary to the Miami council, testified that the opportunity meeting script was a recruitment in geometrical progression (Tr. 2287).

(e) CX 1842V, CX 1840Z75:

Herein lies the strength of the Holiday Magic marketing plan. Why Holiday Magic has grown so readily, because he must always replace himself with a working indian [sic] before he can become a chief. Your number of Masters will never decrease you will only grow in the number of Generals you have.

(f) CX 1842V, CX 1840Z75.

354. The operation of the Holiday grown so rapidly, because he must always to recruiting persons who become Masters and/or Generals contemplates geometrical increases in the number of distributors at each level.

(a) Holiday Magic's Instructor General Manual describes 'Holiday Magic's Formula for Financial Success' based on a quota system of recruitment of organizers, Masters and Generals, to wit:

There is a scientific way to assure your financial success in 'Holiday Magic'. It is the proper use of the 'Quota System.'

A. Set the goals or quotas as follows:

(a) Each organizer in your organization is responsible for enrolling one other organizer into Holiday Magic each week.

(b) Each Master Distributor is responsible for enrolling two new organizers per week into the program, through his organization.

(c) And every General Distributor is responsible for enrolling four new organizers each week into the program through his entire distributorship.

Note that at the General level there is a total of sixteen new organizers each month being brought into his organization. Four or more of these new organizers will become Master Distributors. (If they are being trained properly). The new Master Distributors will become General Distributors by the following month if they are filling their own quotas. Which means that any General Distributor who will establish the 'Quota System' in his own organization will be sponsoring one new General Distributor into Holiday Magic each week by the end of the second month which will earn him three thousand three hundred dollars per week which is well over one hundred thousand dollars per year!

This is Holiday Magic's Formula for Financial Success (CX 1840Z4748).

(b) In diagram form the quota systems for organizers is as follows:

(1) 'Each Organizer in your organization is responsible for enrolling one other organizer into Holiday Magic each week.' Therefore, if all organizers follows the Quota System:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

(c) Any General Distributor who will establish the 'Quota System' in his own organization will be sponsoring one new General Distributor into Holiday Magic each week by the end of the second month * * * Therefore, if all Generals follow the Quota System, the multiples will increase at an even greater rate literally a multiple on top of a multiple, after the fifth month.

(d) The wholesale enrollment describes a recruiting aspect of the Holiday Magic marketing plan whereby a General distributor can make \$39,600 at the end of twelve months by recruiting and sponsoring one General distributor a month (CX 1840Z74Z77).

The diagram looks as follows, assuming that all generals do the same thing:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

(e) According to respondents' former National field director, Senior General and Instructor General Christie, it is possible under the HM program for a General to recruit one Master and for that Master in turn to keep replacing himself to the point where the General has 12 General distributors under him after a year (Christie5999). This has already been shown to have occurred for a lesser period of six steps for respondents' witness Carlson at 64836484, to wit:

Q. All right, do you know if any of the general distributors that we are talking about now were replacement masters of replacement masters?

A. Well, the ones I told you about this morning, I have one rather long line of replacements.

Q. Would you tell the Court what you mean by that one long line, please?

A. Yes, I sponsored a Japanese man, George Nakashigi, and he sponsored a woman, Taina Haapamaki, and he sponsored Taina Haapamaki, and Taina sponsored a woman named Salma Linne, and Linne sponsored a man named Caslanos, and he sponsored a man named Hernandez, and I don't remember his last name.

Q. Is that the end of that line?

A. That's the end of that line.

Q. Were all of these persons masters in your organization?

A. They were at one time.

Q. All of these persons now are generals?

A. All but one, all but the last replacement.

If all General distributors were able to conduct their business in this manner, the diagram pictured above would be accurate in this instance.

355. It is reasonable to assume that a Master wants to become a General for the same reason that the original Sponsoring General became a General (BaumgartenTr. 6618).

356. The Holiday Magic marketing plan also describes a situation whereby if an organizer brings in five other organizers each month, then at the end of three months there will have been 190 [FN5] distributors recruited into the program (see CX 79228238). But since Organizers can become working Masters solely by recruiting other Organizers (ChristieTr. 6001) or by recruiting other Organizers who in turn recruit other Organizers (ChristieTr. 6001) the recruited distributors will not remain at the Organizer level, but will become Masters instead and stay at that same functional level (see CX 79231, CX 1840272, CX 1842T, Part VII B 7).

357. Respondents called Professor Baumgarten to testify, and he conceded that under the Holiday Magic marketing plan there is the possibility of a General only being interested in recruiting Masters who in turn are only interested in becoming Generals and bringing in Masters (BaumgartenTr. 6638).

358. Professor Baumgarten also concedes the possibility of a geometric progression occurring, in theory, in the Holiday Magic marketing plan (BaumgartenTr. 6584).

359. Professor Baumgarten also concedes that the Holiday Magic program can be characterized as primarily horizontal proliferation, up to her about 8 p.m. and asked if she would be interested number of distributors at horizontal levels (BaumgartenTr. 6611).

360. An example of the geometrical effect of the Holiday Magic marketing plan appears in the Holiday Magic Wand at CX 30CFebruary 1968:

When you throw a pebble into a pond, the resulting action is far more widespread than the first tiny plink of a pebble into the water. Two Holiday Magic pebbles who might well be classified in the boulder category are Vincent Talluto and Tony Rubio, partners in KonTiki Distributors of Santa Clara, California.

The two Generals estimate the people they have sponsored and those sponsored by their organization must run far into the hundreds. They have distributors in Colorado, Pennsylvania, New York, New Jersey, Santa Barbara, Fresno, Monterey and Santa Clara, California.

The livewire partners sponsored New York's Jim McKelvey, a wellknown Holiday Magic InstructorSenior General, and Mike Brini of New York, another General Distributor. Brini in turn sponsored Al Pangerl of Hartsdale, N.Y., one of the nation's top Distributors.

361. Mr. Pangerl, Holiday Magic's 'top producer' for 1967, 1968 and 1970 (Tr. 9558) had recruited 200 Masters and 50 Generals in his Organization (Tr. 9562, 9570) with approximately only \$15,000 in products at list price value sold to his Organizers and Holiday Girls (at wholesale) for the year 1970. In 1970, Pangerl recruited 50 Masters. His release fee earnings alone since he has been in the business would range from approximately \$125,000 to \$150,000.

362. At a 65 percent discount, and selling to Organizers and Holiday Girls at 30 percent off, Pangerl's gross income on wholesaling cosmetics, as the year's top producer, would be only approximately \$5,000.

363. The diagram of Opportunity Meeting at CX 79Z37, as drawn by Holiday Magic, Inc. is as follows, after only three months:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

364. Another example of the geometry of the marketing plan can be gleaned from CX 200AZ177, which is a list of Master and General Distributors in the State of Illinois, and the identification of their sponsoring Generals (see also Tr. 9119, 9101).

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

365. A Holiday Magis distributor is not limited to recruiting other Distributors to a specific geographic area. (CX 78W; CX 86D; CX 1842Z6; CX 1800Z8).

366. There is no limit to the number of Master Distributors that a General Distributor may recruit into Holiday Magic, Inc.

CX 200AZ177, where General Distributor Joseph T. LaRose, #1681, has 36 Masters and 37 Generals; General Distributor John Carr, #1035, has 79 Masters and 61 General Distributors; David Dow, #1607, has 5 Masters and 8 Generals; Kreitling, #4214, has 15 Masters and 21 Generals; Bush, #864, 8 Masters and 7 Generals; Berlco, #21124, 17 Masters and 17 Generals; Earl Miller, #5106, has 12 Masters and 29 Generals; Distributor #3260 has 5 Masters and 17 Generals; Distributor Dempsey recruited 50 Masters and 50 Generals (Tr. 6071); Distributor Pangerl has 200 Masters and 50 Generals (Tr. 9562, 9570). (Note: All Generals had previously been in the organization of the same General as a Master.)

367. There is no limit to the number of General Distributors that a General Distributor may recruit or sponsor into Holiday Magic.

CX 200AZ177, where General Distributor La Rose, #1681, has 37 Generals under his sponsorship; Carr, #1035, has 61 Generals; Kreitling, #4214, has 21 Generals; Berlco, #21124, has 17 Generals; Miller, #5106, has 29 Generals, Distributor #3626 has 17 Generals; Distributor Pangerl had 50 General (Tr. 9570); Distributor Dempsey had 50 General Distributors (Tr. 6071).

368. There is no limitation as to the number of Master distributors that may be recruited in any geographic or market area.

(a) Chicago Metropolitan area, where approximately 1600 Masters and Generals were recruited in Cook County and DuPage County, of which approximately 600 became Generals (CX 200AZ177).

(b) (Tr. 10339): Pangerl, who in testifying of an alleged limitation of one General per 10,000 population in Red Lion, Pa. and an alleged limitation of 57 Masters per General, stated that these Master distributors may be located anywhere in the country. (Therefore, even with the so-called limitations-where complaint counsel have shown to be nonexistent, the Masters could literally wind up in one town. It is meaningless!)

369. Holiday Magic, Inc. has never announced a limitation on the number of distributors that may be recruited in any geographic area, except to use the concept of 'limitation' as an impending event to apply greater psychological pressures for enrollment and upgrading distributors to the General position.

(a) See Part XXXII 4.

(b) Holiday Magic's witness Gerry Arrowood, the vice president of training and education (Tr. 6155) in 1969 (Tr. 6170) and supervisor of all the Trainer Generals (Tr. 6167) through 1971 (Tr. 6171) testified that she didn't know what the 'limitations' were, but was sure 'the company had it worked out.' (Tr. 6175).

370. There is no limit to the number of Distributors that can be recruited into the program overall, or in any geographic area.

(a) CX 78Z52 and CX 79Z49:

There is no limit as to the number of direct distributors that you are allowed to recruit.

(b) CX 78J and CX 79J:

RECRUITING You must maintain a constant Personnel Recruiting Program and encourage your distributor to do likewise. You should have no less than one recruiting meeting per week.

(c) CX 79Z33 (Opportunity Meeting script):

You know, there was only one other thing that I could possibly see that was wrong with this marketing concept, and that was the element of chance. The element of chance is right here (point) with this fifth man. He may do as he has always done and sponsor no one.

If this happens to you, that cuts down the size of your initial organization 20%. You don't want that to happen. Now obviously, the way to take the element of chance out is not to stop with five people. Sponsor as many as you can.

The same as _____ has done,

the same as _____ has done,

the same as _____ did.

[Spaces in original] [Emphasis added]

(d) CX 76Z7:

There are thousands of ways to recruit and hundred of thousands of people to be recruited.

* * * Everyone is a potential recruit * * *

(e) CX 78M:

A General can recruit persons as Master Distributors and should make every effort to do so.

(f) Holiday Magic vice president of sales Habuary testified that the Holiday Magic marketing program would never reach 'saturation' because 'Christianity * * * is the same kind of program and they haven't saturated their field yet over 2,000 years.' (Tr. 6091)

(g) CX 1800H:

NOTE: IN ALL CASES we have but one single objective that is to use every situation to increase the size of our Distributor Organization. Build a Distributor Organization under a Health Food Store, Beauty Salon, Barber Shop, and the force of the marketing plan will do the balance of your job for you without the normal pampering required with retailers or the fear of competitors cutting you out. You may always lose the retail outlet but you will keep the Organization.

(h) Testimony of Instructor General Napoletano, who was an IG from July 1969 to Jan. ,1970 that there had been no limitation on recruiting Master Distributors or General Distributors (Tr. 3614).

(i) The executive secretary to William Penn Patrick, Jane Alexander, who was with Holiday Magic through Jan. 1970 (Tr. 5494), testified that she never heard of any restrictions as to the numbers of distributors, either in geographic areas or in the organization of a particular distributor (Tr. 5522).

(j) Former Holiday Magic president Ben F. Gay testified that until he left Holiday Magic in Mar. 1971 (Tr. 9823), there were no limitations on recruiting in Fort Pierce, or anywhere (Tr. 9936).

(k) Judge Dudley, former Senior General of the Miami council, spoke to Fred Pape in Sept. or Oct. 1966 (Tr. 3369) when Dudley was Senior General (Tr. 3369) and Pape was a Holiday Magic official with the corporate team (Tr. 3368, 3370) and Dudley told Pape about the problems in Dade County and Broward County (in the presence of Judge Houston Senior General of Broward County) and that there was an overpopulation of distributorships in Dade and Broward. Pape said Holiday Magic had no intention of limiting the number of distributorships whatsoever (Tr. 3371).

As Judge Dudley viewed the marketing plan, he felt it was a 'fast buck deal similar to pyramid clubs in New England' that he had seen earlier in his youth (Tr. 3338, 3387, 3391) and that it was only a matter of time before everyone in the State of Florida would be selling Holiday Magic (Tr. 3372). The number of distributorships had been a matter of discussion for some time in the Miami council (Tr. 3373) and as Senior General Judge Dudley wrote to Pape, but all letters were ignored (Tr. 3375). On another conversation with Pape later on, in the presence of council members, Pape said, 'When you have a bad crop, you burn the field.' (Tr. 3377).

Pape did not at the time admonish the council that by headhunting they had brought about their own difficulties (Tr. 3405). Pape offered nothing constructive to alleviate the problems (Tr. 3406). Judge Dudley's interpretation of Pape's remark was that all distributors who had proliferated through the territory were to be abandoned by Holiday Magic (Tr. 3406).

Other Witnesses from Miami:

(1) Witness Braddock ceased activity after the first year in business because the council fell apart and she understood the whole area to be 'saturated' with distributors (Tr. 3152).

(2) Witness Yanaros testified that she became inactive in Miami (Tr. 8166) because there were too many in Holiday Magic trying to sell the product (Tr. 3020, See also Tr. 2822, 2891, 2901).

371. Holiday Magic, Inc. refers to its marketing plan as a 'people business,' and the plan is a people business.

(a) Corporate team member Mark Evans informed his audiences, with the approval of Fred Pape (CX 85; Tr. 93941) as follows:

Only way to Sponsor.

Bring your prospects to opportunity meetings. Realize that this is a 'people business'. (CX 85B).

(b) Witness Pence saw HM Instructor General Jerry Booth, at Business Training in February 1968, tell men not to worry since they would not be retailing the product. 'He said men are concerned with the wholesale side of business, and Wholesale is people, and people equals money.' (Tr. 371920). The Business Training class conducted by Booth 'led us to believe this was a people business for men.'

XXXVII. FT. PIERCE, FLORIDARECRUITMENT

372. Ft. Pierce, Fla., is an excellent example of the recruitment syndrome which is omnipresent in the Holiday Magic marketing plan because people in Ft. Pierce were essentially interested in recruiting other people, and not in selling cosmetics. See testimony of respondents' official Dempsey at 60466047, to wit:

Q. Would you describe what happened when you arrived in Ft. Pierce in connection with the distributors in Ft. Pierce in 1967?

A. We held a meeting with the

Q. (Interposing) Who is we?

A. Mr. Pape and Miss McBath and myself, with the distributors in the council, the local council, and urged them to start getting serious about the retail, about their retail organization, because we felt it was an unhealthy situation there

* * * * *

due to the fact that they were recruiting people but were not building a solid retail organization.

Q. All right.

A. And in the middle of our discussion a fellow from the audience, Glen Harned, stood up and interrupted the meeting and said, 'We don't want to get any Holiday Girls, and we don't want you people coming out here from California telling us how to run our business. We want to do it the way we are doing it, we just want to be left alone.'

And then the other distributors clapped, applauded, and it was a bad scene.

Q. What did Pape say if anything?

A. Well, it got into a real heated open discussion, and it was not a success. I mean, the meeting was never concluded with them agreeing to do what we wanted them to do.

Q. What did he want them to do, Mr. Dempsey, what did he tell them he wanted them to do?

* * * * *

THE WITNESS: We wanted them to build a serious retail organization because

* * * * *

Q. (Interposing) Wait, wait, did Pape tell them this?

A. Yes.

Q. O.K. Go ahead, tell us what he said.

A. He told them if he didn't start building a healthy retail organization that the whole program there in that area was going to go down the tubes, because all they were doing was head hunting.

373. Other witnesses testified substantially as Mr. Dempsey did on this occasion:

(a) Gelaine Hutchinson. Pape said the problem in Ft. Pierce could be overcome by retailing the product. Pape was told there were so many people selling the Holiday Magic product that the distributors would have to sell to each other. Pape said 'you have a problem here.' (Tr. 21842187). Hutchinson ceased doing business in Ft. Pierce; there was no one to sell products to. They had all been approached by other Holiday Magic distributors (Tr. 2215).

(b) Jane Alexander. Pape said Jim Hearn put Ft. Pierce on the map, and that everybody in Ft. Pierce has Holiday Magic in their garages but no product is moving. Pape went to Ft. Pierce because there were so many complaints about Holiday Magic he had to find out what was going on (Tr. 5521, 5703).

(c) Jim Sowinski. Pape asked Sowinski to become an Instructor General. Sowinski told Pape that there were a lot of people in Ft. Pierce who were not successful and that Pape should screen them better. Pape's reply was that you can't tell how a person will eventually turn out (Tr. 2010).

(d) K. C. Sloane. He wrote to Holiday Magic, saying there were too many distributors in Ft. Pierce and asked for help. Pape, Dempsey and others came, and Pape said 'go out and retail.' He said the problem was 'of our own making and the solution was to retail.' Pape said to Sloane 'Mr. Sloane, you have a problem' (Tr. 2087, 2123).

374. (a) Holiday Magic, Inc. never imposed any restrictions of any kind to recruiting activities in Ft. Pierce even after it was made aware of the fact that nobody wanted to sell the products and that there were too many Masters and Generals in Ft. Pierce (AlexanderTr. 5707, GayTr. 9936).

(b) Other than the limitations on recruiting testified to by respondents' witnesses Coultas and Pangerl, neither Coultas nor Pangerl testified that they were aware of any restrictions placed by Holiday Magic on recruiting in any other market area (see testimony of CoultasTr. 96529772; PangerlTr. 9209 9651, Tr. 1022310377).

XXXVIII. Eugene, OregonRecruitment

375. Eugene, Ore., a city with a population of 76,346 in 1970 (RX 158) and growing, had approximately 89 General Distributors and 45 Masters, with a total of approximately 145 Organizers, Masters and Generals (George Shephard Tr. 1916, 1917, 1919, 1920).

376. People in Holiday Magic were unable to make a living in Eugene there was no opportunity there any more (General Shephard Tr. 1919, 1920). Mr. Shephard was aware of this situation because he was a General Distributor over everyone else in Eugene, and so he knew from his override statements that distributors were not making money (George Shephard Tr. 1920).

377. Many people left Eugene to practice Holiday Magic elsewhere (Tr. 1919, 1191, 192, 1945, 1313, 1232).

378. The problem in Eugene was that no one wanted to produce they all wanted to bring in distributors instead (Tr. 1194, 95, 1089, 91, 1170, 1172, 1174).

379. Witness George Shephard testified that he informed Bill Bailey and Fred Pape about this, but neither did anything (Tr. 1937, 1939, 1940). Mr. Pape was presented with the problem in Eugene again when he was president of Holiday Magic, Inc. (Tr. 1940).

380. Witnesses from Eugene all told similar stories:

(a) Bill Shephard (Tr. 1191, 1192, 1195).

(b) McCrory (Tr. 1089, 1091, 1097).

(c) Creasy (Tr. 1170, 1172, 1174).

(d) Richard Shephard (Tr. 1297, 1299, 1303).

The testimony of witness Jim Creasy vividly describes saturation in Eugene:

HEARING EXAMINER BUTTLE: He has a right to render a business judgment.

By Mr. Cameron:

Q. Mr. Creasy, what do you mean by the word 'saturation'?

A. Well, everybody I talked to, after a fashion, not at first, but after maybe two months, everyone that I talked to that was in my caliber of person, people I knew or people that were friends of people I knew, had all heard about Holiday Magic. They had an ad on T.V., and everyone in Eugene they were really hitting the ads, and everyone I talked to really knew about Holiday Magic, and that's what I mean about saturation, and it was tough to talk to them about it, because they were sick of Holiday Magic.

HEARING EXAMINER BUTTLE: How do you know they were sick of Holiday Magic?

THE WITNESS: Because they told me, Judge, they were upset because everybody was talking to them about it. Everyone I would talk to they would say, 'Hey, you too, you are in the program.' This is why I got out, it was insane to go any further. (Tr. 11591160).

XXXIX. Corporate Teams

381. Holiday Magic, Inc. sends its representatives, agents and corporate officials out into the field to recruit and 'close' prospects brought to opportunity meeting by distributors, which are also conducted by the corporate teams.

(a) CX 14EWand 9/66 : The corporate team met with fantastic success during its twoweek visit in Chicago. Dustributors from 12 states brought in record numbers of recruits. Daily training classes were conducted by Ern Westmore, Mark Evans, Saul Davis, Bill Dempsey, and Anne Marie McBath. Also present were Trainer Generals Mary Ellen Yaggy, Margert Robertson and Avie Hearn.

The net result of the corporate team's Chicago effort, 564 new distributors were signed including more than 60 Masters who are already active producers. Opportunity meetings attracted as many as 200 people an evening. Mark Evans conducted business training classes with over 100 people. Retail training attracted over 50 people per class.

[Mark Evans] also broke his own record by signing 26 people for area distributors singlehandedly in a single evening following an opportunity meeting. We are convinced that this guy is the finest mass closer in the United States.

All he did during the corporate team's twoweek stay in Chicago was to single handedly sign 278 new distributors. Not for himself, but for other distributors who brought in their own recruits.

* * * Corporate team opportunity meetings are the easiest means of bringing recruits into the program. All you do is bring people in and let the experts sign them up. And, in addition, your people will also gain invaluable experience in the cosmetic, and business training meetings held during these sessions.

The corporate team is working to help you. Take advantage of their capabilities. If you are not convinced how successful this group is, just ask your fellow distributors who have already profited from this program.

(b) CX 11E Wand 16/66 : Special Holiday Magic corporate team carrying the message and training to distributors and prospects throughout Florida. During the entire fiveday Hegira, Fred Pape, Saul Davis, Sam Gillespie, Mark Evans and Jim Hearn held nine training meetings and six opportunity meetings from Orlando to Miami Beach.

The whirlwind trip must be counted as a success for the task force in recruiting an estimated 500 Masters, Organizers and Holiday Girls during the [Florida] trip.

(c) CX 14GWand 9/66 : 'The corporate team will be in New York for four weeks conducting electrifying opportunity meetings, Daily Business and Cosmetic Seminars * * *

All distributors are invited to attend * * *

Bring your prospects to the meetings. Urge them to stay over and attend the Business and Cosmetic Instruction Seminars.

The corporate team will be there to help you! Just bring in your recruits and let the experts sell them for you.

(d) CX 2dWandSept. 1965: 'In the next two months, the home office task force will be on the job in various parts of the country to help recruit key people for you.

(e) From Holiday Magic Instruction General manual at CX 1842Z29:

B. Corporate Team Assistance

The members of the Corporate team or Local Council will then wait approximately three minutes as the back of the meeting ROOM TO ALLOW early guests to leave then to circulate on to floor clockwise assisting distributors in presenting their presentations and completing the enrollments. (CX 1842Z29, CX 1842Z30).

C. Back Up Assistance

One or two of the strongest personnel should be left to roam the floor at random assisting where they are needed in completing hard to enroll guests.

All members of the Floor team should carry or wear something outstanding such as a flower on their lapel or a brightly colored sketch pad, to present the presentations with.

(f) Testimony(1) Witness George Shephard testified that Bill Bailey, Regional Supervisor for Holiday Magic, Inc., came to Portland to give Opportunity meetings, and 'then helped us close' (Tr. 1934). Commissions went to the 'sponsor' (Tr. 194243). He had also seen other Holiday Magic people 'close' for distributors (Tr. 1929).

(g) Witness Pense testified that at opportunity meetings at which he had attended, he saw Fred Pape and Ben Gay walking around. Gay testified that it was part of his duties with Holiday Magic to run the corporate team and help 'close sales' which means sell distributorships (Tr. 9896).

382. Instructor Generals and Trainer Generals are members of the Holiday Magic corporate team, and are paid for their effort by Holiday Magic, Inc.

(a) CX 29FWand 1/68 : During the latter part of 1967, the corporate teams, headed by the national field directors, united 35 cities during 40 weeks on the road. They talked to thousands of people, spoke at hundreds of meetings, taught classes, outlined retail producers, and answered thousands of questions.

Teaching cosmetics and business classes, sometimes in a different state every week, the trainer and Instructor Generals often live out of suitcases and see their families for only a few days each month.

(b) Former Instructor General Napoletano testified that he worked with the corporate team in Oklahoma City, and that Holiday Magic would assign a national field director and two Instructor Generals to go to various cities to help recruit, hold opportunity meetings, and conduct business training. Pay was \$300/week plus travel and lodging (Tr. 3919, 3494).

(c) Former Instructor General Sowinski testified that he personally participated in corporate team meetings in Texas and Ohio, at which time his duty was to conduct opportunity meetings, answer questions, and assist in enrolling people into the program (Tr. 20382039). He was paid \$200 a week for his services by Holiday Magic, Inc. (Tr. 2039).

383. Corporate team opportunity meetings are the easiest and most successful means for bringing distributors into the Holiday Magic program (CX 14E).

384. Teams called Sales Acceleration, headed by Fred Pape and Bill Dempsey, with the corporate insignia 'HM' on their jackets, augmented by high pressure tactics, would induce reluctant recruits and lower level distributors seeking to upgrade their status to either initially participate or further participate. Such Holiday Magic teams were reimbursed by the payment to them of half of the recruiting fees, overrides and release fees generated as the result of additional participations (Tr. 56395643, 3643, 3961, 3604, 364546, 383536, 3911, 3597, 3837).

XL. Holiday Girl Routes and Assignments

385. Early in Holiday Magic's history, the company recognized the possibility of saturation in that there would inevitably be more distributors than space available for them to retail Holiday Magic cosmetics directly to the consumer.

CX 1800T (Masters' and Generals' manual) relates the following:

Routes

Establishing routes for your retail distributors is another of your responsibilities. The senior General Distributor in your area has the total responsibility for the coordination of route assignments. He will assign an area to you and assist you in planning the actual routes. 75% of your area must be under

service within 90 days from the date of the assignment. After that time all routes must be maintained. All route assignments will be made by the Master Distributor. Area assignments will be made by the Senior General responsible for the region. A General's order of preference in assigning an area will be based upon seniority and general effectiveness of Master Distributors competing for area assignments.

An area is to consist of 10,000 homes. A route is to consist of 250 to 500 homes. Route assignment should be based upon a person's general ability and overall effectiveness. Assign to routes only those persons who desire to service a route. You should also establish an order of preference based upon seniority since you will have more distributors than you will have routes available. Make sure that each distributor assigned to a route is properly trained and given continued supervision.

386. The situation of more distributors available to sell in a particular area than available space has been evidenced in one town only: Ft. Pierce, Fla.

(a) The population of Ft. Pierce, Fla., in 1970 was 29,721 (RX 153). But between the period Jan. 1, 1966 and May 31, 1966, twentythree (23) Masters and Generals were recruited in Ft. Pierce; all told, 34 Masters and Generals were recruited in Ft. Pierce, Florida, between 12/65 and 7/25/67 (CX 2081Z6). That does not take into account the additional number of Organizers and Holiday Girls in Ft. Pierce during this same period.

(b) The Senior General of the Ft. Pierce council, K.C. Sloane, testified that the divided Ft. Pierce into twenty routes (Tr. 2091) and allocated them to Masters and Generals by 'chance' (Tr. 2088). Mr. Sloane testified that the purpose of the routes was to keep the Holiday Girls from 'scrambling all over each other' (Tr. 2093).

(c) The second Senior General of Ft. Pierce, Gelaine Hutchinson testified that the council tried to form routes following the Holiday Magic guides of 225 homes per route (Tr. 2178). This would have produced approximately 29 routes by population standards of 1970.

(d) Senior General Hutchinson also testified that at one point the Ft. Pierce council divided Ft. Pierce into as many as 41 parts (Tr. 2178).

(e) At a meeting in Ft. Pierce attended by, among others, Fred Pape and Ben Gay, Gay testified that a woman General distributor related to Fred Pape that there were 42 Master and General Distributors in Ft. Pierce, Fla. and there are only 40 routes available in Ft. Pierce to be laid out (Tr. 990607).

After the woman spoke, there was applause from the crowd, and the meeting broke up. Pape then spoke to a smaller group stating that they may have 42 Masters and Generals in town and only 40 routes but most of the Masters and Generals weren't doing anything; therefore, he said it wasn't a valid complaint (Tr. 9908).

Fred Pape later stated to Hearn and Gay that if the distributors sold lipstick to the cows, there were plenty of customers, and that this became a company joke (Tr. 990809). Of the four corporate officials who testified after Mr. Gay, none stated that there was no such company joke going around Holiday Magic, Inc.

387. An allocation of territories for Holiday Girl distributors was undertaken in the Ft. Pierce and Miami areas by the respective councils due to the large number of Holiday Girls that were attempting to sell to one another's customers or prospective customers. Routes were exclusive territories which were assigned to Holiday Girls by first being given to a Master or General Distributor for reassignment.

(a) Witness Rothman, of Miami, testified that in approximately Sept., 1966, the Holiday Magic corporate team, at which Fred Pape was in attendance, found that some Holiday Girls were infringing on other Holiday Girl prospects. Pape said that they would have to route the Holiday Girls to avoid this (Rothman Tr. 290001).

(b) Rothman added that Anne Marie McBath, who was with the corporate team, said the council would have to designate these areas for the Holiday Girls through the Masters and Generals (Tr. 290102).

Rothman added that after explaining the route system to his Holiday Girls he lost 25 of the 28 immediately, and the other three dropped out 3 months later (Tr. 290304).

(c) As explained by former Senior General Fechtal of the Miami council, the council would assign a route to a Holiday Girl, but she would lose the route if business dropped below \$250 per month, and revert to the Master for reassignment before being available to other distributors (Tr. 24072410).

According to Fechtal, in Miami, at no time were more than 10 percent of the available routes taken (Tr. 2404).

Fechtal stated that he followed Holiday Magic rules in employing the route procedure (Tr. 2410).

388. Holiday Magic rules and regulations may be found in the record at CX 95E G.

389. All routing was handled by the local 'Councils' (CX 84C, CX 29G, CX 24G).

390. Holiday Girls assigned to routes are in business for themselves (CX 911).

391. Holiday Girl routes were 'exclusive' territories (CX 76D, CX 84Z1).

XLI. Initial Misrepresentations

392. Pursuant to its Opportunity Meeting procedures which it places into the hands of its distributors for reiteration, Holiday Magic, Inc. has made the following statements and representations to recruits and prospective distributors, in the 'Formula for Happy Living' movie (Physical Exhibit B).

(a) Tr. 9796: Patrick opens by saying: This is a story about a real financial opportunity. * * * what you are about to see can be the key to your financial future and security.

(b) Tr. 979798 Man B says * * * I bought the Holiday Magic idea right away. I started part time, and now I am full time and rapidly achieving the financial security that will help me to fulfill my longcherished dreams.

(c) Tr. 9799 Man C states: now I have several hundred people working for me, and I am really happy with the progress I have made. I never dreamed that such a small initial investment could reap such large returns and that I would be earning several thousand dollars per month, as I am now.

(d) Tr. 9800 Man D: It is such a sound, profitable, and distinguished business, and easy too, I think anyone can do it.

(e) Tr. 9800: The folks you just met are only a few from the many walks of life that make up our Holiday Magic group.

* * * They found the method by which they will achieve their longcherished dream of a new and better life.

(f) Tr. 9800: Let's go back for a moment and discover what it is that brought outstanding success to these people and thousands of other like them in Holiday Magic.

(g) Tr. 9800end: Now let's call our retailer distributor 'Mary,' and let's say that Mary begins today as a retaildistributor. What can Mary expect to earn in the next 30 days? Let's say that Mary has decided that her method of retailing will be through home parties, or what we call beauty seminars, and that she has decided to hold one beauty seminar per week. The maximum time required to hold one seminar is three hours, so Mary will work 12 hours this next month.

Statistics show that she will gain no less than five customers per seminar, or 20 customers for the month. Her average will be \$15 per customer. This \$15 per customer is particularly easy, since the Holiday Magic cosmetic line includes products for the entire family. Mary's sales volume will be \$300. She will receive 35 percent of \$300, or \$105, as her profit. An extra hundred dollars per month will do a great deal to relieve the family budget.

Let's say now that Mary desires to hold two beauty seminars per week. This means that she would work 24 hours per month. Mary's sales for the month would total \$601. She will now receive 40 percent of \$601, or \$240. \$240 profit is a very interesting parttime income.

Mary is earning \$10 per hour. Each month, Mary can service these 40 customers and still earn \$240.

Let's say that Mary's needs or desires are greater and she can hold three beauty seminars per week, or work 36 hours per month. That is a little more than an hour a day. Mary's sales volume would be \$901. Mary would earn 41 percent of \$901, or a profit of \$369.

Let's say that Mary services four customers a day and works 72 hours per month. Her retail sales volume would be \$1,801. Mary would earn 44 percent of \$1,801, or \$792, as her profit for the month. All this for just two hours a day.

This is a very exciting income. In fact, \$792 times 12 months will give Mary an annual income of \$9,504. It all depends on Mary's needs and her desire. Mary can earn up to 55 percent on all other retail sales. You may note that the percentages keep increasing. Holiday Magic believes that those who do more earn more. Holiday Magic has the most exciting opportunity for those who desire it. And, now that you are aware of the first part of our formula of success, let's turn to the final and most exciting part of our story, which is the key to your financial opportunity.

You are about to see the most unique method ever devised to market a product. The success you desire and the goal you wish to reach can be achieved through this unique Holiday Magic concept. Now let's talk about the whole side of this business and what we call our sponsor system. A wholesaler has two primary functions: first, to supply his outlets with product and, secondly, to create new outlets. Let's say that during your first month on a parttime basis, while you are learning, you sponsor or create five outlets which must buy from you. Let's say that two are beauty salons, one is a barbershop, one is an organizer or subwholesaler, and one is Mary, the retailer, the housewife.

Now let's assume that each one of these outlets purchases only \$300 at retail from you during the calendar month. Their total purchase will give you the sales volume of \$1,500. \$1,500 places you at 43 percent on our volume schedule. Since your outlets are \$300, they are at 35 percent on the volume schedule. Your product is the difference, or 8 percent of \$1,500. This gives us a profit of \$120.

Since all of your outlets desire to increase their profits and can do so either by gaining more retail customers or sponsoring other outlets which must buy from them, you can expect the following results to accrue to you during your second month in the business:

Let's say that Mary's five outlets purchased \$1500 of Holiday Magic cosmetics at retail value from Mary. Mary, by maintaining her \$300 personal retail sales, must purchase a total of \$1,800 from you. Let's assume, for the sake of this example, that your other four outlets have done exactly the same as Mary. This means that your five outlets have purchased a total of \$9,000 at retail from you during this, your second month in the business.

Since you have now exceeded \$5,000 in sales in one month, you are now classified as a Master Distributor and your discount goes up to 55 percent. Your outlets are selling \$1,800 at 44 percent, but your profit is 11 percent of 9,000, or 990. You have earned \$990 from your first five outlets which you have sponsored.

Let's assume that during your second month, you have sponsored an additional or second five outlets and they, as your first group of five, have purchased \$300 each for a total of \$1,500. Since you are now a Master Distributor at 55 percent and they are at 35 percent, you can see that your profit from the second five outlets is 20 percent, or \$300. Add the profit of \$990 derived from your first five outlets to the \$300 profit from your second five outlets and you will realize a profit of \$1,290 from your second month.

At this point, you may desire to consider the possibility of working full time in your Holiday Magic cosmetic business. By the end of your third month with Holiday Magic, you will be pleased to discover that your first five outlets have reached the volume of \$9,000 each and, as you have done, they, too, become Master Distributors. At this point, they begin to purchase directly from the company.

Although you are no longer required to service them with product and they no longer need your service or your help, you begin to receive 2 percent of their volume. Two percent of \$9,000 is \$180 times five, which equals \$900. This 2 percent is a perpetual override for you each and every month so long as you both remain a part of the Holiday Magic organization or until you or they become General Distributors.

Your total profit for the third month is calculated as follows: You receive \$900 as an override from your first five outlets without lifting a finger. Your second five outlets, sponsored during your second month, have now reached a volume of \$1,800, thereby giving you a profit on their volume of \$900. Assume that you have sponsored, during your third month, five new outlets and that each outlet purchased \$300 from you. Your profit from these five outlets would be \$300, giving you a total income for your third month from Holiday Magic of \$2,190.

Do you see what could happen for you? This is happening to countless others, as it will happen to you should you desire it.

The next position above Master Distributor is that of General Distributor. General Distributor has a purchasing discount of 65 percent. Let's assume that you have achieved a General's position with Holiday Magic. This will entitle you to receive 10 percent override on each of your Master Distributors.

Imagine only having a small organization such as the one just described in the previous example. What could this mean to you? What you have just seen is within your reach if you desire it. The chances are there are several people viewing this program with you who have achieved all of what you have seen in less than three months. Turn to these people. They are much like yourself. Ask them the magic question 'How do I get started?' and this formula for happy living will be yours. This is your chance. This is your choice. This is your challenge.

(End of script of Physical Exhibit B.)

393. Through its opportunity meeting procedures, Holiday Magic, Inc., directly and through its distributors to whom it provides the scripts, has made the following statements and representation to recruits and prospective distributors, in the opportunity meeting script (CX 79 Z28Z38).

You were invited here tonight to discuss a business a very successful business. A business where people are earning \$100, \$300, \$500 extra per month on a parttime basis.

You will probably have the opportunity to meet several of these people tonight.

We will also be talking about a business where people are earning (point to each of these board figures) \$1000, \$3000, \$5000 and more per month with a fulltime effort.

* * * Why, over last 10 years it's [the cosmetics industry] grown an average of 9.6% per year last year alone it grew 13.6%, so it's on the uphill rise. That's why we're in it! That's why I'm in it. I want to be where the money is. Obviously so does Holiday Magic!

Holiday Magic's first month in business was December, 1964. The sales volume the first full month was \$16,000.

Ten short months later it had grown to One Million Dollars per month 11 months after that Two million per month 2 months later Three Million per month and is Still Growing. There has to be something in that.

* * * You know, I have been with Holiday Magic months now and I have seen some fantastic, amazing things happen in those last months. I have seen people like you and me earn \$5, \$10, \$15, and even \$20,000 per month. That is a tremendous amount of money.

Now I mention this not particularly to impress you with the calibre of people we have in Holiday Magic, but because I want your undivided attention over the next 25 minutes while I explain to you exactly the way that these people are making this kind of money.

* * * Now as you will recall in the film, this is you and your first 30 days you sponsored five people into the business.

Now as you will recall these people did \$300 each. Because you have sponsored them, 5 X \$300 gives you a volume of \$1,500. That is the total volume they have purchased from you your first 30 days.

* * * If you will refer to that 3 X 5 card in front of you, look at the first column, and you will find that the volume fits between two numbers. At \$1,501 you are at 43%. Your people at \$300 volume are at 35%. The difference is 8% and 8% of \$1,500 is \$120.

* * * That's what you have earned your first 30 days in the business. Now that's not a great deal of money. It's certainly not the kind of money we were talking about earlier. But it is a beginning.

* * * Let's analyze this for just a moment, and see just exactly what you have done to earn this money. You invited five people to a meeting just like this one tonight. We presented the opportunity to your people for you and after the meeting, we thoroughly answered all of their questions.

* * * We then helped your sponsor them into the business and that's all you have done. For that, you have made \$120.

* * * Assume that took you 30 days, Now let's look at your next 30 days in the business.

* * * Let's assume that this person right in the middle here is Mary. We had Mary in training all this past month. Because she was in training, we had a further opportunity to thoroughly explain our business to her. We showed her all the wonderful things about Holiday Magic.

* * * We showed her how she produced \$300 in volume, worked at 35% and earned \$105. We showed her that she was doing the work but you made more money than she did.

* * * For that reason, we had Mary do the same thing that you did last month, sponsor five new people into the business. Let's see the reason why she did that.

* * * We have determined that Mary's volume is now \$1,800. You have four others just like Mary, for a total of five. $5 \times \$1,800$ is \$9,000. That becomes your total volume for your second month in the business.

* * * If you will pick up that 3 x 5 card again, you will find that the discount stops at \$5,000. After \$5,000, your total buying discount is 55%.

* * * Your people Mary and the four others are at 44%. That's a difference of 11%. 11% of their \$9,000 in volume is \$990.

* * * That's what you have earned from your first five people their second month in the business. Now let's analyze this for a moment. Exactly what have you done to earn that \$990?

* * * Every one of these new people in the business this month has been sponsored by someone that you brought into the business in the prior month. Actually you haven't done a great deal.

* * * We now ask you to do the same thing you did last month, sponsor five new people.

* * * Now, let's look at the next 30 days in the business your third month.

* * * Each one of these people will do the same thing that Mary has done and for the very same reason- they will reproduce themselves five times. And now that that has happened, you have reproduced yourself five times.

* * * At that time you became a Master Distributor. As a Master Distributor you buy directly from Holiday Magic. You receive as their sponsor an override. In this case that override is 2%.

* * * So, in your third month you have earned a total of \$900.00 from your first five people. Again, all the new people in the business this month were sponsored by someone you sponsored in a prior month. As yet you haven't done anything.

* * * Let's look at these five people that you sponsored last month. Each one of them will sponsor five people as Mary has done and for the same reason, and you will earn an additional \$990.00.

* * * Again, these people were sponsored by someone that you sponsored in a prior month. We now ask you to do the same thing you did last month, sponsor five new people.

* * * And now that you have done that, you have earned another \$300.00. (Point to \$300 in right margin.) Added to this \$900.00 this brings your total income to \$2,109.00 your third month in the business and now we are talking about a lot of money.

* * * Now in a moment I am going to show you how we turn this into a fortune in one easy step. But before I do, let me share with you a few things that occurred to me the first time I saw this presentation.

* * * The first theoretical point is assuming that each one of your people is going to do \$300 in volume. Of course he is not going to. We know that.

* * * This first person may do \$300, however, the next person may do \$450, the next person \$250, the next one \$75 and the last one \$600. Keep in mind this, we are talking about an average of \$300.

* * * Now, the next theoretical point is assuming that each and every person is going to sponsor five people. Again, they are not going to. People do not put forth the same effort, consequently they do not get the same results.

* * * However, this first person may sponsor five people, the second may sponsor fifteen, the third person twentyfive, the fourth person seven, and the final person may do as he always has done in life, nothing. Again, we're talking of an average of five people.

* * * Our National Sales Manager, Mark Evans, sponsored 137 people his first 30 days in the business.

* * * What will happen when you have some of these people in your organization? Of course that average of five will go way, way up. I hope that takes the theory out of that for you.

* * * So, each month you bring in five new people and work with them for 90 days until they reach that size. And then it stops. Do you have any idea in the world what will be happening to you?

* * * You will be earning in excess of \$900 each and every month as an increase in salary. In other words, you will be giving yourself a \$10,000 a year raise. Interesting, isn't it.

* * * You know, there was only one other thing that I could possibly see that was wrong with this marketing concept, and that was the element of chance. The element of chance is right here, (point) with this fifth man. He may do as he has always done and sponsor no one.

* * * If this happens to you, that cuts down the size of your initial organization 20%. You don't want that to happen. Now, obviously, the way to take the element of chance out is not to stop with five people. Sponsor as many as you can.

* * * Now a few moments ago I told you that I was going to show you one easy step that will turn this amount of money into a fortune. I am going to show you that right now.

* * * If you will recall in this film, it mentioned a position called a General Distributor. A General Distributor buys his cosmetics as 65% off retail.

* * * Here you sit with five Master Distributors in your first organization. They are producing \$9,000 in volume you are receiving a 2% override. That amounts to \$180.00. You have five of them so that was \$900 a month you were earning from your first five people, if you remained a Master Distributor.

* * * But, let's make you a General Distributor at 65%.

* * * Your people are at 55%, the difference now is 10%, instead of 2%. That's your override. 10% of their \$9,000 is \$900.00. You have five of them and so now you are earning \$4,500 a month and that is a great deal of money.

* * * This is exactly the way that our people are making the kind of money that they are making and the kind of money that I was talking about earlier.

* * * Let me share this with you. I presently am making this kind of money and more and there isn't a person in the room that isn't every bit as good and doesn't have every bit as much ability as I have. If I can do it, what can you do?

* * * * *

* * * Now, a lot of people don't really understand a marketing plan like this. They say it just won't work. So we have another way of showing you our business. One that no one can argue with.

* * * You know the world's largest cosmetic company last year sponsored over 200,000 parttime girls. That's rightover 200,000 girls. Do you think it's safe to assume that if you worked full time, 8 hours a day, five days a week that you would accomplish this one thingsponsor two retail girls into the business?

* * * Do you think that you could do that? Is there anyone in the room that doesn't think that they could sponsor two girls a week working at it full time? No one? Wonderful!

* * * You are now sponsoring two girls a week and at the end of one year of hard work you have sponsored 104 girls. Now let's assume that you took two weeks for vacation, so you have sponsored only 100 girls.

* * * Assume that they do no more than \$300 in volume. 100×300 is \$30,000 in volume that they are purchasing from you each and every month.

* * * Right here people say 'ha.' There he goes with his big figures again. Well, \$30,000 is not a lot of money in the cosmetic industry.

* * * Now, you will automatically be a Master Distributor at 55% because of the volume of your people. They are at 35% the difference is 20% and 20% of \$30,000 is \$6,000 a month in income that you're earning. It's a great deal of money, isn't it? That \$72,000 a year.

* * * Now, remember that one easy step when you became a General Distributor? Let's do that now. Make you a General Distributor at 65%. The difference now is 30%, 30% of that \$30,000 is \$9,000 a month.

* * * That Ladies and Gentlemen, is \$108,000 a year, and that is \$8,000 more than the President of this Nation makes. That is a lot of money, isn't it!

* * * Now, lots of people stop me right here and say, 'Oh, those figures are ridiculous.' They are not. Let's see how we got there.

* * * We used two figures to get theretwo numbers. We used 100 girls and every one in the room agreed that if they worked full time they could sponsor two girls a week and \$108,000 a year is certainly worth your full time efforts. Isn't it? time. I know that's ridiculous. But let's say for a we used was \$300 \$300 in volume. Let's say for a moment that you say that you can't earn \$108,000 a year with Holiday Magic because your girls can't average \$300 in sales part time. I know that' ridiculous. But let's say for a moment that I go along with you and I agree that they can't average \$300 and can only average \$150, part time.

* * * We will cut the figure in half and now you are earning \$4,500 a month. That was a lot more money than I was earning before I came into Holiday Magic.

* * * Let's say that you can't earn \$4,500 a month because you don't think that your girls can do \$150 in volume. Let's say that you think they can only do half that mucha mere \$75.00 a month in sales. You are now earning in excess of \$2,600.

* * * Let's say that you don't think your girls can do \$75.00 a month, that all they can do is a mere \$37.50 a month, a little better than a dollar a day, not in profit, in sales. You are now earning a little better than \$1,300 a month and you don't deserve a penny of it. Your girls aren't selling cosmetics they're using them.

* * * If you totally commit yourself to working with your people and giving them everything in the world that they need to get the job done give them all the training they need, the motivation, the supervision, give them of yourself, work with them you will indeed earn \$9,000 a month. (Point to \$9,000 and underline).

* * * If you only half commit yourself and you only give your people half of what they need, you will earn \$4,500. (Same for \$4,500).

* * * If you 'quarter' commit yourself, \$2,600, etc.

* * * Ladies and Gentlemen, this is Holiday Magic and this is what we have to offer you.

* * * At this time, I would like you to turn to the person who invited you here and ask them to help you select one of the four positions for you in Holiday Magic.

394. Through its opportunity meeting procedure and business training procedure, Holiday Magic, Inc., directly and through its distributors to whom it provides this material, has made the following statements and representation to recruit prospects and distributors sought to be upgraded to a higher level in the 'six enrollments' (CX 1842UY, CX 1840Z, 7481).

#3 WHOLESALE ENROLLMENT

For just a moment, put yourself in the position of a General Distributor working at 65%. Each time you create a new Master Distributor you receive 10% of the total retail volume that must change hands. Ten percent of \$5,000 has just earned you \$500.00 cash!

This newly created Master Distributor that you have just enrolled will want to become a General Distributor like you so that he may earn the kind of money that you are earning here. In order for any Master Distributor to become a General Distributor he must fulfill four qualifications.

First, be a Master Distributor, second have knowledge this he gains through attending Instructor General Classes because final approval rests with the factory and they will not approve any General Distributor who does not understand the marketing plan. Third, submit a second certified check for \$2,500 to the factory which is called a General's release fee and will be held in escrow at the home office until the fourth qualification is completed, with we term recreating yourself. This means he must bring in a replacement Master Distributor to you, his sponsoring General Distributor, before you will release him from Master Distributor to become a General Distributor.

Herein lies the strength of the Holiday Magic marketing plan: why Holiday Magic has grown so rapidly because he must always replace himself with a working Indian before he can become a chief. Your number of Masters will never decrease; you will only grow in the number of Generals you have.

This replacement Master was brought into the sponsoring General Distributor which just caused another \$5,000 in retail product to be purchased from the factory and you, with your 10% override, have just been paid another \$500.00 in cash. But, the rules say that you must pay out \$200.00 in cash as a finder's fee to whomever brought in this Master so you only net \$300.00 on replacement Masters. But the moment that the replacement Master is recorded at the factory the \$2,500 cash, being held in escrow, is released to you, the sponsoring General Distributor, for a total of \$3,300 cash each time you sponsor in a new General Distributor as a General Distributor.

If you did this only once each month, on a parttime basis for the next year, you will have earned \$39,600 cash at the end of 12 months and you would still have twelve Master Distributors below you. If you are only doing this once each month you are most certainly working parttime; one opportunity meeting per month, where you will bring a qualified prospect to the meeting who would want to earn that kind of money parttime. However, if you were to do this once each week for the next year, you will earn yourself in excess of \$150,000 cash.

ENROLLMENT)

I've just shown you how to earn \$150,000 cash full time or \$39,600 on a part time basis, but to truly understand the marketing concept you must attend the business training classes. You told me that you had a notebook and pen that you could use to take notes with in training classes, didn't you? Wonderful! Put your names and mailing address right here on the application and I'll help you fill it out!

THE RETAIL ENROLLMENT

I am quite sure that anyone could find two parttime girls each week that would want to earn extra money with Holiday Magic and be able to buy her cosmetics at wholesale. When you sponsor two girls a week for the next year, taking two weeks off for vacation as most of us do; you will have 100 active girls. Now, these girls hold at least one home demonstration per week and they will average three hundred dollars per month in total product sold. Some may sell \$150, others \$450. They will average \$300 per month. 100 active girls times \$300 a month will give you \$30,000 a month flowing through you the General Distributor. Not one drug store or one beauty salon, but 100 separate outlets. You work at 65% and these girls work on a sliding scale and would be at 35%. Subtract that from your percentage and it will leave you with a 30% override on each of your girls.

30% of that \$30,000 flow of retail cosmetics will be earning you \$9,000 per month which is \$108,000 per year. (voice up) But now you have an upgrade problem. John, you and I realize that keeping 100 active retail girls in the field might be a lot of work, because some of these girls are going to start retailing more than \$300 in product which means your Holiday Girl goes to Organizer, then to Master then to

General which gives you \$3,300, but you've lost one girl. So, let's say that you don't want to devote all your time to keeping these 100 girls working so let's hire a manager and pay that manager \$10,000 a year, if the girls maintain a \$300 a month average, you pay the manager a bonus of \$10,000 for a total of \$20,000 per year and the average person will work hard for \$20,000 per year. This leaves you with a net income of \$88,000 a year and I think you can afford it! Now, duplicate this manager in six or seven cities around the country and you will have an income in excess of \$500,000 a year!

(ENROLLMENT)

I have just shown you how to earn a half million dollars per year, but you must enroll in the training class to gain the knowledge necessary to conduct this business. Just put your name and mailing address right here on the application and I'll book you into your business training class _____ night at ____ P.M.

(b) CX 1842Z5Z6:

THE GENERAL'S RETAIL PRESENTATION:

Start your presentation by receiving a commitment from you prospect that he could find two girls a week that would like to earn more money!

If you found two girls a week for the next year, taking two weeks off for vacation (like most of us do) you would have one hundred (100) active Route girls beneath you. Now, a route girl does nothing more than service one hundred to two hundred separate homes each month and they will normally average nine hundred dollars (900) a month or more in total retail product sold. Now, some of these girls may only sell half of this amount, but other girls will sell double that amount. They will average nine hundred dollars (\$900) a month. Now, if you have one hundred (100) girls averaging nine hundred dollars (\$900) a month that is a total of ninety thousand dollars (\$90,000) a month flowing through you the General Distributor. Your route girls work on a sliding scale and will receive forty percent (40%) on all the product they retail! You are a General Distributor working at sixtyfive percent (65%) which leaves you twentyfive percent (25%) override on each of your one hundred (100) active route girls, earning you twenty two thousand five hundred dollars (\$22,500) a month, which is two hundred seventy thousand dollars (\$270,000) a year. Now, let's go one step further. You and I realize that keeping one hundred (100) active route girls beneath you could be a problem, so let's hire a manager with a guarantee of ten thousand dollars (\$10,000) a year for keeping one hundred (100) route girls trained and in the field and then pay that manager a ten thousand dollar (\$10,000) bonus for maintaining a nine hundred dollar a month average per route girl, which is a total of twenty thousand dollars (\$20,000) a year to your manager and that will leave you two hundred and fifty thousand dollars (\$250,000) and I think you can afford it!

And, if you want to make one million dollars a year, just duplicate your manager in four separate cities with one hundred (100) active route girls beneath them. Your managers are doing all the work and you are making all the money.

395. Holiday Magic, Inc. has made the following statements and representations to recruits and prospective distributors directly in its 'Formula For Happy Living' Booklet (CX 77), which is a recruiting booklet (CX 180OI).

(a) CX 77F: Let's talk about the magic of our marketing plan and how it may be the answer to your financial dream come true.

(b) CX 77D: Holiday Magic Marketing plan very well may be the key to your financial future and security.

(c) CX 77B: Holiday Magic is that once in a lifetime opportunity that comes your way. If you are looking for a secure future and an immediate increase in you income, you will find this booklet the key to the door of your dreams come true. Read and study this booklet with great care, that door will open as surely as you do.

(d) CX 77'O': This magic formula is now fulfilling the financial dream of thousands, as it will for you should you desire it. In Holiday Magic there is a place for you to enjoy this wonderful world of magic. Call the friend who left this booklet for you to read. Call now you are expected!

396. Holiday Magic, Inc. has made the following statements and representations, directly and indirectly, to prospects and to distributors sought to be upgraded to the Master and General level, in its Masters' and Generals' manuals.

(a) CX 78Z6465 and CX 79Z6162:

A wellorganized retail program will accomplish the following for you:

1. Put money in the bank for you, both on a short term and, especially, on a long term basis.
2. Reflect an overall firm business posture.
3. Provide a technique that will enable you to close more recruiting attempts at the Master level than you had been able to accomplish before.
4. Provide a method that will reap very large profits on a continuing basis with very little personal time and effort and NO additional expense.

* * * We suggest that financial rewards be discussed in terms that are commensurate with the local community earning capacity. In a small town, \$150 a month for parttime work is realistic remuneration for earnest effort. If the interviewer tells a woman that she can earn \$300 or \$400 a month, she is apt to be frightened away because earning this amount of money is unrealistic. On the other hand, in San Francisco or any other metropolitan area earning this amount of money does sound realistic.

(b) CX 78J; CX 79J: A Master Distributor who conducts himself ambitiously in following the Holiday Magic Formula for success will have a business which he can enjoy for the balance of his life with an income of \$15,000 to \$24,000 per year. Achieving this income level is not difficult * * *

(c) CX 78F and CX 79F: Once a man knows this business, he will not * * * he cannot * * * fail.

(d) CX 78T and CX 79T: Avoid buyer's chill; tell them they are going to be happier, healthier, wealthier and receive what they want out of life with the Holiday Magic program.

(e) CX 79Z60: Don't for a minute think that many people in the world earn as much as our average General does.

(f) CX 1800'O': The public is receiving our Holiday Magic products with great enthusiasm. Our repeat business is almost unanimous. See for yourself what a superb line of products we carry. Once you have tried them, you will never want to use anything else.

397. Through its Holiday Magic Wands, which are recruiting tools, Holiday Magic, Inc. has stated to recruits, prospective distributors and distributors it seeks to upgrade to the Master and General level, that '* * * the surest way to amass a fortune is through Holiday Magic * * *' (CX 21H Apr. 1967).

(a) See also: CX 49F; CX 51K; CX 57D; CX 60F; CX 132C; CX 159A; CX 163E; CX 34E; CX 35G; CX 35J; CX 42B; CX 54A; CX 56B; CX 146T; CX 158A; CX 35F; CX 43H; CX 42G; CX 43D.

(b) See CX 64AH, the Permanent Wand, which is replete with the big money potential in Holiday Magic.

398. Through its Holiday Magic Instructors and Trainer Generals, Holiday Magic, Inc. has made the following statements and representations to prospective distributors and to Holiday Girls it seeks to upgrade to the Master and General Level:

3. HOLIDAY GIRL'S EARNING POWER

A full time Holiday Girl gives 4 individual demonstrations per day. A part time girl gives two demonstrations per day. The times she usually sets for these demonstrations are 10 a.m., 11:30 a.m., 1 p.m., and 2:30 p.m. The Holiday Girl that works parttime works either the morning hours or the afternoon hours depending upon the hours she has chosen to work.

We know that we can always count on a larger sale when we give an individual demonstration. As a matter of fact, it is usually around \$25.00.

However, just for the sake of taking a figure we are all familiar with, we will use the average of \$15.00 per sale. With 4 demonstrations per day at \$15.00, Suzy has a volume of \$60.00 per day. She works 5 days per week like everyone else and this would give her \$300.00 volume for the week. Multiply that

with 4 weeks out of the month and we now have a sales volume of \$1,200 (And add \$1.00) for the month. Her profit the first month on this schedule and this average is \$504.42.

Following Suzy along during the second month, she will repeat the same performance plus she must service the customers from last month. Consequently, the earnings the second month will be even greater.

The time it takes Suzy to cover her Route is approximately 3 months, after which time she no longer needs to do any demonstrations or book any appointments. All she needs to do is every single month collect her automatic sales, which we will cover later in class and this takes around 34 hours per day. Her income will settle down to more than a fulltime salary on a parttime basis.

Following is another example.

ERASE BLACKBOARD AND WRITE OF [sic] THE FOLLOWING FOR YOUR CLASS.

A Holiday Girl servicing a route is actually in business for herself, and she must consider it as such because the greater her efforts, the greater will be her earnings.

Let's use another example of what a Holiday Girl is capable of earning on a different schedule than the one we just talked about.

She gives three individual demonstrations per day and at each of these, sales total \$15.00, this will equal \$45.00 in retail volume per day.

3 per day x \$15.00 Average = \$45.00 Retail per Day x 20 Working Days \$900.00 Sales Volume.

There are 20 working days in every month. This means that her retail volume through individual demonstrations will be \$900.00 for the month.

She gives at least one Block Seminar a week. The hostess has a total of five buying guests an average of \$15.00 or \$75 per Block Seminar. This will give her an additional \$300.00 retail volume per month, or a total of \$1,201.00 retail.

5 x \$15.00 per Week Seminar x 4 = \$300.00

This places her at 42%. This means that the Holiday Girl working routes has earned \$504.42 her first month in business. Referring back to the first month, she has established 60 customers from individual demonstrations and 20 customers from Block Seminars for a total of 80 customers for her first month.

In her second month she will do exactly the same thing. She does three demonstrations per day for an average of \$15.00 volume per demonstration which gives her \$45.00 volume per day. During 20 working days, this gives her a total route volume of \$900.00.

She gives one Block Seminar per week with five ladies for an average of \$75.00 volume per week which would give her a total of \$300.00 volume from the Seminars. Total volume \$1,201.00. She services 80 customers from last month with a \$10.00 reorder. $80 \text{ customers} \times 10 = \800.00 service volume. This gives gives her a total for her second month of \$2,000.000. She is now at 44% which means that she has earned \$880.00 for her second month in business. Now, do you see what we have to offer a girl working routes?

Now let's see the same girl working a route as a Master Distributor, AND ASK, How many of you are Master Distributors?

You are a Master Distributor working a route of 250 homes doing a service volume of \$10.00 each, you would earn \$1,360. Have any of you thought of having a route of your own? Well, think about it!

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

How many of you are General Distributors? Let's see what you would make. Can you figure it out? Looks nice doesn't it.

The third and final earning power we will cover is also the amount of hours a Holiday Girl spends working a route.

USE BLACKBOARD:

First Month:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Second Month:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Third Month:

3 demonstrations per day and 1 Block Seminar per week is repeated.

By this time you have 160 customers and together with the new business volume you now have \$1,600.00 for the month.

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Fourth Month:

For your fourth month we will change the schedule a little. Since you now have 240 customers you will find that you need more time for servicing. So we book and do 2 demonstrations per day instead of the previous 3. You continue to give 1 Block Seminar per week. Income eases, your route will be built by this time, but there are occasions when a route consists of a few more homes depending upon the area. However, if you are still building the fourth month, your total picture will look like this:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Your profit is \$792.00

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Now you have built for yourself a sound business. You will have to spend approximately 3 and a half hours per day servicing these customers that you acquired during these four months. Your income will settle down to approximately \$600.00 per month. We will all agree that this is a very interesting income, since it is by now a parttime job. (CX 91D; CX 91HM).

See additional Opportunity Meeting scripts at CX 78Z3132; CX 96AN; CX 97AP; cx 98an; cx 99ao; cx 100a-p; cx 1468ap; cx 102ap; cx 103ak; cx 1840z6z38.

See also additional six enrollments scripts at CX 85AZ29; CX 86AF; CX91; CX 1840Z69Z88.

See also additional manual misrepresentations at CX 78Z4952; CX 78U; CX 78V; CX 78Z38; CX 78Z44; CX 78Z48; CX 1800B.

399. Distributor after distributor testified that they heard the representations as contained in the opportunity meeting scripts, business training classes, six enrollments, movies, manuals, wands and corporate team lectures. Cf. Tr. 3389; 3392; 10931096; 1130; 11501153; 3684; 5993; 253839; 3613; 2401; 30493051; 3127; 1098; 2553.

(a) Witness Charles Porst testified that at an opportunity meeting given by Fred Pape, he heard Fred Pape say that one could make \$250,000 or more in Holiday Magic (TR. 30493050).

(b) Mrs. Stanley Pierce testified that at an opportunity meeting, she was told that she could make up to \$100,000 a year by recruiting (TR. 2259).

(c) Joseph Rothman testified that at a corporate team meeting attended by Fred Pape and William Penn Patrick, he heard Jim Hearn say that he had made a quarter or a million dollars in a very short period of time and that witness could make the same amount in less than a year (TR. 28932898).

(d) William Pence testified that his sponsor, in persuading him to come to an opportunity meeting, told him that he was making \$200,000 a year in Holiday Magic (TR. 3667).

XLII. Other Specific Misrepresentations

400. Holiday Magic, Inc., directly and through its distributors, falsely represents to prospective distributors and to lower level distributors it seeks to upgrade to the Master and General level, that:

(a) General distributors can reasonably anticipate a gross income of \$108,000 per year after their first year in the Holiday Magic business, by selling to Holiday Girls at wholesale, and working full time.

(b) General distributors can reasonably anticipate earning \$39,600 a year on a parttime basis by attending only one opportunity meeting a month and recruiting one General distributor a month.

(c) General distributors can reasonably anticipate earning \$150,000 a year on a parttime basis by attending only one opportunity meeting a week and recruiting one General distributor a week.

(d) It is easy for a General distributor to recruit other General distributors into Holiday Magic.

(e) General distributors can reasonably expect to earn \$2,190 gross profit his third month in the business and his first month as a General distributor.

(f) It is reasonably possible for a Holiday Magic distributor to earn \$500,000 a year.

(g) It is reasonably possible for a Holiday Magic distributor to earn \$1,000,000 a year in the Holiday Magic program.

(h) Not many people in the world earn as much as the average General in Holiday Magic.

(i) Master distributors can reasonably anticipate a gross income of \$72,000 per year after their first year in the Holiday Magic business, by selling to Holiday Girls at wholesale, and working full time.

(j) Master and General distributors who recruit Holiday Girls into the Holiday Magic business can reasonably expect that the Holiday Girls will produce and stay in business for at least one year and longer.

(k) It is easy to recruit two (2) Holiday Girls a week for a year, each of whom will produce sales for a year or longer.

(1) A Master distributor can reasonably anticipate earning a gross profit of \$1,290 his second month in the business, and his first month as a Master distributor, on a part time basis.

(m) Holiday Magic distributors can reasonably anticipate that they will earn \$500 per month on a part time basis.

(n) Holiday Magic distributors can reasonably anticipate that they will earn \$20,000 per month working full time in the Holiday Magic business.

(o) The only turnover problem a distributor will face in the Holiday Magic business is that a Holiday Girl will become a Master or a General distributor and earn the distributor \$3,300 in doing so.

(p) Achieving a lifelong income of \$15,000 to \$25,000 for a Master distributor is not difficult.

(q) Organizer distributors can reasonably anticipate recruiting five (5) distributors each month for their first three months in the Holiday Magic business, on a part time basis.

(r) Organizer distributors can reasonably anticipate that the distributors they have recruited as organizers will in turn recruit five distributors apiece, on the average, each month as they come into the Holiday Magic business.

(s) Organizer distributors can reasonably anticipate earning a gross profit of \$990 their second month in the Holiday Magic business, on a part time basis.

(t) Distributors who choose to retail the Holiday Magic products to the ultimate consumer can reasonably expect to gross between \$300 and \$900 per month.

(u) Holiday Girls will average \$15 per customer in retail sales.

(v) Holiday Girls can easily earn \$10 an hour.

(w) By working only one hour a day, a Holiday Girl can reasonably anticipate a gross income of \$901 and a gross profit of \$369 per month.

(x) By working only two hours a day, a Holiday Girl can reasonably anticipate a gross profit of \$792 a month.

(y) A full time Holiday Girl will have a gross volume of \$60 per day, \$300 per week, and \$1,201 for the month.

(z) A full time Holiday Girl will have a gross profit of \$504.42 her first month in the business.

(z1) The gross profit of a Holiday Girl her second month in the Holiday Magic business on a full time basis will be greater than \$504.42.

(z2) Holiday Magic can be the key to a person's financial future and security.

(z3) Anyone who wants to can be a success in the Holiday Magic program.

(z4) Holiday Magic is a sound, profitable and distinguished business.

(z5) There are 'thousands of successful people in Holiday Magic'.

(z6) Holiday Magic, Inc. is a once in a lifetime opportunity.

(z7) Holiday Magic, Inc. is fulfilling to financial dreams of thousands, and that it will work for any person who desires it.

(a8) A man who knows the Holiday Magic business cannot fail.

(z9) The public is receiving the Holiday Magic products with great enthusiasm, and the repeat business is almost unanimous.

(z10) The surest way to amass a fortune is through Holiday Magic, Inc.

(z11) That Holiday Magic, Inc. provides training and meeting facilities to distributors at no cost to them (See CX 79Z28 and TR. 1571, 1526, 1520).

(z12) CX 1800Z13: 'Any person who fails in the Holiday Magic program must fall into one of the following categories:

1. Lazy

2. Stupid

3. Greedy

4. Dead

401. All of the above described representations are false, misleading and deceptive because:

(a) Holiday Girls, when they are working, average approximately \$75.00 per month in volume or \$22.50 gross profit per month.

(1) 'Top producer' with her Holiday Girls averaged \$66 per month in direct retail sales (Tr. 7004).

(2) Holiday Magic's Holiday Girl survey shows that active Holiday Girls who reported on their sales volume, averaged \$138.40 per month (CX 8781095, CX 1560).

(3) Al Pangerl, Holiday Magic's all time top producer, had Holiday Girls average \$75 a month (Tr. 10367).

(b) Holiday Girls, when they are working, average less than \$300 a month retail volume, and Holiday Magic, Inc. is aware of this.

(1) CoultasTR. 9680: \$300 requirement for a Holiday Girl was unrealistic.

(2) CoultasTR. 9760: Is aware that excluding considerations of turnover, the Holiday Girls who do sell on the average sell less than \$300 a month at retail volume.

(3) TR. 5993Former Senior General of N.Y. and Former National Field Director Christie: Doesn't recall a single Holiday Girl who averaged \$300 a month in retail volume for a year's time.

(4) President and Top Producer Al Pangerl's Holiday Girls averaged \$75 per month (TR. 10367).

(5) Former President Ben Gay had only one Holiday Girl in his distributorship termed by Holiday Magic as 'one of the most successful' (CX 64C) earn at least \$300 volume in one month. The next highest was \$100 volume in one month (TR 9868).

(6) See Holiday Magic's own survey, 2(a)(2) above.

(c) The turnover of Holiday Girls is such that the average Holiday Girl works for approximately six weeks (see VIIA5).

(d) On the average, Organizers, Masters and Generals recruit less than one Holiday Girl in the lifetime of their distributorships (see CX 457AC).

(e) At most, and assuming that no Organizers recruit Holiday Girls, the average number of Holiday Girls recruited by Masters and Generals is less than, 5, in the lifetime of their distributorships (see CX 457AC).

(f) Most Master and General distributors do not make the money which Holiday Magic, Inc. represents can be reasonably anticipated by selling cosmetics at wholesale because:

(1) Only 810 percent of Master and General distributors in Holiday Magic earn a minimum of \$12,000 per yearDavisTR. 6286 (expert witness called by Holiday Magic).

(2) 'There is a very, very slim minority [of Masters and General distributors] that earns in excess of \$25,000' in Holiday Magic (DavisTR. 6287).

(3) As of Sept. 1969, Holiday Magic's total cumulative cosmetic sales at retail list price value was \$76,329,757 (RX 16; TR. 9212).

The total number of Masters in Holiday Magic at any time as of Feb. 26, 1969, which is prior to the total cumulative volume is 9,252 (CX 457A).

The average volume of purchases for Master and General distributors in their lifetimes as distributors is less than \$8,250. (Dividing \$76,329,757 by 9,252 Master and General distributors.)

(4) With an average volume of \$8,250, there is no way mathematically that most Master and General distributors can earn between \$72,000 and \$108,000 a year gross income selling cosmetics at wholesale. At the 35 percent level for Holiday Girls, gross income will average out to between \$1,650 for Masters and \$2,475 for Generals!

(5) With Holiday Girls averaging between \$75 and \$139 when they are working for six week periods, there is no way that most Holiday Girls will average \$900 per month or even \$300 per month at retail volume.

(6) Respondents' former East Coast regional vice president and current president of SDI, the Instructor General program, testified that he doesn't know what percentage of distributors made \$108,000 in Holiday Magic, but that it was a 'small percentage' (DempseyTr. 6070).

(7) Holiday Magic president Al Pangerl never heard of a single Master who made \$72,000 a year (PangerlTr. 9613).

(8) Holiday Magic president Al Pangerl doesn't know of a single General Distributor who made \$49,000 attending one opportunity meeting a week (PangerlTr.9615).

(9) Holiday Magic president Al Pangerl, the top money maker in Holiday Magic for three years, including 1970, testified that he sold only \$15,000 at retail value to his Organizers and Holiday Girls in 1970 (Tr. 95599560).

(g) Distributors do not recruit on the average five new distributors a month.

(1) Since Holiday Magic's first month in business was Dec. 1964, if this were the case, Holiday Magic would have had over 390,625 distributors in its program after only seven months, which it did not (CX 457AD).

(h) It is not easy to recruit other distributors into the program at the Master and General level:

(1) The vast majority of people have neither the desire nor the potential to become Holiday Magic distributors (Tr. 6586).

(2) For some, recruiting is easy, for others, tremendously difficult (DavisTr. 6286).

(3) Making profits by release fees (sponsoring General distributors) 'is a highly speculative way of receiving return on money.' (BaumgartenTr. 6616).

(4) It is highly speculative to encourage a Master to go General with the hope that he will be able to encourage others to do the same (Baumgarten Tr. 6617).

(i) Distributors in Holiday Magic do fail, and that the vast majority fail:

(1) With at least between 2025,000 Masters and Generals recruited into Holiday Magic, as of May 1972, (Tr. 9759, 9984) Holiday Magic had approximately 2842 active Masters and Generals (Tr. 9629, 5881). All others are no longer in business, and it can be presumed that most active Distributors are recent entrants into the program.

It can also be presumed that many distributors remain active although not successful in their businesses.

(2) With an average monthly retail volume of \$75 to \$139 per Holiday Girl, and an average of less than five Holiday Girls, and a turnover rate of one Holiday Girl every six weeks, there is NO WAY that Master and General Distributors cannot for the most part fail in their wholesale cosmetics business.

(j) Holiday Magic, Inc. makes and keeps no records or studies of the public's acceptance of Holiday Magic products (Tr. 10386, 1039192, 10396).

(k) Master and General Distributors are required to pay for Council privileges (see Part XXXI).

402. Holiday Magic, Inc. directly and indirectly misrepresents to prospective distributor and recruits at its Opportunity Meeting procedures, that:

(a) There is no turnover of Holiday Girls, except that Holiday Girls who average more than \$300 per month will become Masters and Generals.

(1) CX 78Z34:

You know the world's largest cosmetic company last year sponsored over 200,000 part time girls. That's right over 200,000 girls. Do you think it's safe to assume that if you worked full time, 8 hours a day, five days a week that you would accomplish this one thing sponsor two retail girls into the business?

Do you think that you could do that? Is there anyone in the room that doesn't think that they could sponsor two girls a week working at it full time? No one? Wonderful!

You are now sponsoring two girls a week and at the end of one year of hard work you have sponsored 104 girls. Now let's assume that you took two weeks for vacation, so you have sponsored only 100 girls (40).

Assume that they do no more than \$300 in volume (41). 100×300 is \$30,000 (42) in volume that they are purchasing from you each and every month.

Right here people say 'ha.' There he goes with his big figures again. Well, \$30,000 is not a lot of money in the cosmetic industry. If we are talking about a store purchasing \$30,000 in volume, it would be ridiculous. If we were talking about a beauty salon grossing in total sales \$30,000 a month it would be absurd. If we were talking about a jewelry store, a small grocery store, a fur shop, a clothing store, an appliance store, grossing \$30,000, of course it would be ridiculous. But, that's not what we are talking about. We are talking about the efforts of 100 people and we are talking about their efforts in the cosmetic industry.

We used two figures to get theretwo numbers. We used 100 girls and everyone in the room agreed that if they worked full time they could sponsor two girls a week and \$108,000 a year is certainly worth your full time efforts. Isn't it?

(2) CX 90L = Opportunity meeting Script, Jan. 1970:

First let me tell you something that was a real surprise to me when I first heard it. Did you know that the world's largest cosmetic company last year sponsored over 400,000 girls to work part time? That's right over 400,000 girls. Keeping that in mind, do you think it's safe to assume that if you worked full time 8 hours a day five days a week that you would accomplish this one thing recruit two (A) Holiday Girls into the business on a part time basis?

Do you think that you could do that? Is there anyone in the room who doesn't think that he could sponsor two girls a week if he worked at it full time? No one? Wonderful!

Let's assume that you are now sponsoring and training two girls a week and at the end of one year of hard work you have sponsored 104 girls. No let's assume that you took two weeks for vacation, so you trained only 100 girls. (1)

(3) CX 90ST = (The retail enrollment)

It's not too difficult to find two girls per week who would work part time to earn extra money with Holiday Magic and who would like to be able to buy their cosmetics at wholesale. If you were to sponsor two (2) girls a week for the next year, taking two weeks off for vacation, you would have 100 active girls. * * * Now you have an upgrade problem. John, you and I realize that keeping 100 active retail girls in the field is a lot of work. Some of these girls are going to start selling more than \$300 in product, which means your Holiday Girls may move up to become an Organizer, then to Master, then to General, which may earn you \$3,300, but you've lost one girl, and now you have a replacement problem.

(4) CX 1842 WX =

I am quite sure that anyone could find two part time girls each week that would want to earn extra money with Holiday Magic and be able to buy her cosmetics at wholesale. When you sponsor two girls a week for the next year, taking two weeks off for vacation as most of us do; you will have 100 active girls.

Now, these girls hold at least one home demonstration per week and they will average three hundred dollars per month in total product sold. Some may sell \$150, others \$450. They will average \$300 per month. 100 active girls times \$300 a month will give you \$30,000 a month flowing through you the General Distributor. Not one drug store or one beauty salon, but 100 separate outlets. You work at 65% and these girls work on a sliding scale and would be at 35%. Subtract that from your percentage and it will leave you with a 30% override on each of your girls.

30% of that 430,000 flow of retail cosmetics will be earning you \$9,000 per month which is \$108,000 per year. (voice up) But now you have an upgrade problem. John, you and I realize that keeping 100 active retail girls in the field might be a lot of work, because some of these girls are going to start retailing more than \$300 in product which means your Holiday Girl goes to Organizer, then to Master then to General which gives you \$3,300, but you've lost one girl. So let's say that you don't want to devote all your time to keeping these 100 girls working so let's hire a manager and pay that manager \$10,000 a year, if the girls maintain a \$300 a month average you pay the manager a bonus of \$10,000 for a total of \$20,000 per year and the average person will work hard for \$20,000 per year. This leaves you with a net income of \$88,000 a year and I think you can afford it! Now, duplicate this manager in six or seven cities around the country and you will have an income in excess of \$500,000 a year!

(5) CX 184256

THE GENERAL'S RETAIL PRESENTATION:

Start your presentation by receiving a commitment from your prospect that he could find two girls a week that would like to earn more money!

If you found two girls a week for the next year, taking two weeks off for vacation (like most of us do) you would have one hundred (100) active Route girls beneath you. Now, a route girl does nothing more than service one hundred to two hundred separate homes each month and they will normally average nine hundred dollars (900) a month or more in total retail product sold. Now, some of these girls may only sell half of this amount, but other girls will sell double that amount. They will average nine hundred dollars (\$900) a month. Now, if you have one hundred (100) girls averaging nine hundred dollars (\$900) a month that is a total of ninety thousand dollars (\$90,000) a month flowing through you the General Distributor. Your route girls work on a sliding scale and will receive forty percent (40%) on all the product they retail! You are a General Distributor working at sixty five percent (65%) which leaves you twentyfive percent (25%) override on each of your one hundred (100) active route girls, earning you twenty two thousand five hundred dollars (\$22,500) a month, which is two hundred seventy thousand dollars (\$270,000) a year. Now, let's go one step further. You and I realize that keeping one hundred (100) active route girls beneath you could be a problem so let's hire a manager with a guarantee of ten thousand dollars (\$10,000) a year for keeping one hundred (100) route girls trained and in the field and then pay that manager a ten thousand dollar (\$10,000) bonus for maintaining a nine hundred dollar a month average per route girl which is a total of twenty thousand dollars (\$20,000) a year to your

manager and that will leave you two hundred and fifty thousand dollars (\$250,000) and I think you can afford it!

And, if you want to make one million dollars a year, just duplicate your manager in four separate cities with one hundred (100) active route girls beneath them. Your managers are doing all the work and you are making all the money.

403. That training facilities and meeting rooms at the Holiday Magic councils will be provide and made available by the the corporation to distributors at no cost to them:

(1) CX 78Z3031

Let's analyze this job for a moment, and see just exactly what you have done to earn this money. You invited five people to a meeting just like this one tonight. We presented the opportunity to your people for you and after the meeting, we thoroughly answered all of their questions.

We then helped you sponsor them into the business and that's all you have done. For that, you have made \$120.

Let's assume that this person's report in the middle here is Mary. We had Mary in training all this month, we had a further opportunity to thoroughly explain our business to her. We shared her and the wonderful things about Holiday Magic.

We should hear how she produced \$300 in volume, worked at 35%, and earned \$105.

So in your third month you have earned a total of \$900 from your first four people. Again, all the new people in the business this month were sponsored by someone you sponsored in a prior month. As yet you haven't done anything.

(2) See witnesses who testified they were not informed of dues requirements for council until after they became Master distributors at TR. 1520, 1571, 1526.

(3) Council signs refer to Holiday Magic throughout and gave appearance of Holiday Magic corporate offices.

(i) TR. 1499; TR. 3898.

(ii) Holiday Magic, Inc. tells its councils to drape the opportunity meeting room with Holiday Magic banners and photos of Patrick TR. 3899; CX 90F ('the room should be draped with Holiday Magic banners to give the appearance of Holiday Magic Opportunity Meeting').

(4) At CX 90U 'The Six Enrollments' used Jan. 1970 =

NO. 6 GUEST ENROLLMENT (Use only when necessary as a final step)

If John hasn't enrolled by now back way off, because something is radically wrong. Turn to John and say, 'Now, John, I don't know what I've missed explaining but I've missed something. I've tried to show you how you could earn some really attractive profits in the retail side of the business and even as much as \$39,600 per year part time in the wholesale side of the business and I still haven't gotten it across to you.

Now what I would like to do is invite you to our next business training class as my guest so that you can see the training that we offer, meet some people and really see what Holiday Magic is all about. That will be next (Thursday at 8:00 p.m.) and I'll be by to pick you up so we can be there on time. Bring that notebook and pen that you said you had with you, okay?' (When he comes to class and signs the roll sheet, you may assume that he will come into the program.)

After teaching the above in training class, explain:

Business training is provided by functioning councils, Masters and Generals who belong to these councils pay small monthly fees to support them. When your guest is invited to a council training meeting he will have to sign the guest register and you're going to try to use the training facilities to sponsor your guest into the program.

John has been invited as a guest and when John signs his name on the sign up sheet, he has just theoretically enrolled. Try to persuade John to take home a \$39 demonstration kit. John may not wear cosmetics but his wife does. He may not be the least bit interested in this program right now but he may be.

(c) That there are no substantial business or operating expenses for distributors, and that gross income is 'net income' or 'profit.'

(1) CX 78Z31, compares gross income with salaries.

(2) CX 78Z31, 32, 33, 234, 235, CX 1842V, X, Z, Z5, Z8, refer to gross income as earnings.

(3) CX 7933 refers to gross income as a 'salary.'

(4) CX 1842T, Z2 refers to taking home in cash one's gross income.

(5) CX 1842O, W, refers to gross income as cash earnings.

(6) CX 1842X refers to gross income less a manager's salary only as a 'net income.'

(7) CX 1842Z3 refers to gross income less a finder's fee as 'net profit' and release fee income as 'profit.'

(8) Nowhere in the Opportunity Meeting procedure is any inclination given to prospective distributors of the nature and amount of reasonably anticipated expenses.

404. Many participants at the time that they enter the program do not fully understand the Holiday Magic marketing plan.

CX 1842W; CX 90T ('You must enroll in the training class to gain the knowledge necessary to conduct this business.')

See also (McKinnon) TR. 4057, (Duden) TR. 1759.

405. Holiday Magic, Inc., through its Opportunity Meeting procedure, has a policy of failing to inform prospective distributors, recruits and prospects of the number of prior entrants in Holiday Magic, Inc. in the geographic or market area in which the prospect is enrolling or the degree of consumer acceptance of the Holiday Magic cosmetics (see Part VIII).

406. By failing to inform prospective distributors of any limits of market structure for product and distributorships, the consumer acceptance of the Holiday Magic products, and other market surveys or data, the prospective distributor is falsely given a reasonable expectancy of receiving larger profits or earnings than is actually the case.

407. Holiday Magic, Inc. in its Opportunity Meetings, compares the large profits of the cosmetics industry at manufacturing levels with the expected earnings for distributors, who are at other levels in the business.

CX 79228 indicates as follows:

Let's talk about the Cosmetic Industry for a minute now.

It's a big business a growing business a multiBILLION dollar a year business.

I don't know of one stock broker who isn't commending it for its growth.

And why shouldn't they. It's one of the fastest growing industries in the world today.

Why, over the last 10 years it's grown an average of 9.6% per year last year alone it grew 13.6%, so it's on the uphill rise. That's why we're in it! That's why I'm in it. I want to be where the money is. Obviously so does Holiday Magic!

408. By comparing the allegedly large profits in the cosmetic industry with Holiday Magic Distributorships, Holiday Magic, Inc. misrepresents to prospective distributors that they have a reasonable expectancy of receiving the same large profits at their levels that may be available to other levels in the business.

409. Holiday Magic, Inc. in its opportunity meetings and statements and representations in the Holiday Magic Wands represents to prospective distributors and recruits, and the lower level distributor it seeks to upgrade to the Master and General Level, that the retail list price value of Holiday Magic products sold by Holiday Magic to its distributors actually represents either the gross income of Holiday Magic, Inc. or the actual sales of products to consumers:

(a) CX 79Z28 (Opportunity Meeting Script):

Holiday Magic's first month in business was December, 1964. The sales volume the first full month was \$16,000.

Ten short months later it has grown to ONE MILLION DOLLARS per month11 months after that TWO MILLION per month2 months later THREE MILLION per month and is STILL GROWING. There has to be something in that.

(b) WandCX 4BNovember 1965

Today the company has expanded into 22 states and gross sales have reached the 1,000,000 a month level.

(c) CX 4CHoliday Magic sales figures for the first of the month of operation are as follows: October 1965-\$1,077,055.42.

(d) WandCX 14D1966: Fred Pape talked about how Holiday Magic had, just last month, surpassed 1.5 million dollars in monthly sales.

(e) WandCX 17C 12/66 : '* * * in two short years we find ourselves with a multimillion dollar operation doing a monthly sales volume in excess of \$3,000,000.'

(f) CX 17E'I remember when * * * \$3 million a month in retail sales was a dream of the future.'

410. In referring to the retail 'sales volume' a sales figure as it does, Holiday Magic, Inc. misrepresents to prospective distributors and recruits and to distributors that it seeks to upgrade to the Master and General level that the sales volume figures are indicative sales to the consuming public, and thereby are falsely given a reasonable expectancy of receiving the large profits or earnings based upon such consumer acceptance.

See RX 16, TR. 9212 (Holiday Magic only uses retail list price figures) and TR. 1028182; 10396. (Holiday Magic doesn't know what the retail sales actually are.)

XLIII. The Adoption Policies of Holiday Magic

411. Witness Janz testified that she told Fred Pape in May 1965, in San Rafael, Calif., that her sponsoring General, John Woloshyn, gave her no training. Pape said he would check into the matter (TR. 5350).

On a second occasion, after May 1965, Janz approached Pape about Woloshyn's lack of training at a corporate team meeting. The response was that training was coming and that Janz didn't need Woloshyn. (TR. 5351)

Janz paid \$100 for training subsequently (TR 5351).

412. Witness Don Kelly joined Holiday Magic in Sept. 1967 (TR. 5434), recruited by Rick Spranzo and John Woloshyn (TR. 5434).

Spranzo informed Kelly that as soon as he understood that marketing plan, he would be better off taking the \$5,000 worth of merchandise and dumping it in the desert (TR. 6442, 5468).

Kelly complained to Holiday Magic in letter of Dec. 26, 1967 about Woloshyn and Spranzo (CX 1342A, B), claiming he was brought into Holiday Magic under 'false pretenses' (CX 1342A), such as misrepresentations as to numbers of distributors already in Phoenix, that \$2500 could net him \$38,000, that he had to pay for the school, and that the ad he was recruited under was not a legal Holiday Magic ad.

Mr. Kelly asked for his money back (CX 1342AB).

On Jan. 9, 1968, Holiday Magic replied that Spranzo and Woloshyn did help Kelly, and that all purchases were final, even though Spranzo and Woloshyn left Phoenix 3 weeks after Kelly joined (part XLI2).

413. Witness Herb Davis met up with John Snider, John Woloshyn and Rick Spranzo after answering an ad in the Phoenix paper and joined Holiday Magic as a Master in July 1969 (TR. 1356, 1341, 135152).

Spranzo, Woloshyn and Snider all guaranteed Mr. Davis a return of his money within 45 days (TR. 1351-52). Davis heard Snider and Woloshyn promise to set up an organization for him, to hire and train Holiday Girls, recruit Organizers and Masters, and turn them into Generals. He was told a General would make \$39,000 a year by recruiting one General a month, and that he would make \$9,000 a month profit by recruiting two Holiday Girls a week (TR. 134950). All he had to do was supply them with product (TR. 1349).

He was also told by John Snider, a General, that National TV on the Johnny Carson show was planned by Holiday Magic for Jan. 1970 (TR. 1346). He was shown the 'ads' with the opportunity meeting film (TR. 1349).

He was also told there was more money in recruiting Masters and turning them into Generals than in retailing (TR. 1357).

In Aug. 1969, Davis complained to Holiday Magic vice president Powell about the representations, the false and broken promises, the stacking of masters, and the lack of training as promised. He also wrote in Oct. 1969, complaining about Spranzo and Woloshyn (CX 1397A).

Holiday Magic, Inc. acknowledged receipt of Davis' complaint in Oct. 1969 (CX 1398).

414. Witness Elvin Cherrington answered an ad in a Phoenix paper on July 1, 1969, and met John Snider, John Woloshyn and Rick Spranzo (TR. 14181424).

He was told he 'wouldn't have to do hardly anything' to earn \$108,000 a year, and that he could earn \$39,000 a year by recruiting one general a month for 12 months (TR. 1422).

He was also shown 'TV Commercials' which he was told would appear on National television in Jan. 1970 (TR. 1424).

Spranzo said there was no selling that they would hire and train the people to do the selling for Cherrington.

He talked to Vance Powell, Holiday Magic's regional vice president in the latter part of 1969, at which time Powell said he had also talked to Herb Davis (TR. 14511452).

Mr. Cherrington to this day hasn't attended Instructor General School, but is a Holiday Magic General Distributor (TR. 1453, 1474).

Mr. Cherrington's money would not be refunded (CX 1411).

415. Witness Ted Crosby tells a similar story involving Spranzo, Woloshyn and Powell. Crosby answered an ad in a Phoenix paper in July, 1969 (TR. 1487).

Spranzo said he was a General Distributor with Holiday Magic, sent to Phoenix to open up a new area, and that distributorships were going fast (TR. 1492). He was shown the Holiday Magic Council and told 'there are your offices, here is where we will have your new Holiday Girls. They are for your use.' (TR. 1500).

Crosby was shown two commercials and Spranzo said they were going on national television on the Johnny Carson show (TR. 150406).

Spranzo also told Crosby that 'we do not bring you into the program and drop you,' but that 'we work with you and start you making money' (TR. 1509).

Crosby saw Vance Powell in 9/69 or 10/69 (TR. 1590) and told him everything Spranzo had said to him, asking for his money back (TR. 1548, 1564, 158990). Also wrote to company, which was acknowledged Sept. 26, 1969 (CX. 1353).

Powell told Crosby that he agreed that what Spranzo had done was 'fraudulent, but that it was Holiday Magic policy not to return any money (TR. 188990). Powell said he would take steps to stop Spranzo because he had done it before (TR. 1594).

416. Witness Vermilye also met up with Spranzo and Woloshyn, and became a Master Sept. 11, 1969. By letter of Nov. 12, 1969, Vermilye detailed his gripes about Spranzo and Woloshyn to Holiday Magic (CX 1379AD).

Spranzo said that he and Woloshyn would help Vermilye, but he got nothing (TR. 1679).

By letter of Nov. 14, 1969, Patrick acknowledges Vermilye's letter, and states he has received similar reports from Crosby (CX 1380).

Meanwhile, Holiday Magic, Inc. is returning no money and waxing verbal about the great Rick Spranzo.

CX 538AD distributed by Holiday Magic, Inc. in late 1969 (TR. 5555) and referring to the month of August, states in part:

Now working Phoenix, Arizona, Rick Spranzo's work in the Holiday Magic program has taken him from Northern California (his home) to Seattle, Washington where he helped build a strong Distributor Council and helped many distributors achieve success in the Holiday Magic program.

Rick's high sales volume, his ticket to entry in the \$25,000 Round Table Club, shows his good work in Phoenix. Building his own sales organization and working with other distributors, Rick has seen the area develop sufficiently for the establishment of a Distributor Council with lots of enthusiastic members.

Next for Rick could very well be membership in the President's \$50,000 Club!

Ad in CX 151KFamily News9/5/69: Longtime distributor RICK SPRANZO has just become Round Table Club member number two! RICK'S volume at retail value has topped \$25,000 in one month so he'll be receiving a handsome leatherbound Accutron desk clock with a handtooled medallion opposite, describing his achievement. IRCK'S work has been centered mainly in the Phoenix, Arizona, area. Congratulations!

Holiday Magic would now have us believe that action was taken to terminate Spranzo. But see RX 120 in which Spranzo was 'terminated' as of Dec. 1969, but only for supplying other distributors who had gone General with replacement Masters (RX 120C). No mention is made of promises of help, guarantees of income, TV commercials, etc.

417. Termination? Spranzo is now working in Tucson. Witness Duden reports answering an ad in the Tucson paper on Feb. 8, 1970 (TR. 1696, 1762), less than two months after Spranzo's alleged termination.

Spranzo tells Duden he will hire and train Holiday Girls for him, and have high school boys to get leads for the girls (TR. 1698).

Spranzo assured Duden he would have his investment back (of \$6,000) in two months (TR. 1700). Spranzo's 'training' consisted of two 1/2 hour classes, which consisted of what to say to a prospect who compared Holiday Magic to a pyramid (TR. 1708).

Duden spoke to Vance Powell, Feb. 18, 1970, Holiday Magic's vice president (TR. 1712) and told Powell he didn't like the operation (TR. 1715). Powell said Duden should be recruiting organizers (TR. 1717). Duden told Powell assistance was needed, and Powell told Duden he needed the Holiday Magic manuals (TR. 1718). This he had to pay for (TR. 1762).

Duden requested his money back from Holiday Magic 7/15/70 (TR. 1727). Told Holiday Magic he was defrauded and that Spranzo didn't keep his promises (TR. 1764) and even offered to return all stock (TR. 176465).

By letter of 8/3/70, Holiday Magic told Duden that 'regardless of past obstacles,' his financial goals could be achieved. He was also told that no monies can be refunded (CX 1419AB). See also CX 1422.

418. Witness Thomson testified that he met up with Spranzo in Feb. 1970 (TR. 1833) when he became a Master. Spranzo said he would hire and train boys to make appointments for Holiday Girls (TR. 1830).

Thomson spoke to Holiday Magic vice president Vance Powell, complaining about no business guidance from Spranzo (TR. 1842). Powell told Thomson to check the Masters and Generals' procedure handbook, which Thomson didn't have, so Powell told him he would get it for him, but never did (TR. 1844).

Thomson complained Apr. 22, 1970 to Holiday Magic (CX 1444AC).

By July 1970, respondents 'terminated' Spranzo again, this time as stated in RX 120A: '[T]he main reason for your termination is your insistence upon continuing to place unapproved ads in Texas newspapers.'

419. Former Holiday Magic President Ben Gay, who terminated Mr. Spranzo (RX 120A, 120C; GayTr. 10193, 10096) testified that Spranzo was terminated because his activities were causing trouble with the attorney general's office in Arizona, and not because he violated company policies (Tr. 1011210114). The concern was in getting caught, and not in the malpractice (GayTr. 10115).

Gay notes that it took 5 years to get to Spranzo (Tr. 10113) and that Spranzo had recruited over 100 Masters and Generals (Tr. 10202).

None of Spranzo's distributors were ever refunded their money by Holiday Magic (Tr. 10203) all of the distributors who testified lost money (CX 1829A, B; Tr. 1382, 1460, 1524, 1679, 1720, 1854).

420. Holiday Magic, Inc. represents and requires its distributor to represent to prospective distributors and recruits that the distributors are representatives and agents of Holiday Magic, Inc.

(a) Opportunity Meeting scripts: CX 79Z28:

Good evening, ladies and gentlemen. My name is _____ and I am a _____ with Holiday Magic. * * [space in original].

You will see a film which explains our general program. * * *

So as we say in Holiday Magic, let's get started! * * *

We're really proud of that film. They're all real peopleHoliday Magic people. * * *

So at this time it is my pleasure to introduce as a General Distributor with Holiday Magic. * * *

listen carefully to one of Holiday Magic's most successful men, Mr. _____.

You know, I have been with Holiday Magic months now * * *.

Now I mention this not particularly to impress you with the calibre of people we have in Holiday Magic,
* * *.

Our National Sales Manager, Mark Evans, sponsored 137 people his first 30 days in the business.

This is exactly the way our people are making the kind of money that they are making * * *

Many of us in Holiday Magic are earning this kind of money and more * * *

Ladies and Gentlemen, this is Holiday Magic and this is what we have to offer you.

At this time, I would like you to turn to the person who invited you here and ask them to help you select one of the four positions for you in Holiday Magic.

(b) Six Enrollments:

CX 1842R, CX 90P: Now, _____ I am going to explain the four basic positions that Holiday Magic has to offer and I want you to select the position that you feel will suit your needs best.

CX 86A: We offer four positions to every person who comes into Holiday Magic.

421. Bill Dempsey, when he appeared in Chicago with Holiday Magic president Fred Pape (Tr. 3703) and Mark Evans, national sales manager, on Feb. 10, 1968 (Tr. 3703), at a meeting of all Masters and General

Distributors who had completed Instructor General courses (Tr. 3703) was at the time vicepresident of sales, East Coast (Tr. 3703). He stated, as reported by witness Pence, that:

* * * when the dust cleared, the only thing that counted was who had the money, and he had it, and then he flashed three or four one hundred dollars bills in the air.

The next thing, the next statement along those lines that he made, was that you are to consider a prospect, * * * that he has my money in his wallet, and whatever method that I can use to get my money back out of his wallet, that was perfectly all right. (Tr. 3710).

422. Mr. Dempsey testified for respondents after Mr. Pence did, but did not deny the allegation. Respondent William Penn Patrick is also quoted by witness Pence as saying:

There is no reason why you shouldn't be earning \$3,300 a month at least. If you can't do that, then get out. (Tr. 3684).

See CX 85U and CX 86C, wherein \$3,300 a month is described as being earned by recruiting and upgrading one General a month.

423. Corporate Team opportunity meetings given in Miami featured Jim Hearn (Tr. 2004) at which he gave his standard presentation:

Now, I came into this program, and there are two horses to ride, a fast horse and a slow horse. The fast horse is the recruiting fees of bringing people into the business where a lot of money exists, and the slow horse is building up a retail organization, with Holiday girls and so forth, to retail cosmetics. I am riding the fast horse. I suggest that if you want to make a lot of money fast, ride the fast horse. You can go either way you want.

XLIV. Advertising

424. Respondent Holiday Magic, Inc. has represented directly or by implication, or by adopting and ratifying the misrepresentations of its distributors, that:

(a) Holiday Magic, Inc. does and will utilize television advertising throughout the country through its Wands and manuals which it distributes to all distributors:

(1) CX 78Z31Television advertising is conducted on a saturation schedule. Everyone knows the power of T.V. advertising.

(2) CX 1CWands 8/65 : The corporation intends to support this training by creating in the public mind an image of the Holiday Girl as a real authority in the field of cosmetics care and beauty. We will achieve the creation of this image through television advertising and other mass media.

(3) CX 37MWands 9/68 : HM distributors are about to see the first television commercials to be broadcast on a national basis by independent distributors.

(4) CX 64AWands (Permanent) HM plans National T.V. Watch for us in your city.

(5) CX 159MFN 4/10/70: HOLIDAY MAGIC ON NATIONAL T.V. * * *

(6) CX 79Z9: The corporation will use television as its primary advertising medium. From time to time it may use other media.

(7) Physical Exhibit B. Tr. 9803: Each Holiday Magic retail distributor is thoroughly trained in cosmetic knowledge, samples, exciting hostess gifts, superb literature, and supporting product advertising.

(8) CX 76Z19 (Script on technique to recruit a Beauty Salon): Mrs. Jones, I am _____ with Holiday Magic. I'm sure that you have heard of us. You haven't? Well, Mrs. Jones, this is one reason why I am here. We will be going on T.V. very soon and we would like to give you some free advertising. * * *

* * * All that we expect of you is to act as a depot for our T.V. advertising so girls will be able to buy products from you when they need them.

(b) That one million dollars was being spent to advertise Holiday Magic products in national magazines (see CX 25AEWands 8/67 ; GayTr. 9990; CoultasTr. 9676).

(c) Holiday Magic, Inc. represented to its distributors that the magazine ads were helping distributors (LipskaTr. 1040304).

(d) That television commercials would appear on national television on the Johnny Carson show.

425. In truth and in fact, respondents do not advertise their products to the extent that they or their representatives represent:

(a) Holiday Magic, Inc. has never advertised on network television (Lipska Tr. 9258).

(b) Holiday Magic, Inc. has never advertised on television that covered more than half the nation (LipskaTr. 9259).

(c) Holiday Magic's 'advertising' expenditures for the fiscal year ending Sept. 1965 were \$43,764; Sept. 1966\$165,380; Sept. 1967\$444,524; Sept. 1968 \$287,742; Sept. 1969\$110,322; Sept. 1970\$220,099; and Sept. 1971\$107,715. These figures include advertising, promotion, entertainment, salaries, special brochures, productions, announcements to distributors and 'perhaps the Holiday Magic Wands' (Tr. 6388, 6390, 9260, 9261).

(d) Sherman Coultas was aware of spot T.V. for Holiday Magic only in San Francisco, Milwaukee and Minneapolis (CoultasTr. 9687).

(e) Holiday Magic spent only between \$150,000 and \$300,000 (LipskaTr. 10385 92) or \$200,000 (GayTr. 9990) on the \$1,000,000 magazine advertising representation.

(f) Distributors were constantly and continually advised that Holiday Magic was engaging in a continuing national advertising program in women's magazines even though the said campaign lasted only several months and was already terminated (LipskaTr. 1038592; 104034; GayTr. 10133, 9990; GuardTr. 10494; CoultasTr. 9690; CX 90KNational Adv. Marketing or recruiting tool; RX 164).

(g) Holiday Magic, Inc. has no knowledge as to whether or not the magazine ads had helped distributors (LipskaTr. 104034).

426. Holiday Magic, Inc. has ratified and adopted the representations of Joh Woloshyn and Rick Spranzo that Holiday Magic products will be advertised on national television on the Johnny Carson show, by failing to take any action in refunding the monies to distributors who relied upon said misrepresentation on becoming Holiday Magic distributors.

427. Holiday Magic is stopped from denying the ratification and adoption of the misrepresentation of television advertising by Messrs. Spranzo and Woloshyn because of the Holiday Magic recommendation that ads such as those shown by Spranzo and Woloshyn be incorporated into the opportunity meeting presentation (see CX 712).

XLV. Employment OffersHelp Wanted Ads

428. Holiday Magic, Inc. has represented directly or indirectly, to prospective distributors, that employment is being offered:

(a) See CX 1800AZ15:

NEWSPAPER ADS

For Holiday Girls: Housewife make \$50 to \$100 per month in your spare time. Phone ____.

I WANT A HUSBAND. Who will draw his wife's attention to this ad. Glamorous profession. Looking for qualified applicant. Ages 1855. Call Mr. ____ for appointment 95 (Phone No.).

If you are interested in part time work and would like to earn \$5000 per month in your spare time working from your home write Box ____.

For Organizers:

LOOKING FOR THE RIGHT KIND OF MAN: Must have management potential and like to work with attractive women. Phone _____.

DO IT NOW * * * Phone _____: Brand new company with exciting ideas. Fantastic financial opportunity if you qualify. DO IT NOW * * * Phone _____.

REWARD: If you can handle people, will work hard, DON'T want to sell, want a millionaire's income, Call _____.

UNIQUE URGENT POSITION: Not a better opportunity in ____ county for the man who can fill this position. For appointment only with ____, call (Phone No.).

WANTED Lazy salesman accustomed to a high standard of living. Phone _____ for interview.

For Masters:

I AM LOOKING FOR A MAN who is capable of earning \$20,000 to \$30,000 annually. Fantastic financial opportunity if you qualify. Must have management ability. Phone _____.

TIRED of answering doortodoor selling ads? I'm looking for a man who likes to WORK and to whom \$25,000 per year is a reality. If you are this man and can supervise an organization of attractive women, call me Monday 71 P.M. _____.

MAJOR COMPANY BUILDING COMPLETE EXECUTIVE AND SALES FORCE IN _____. EXCEPTIONALLY HIGH INCOME IF YOU QUALIFY.

EXECUTIVE and PEOPLE with MANAGER potential needed for expanding California company. If you qualify and can accept \$25,000 per year as a reality call of appointment. _____.

429. All Holiday Magic distributors are independent contractors and not employees (Answer, p. 4).

430. All Holiday Girls are in business for themselves; never hired on salary (GillespieTr. 9307).

431. Distributors were placing ads indicating that they were offering employment, and this was not the case (CoultrasTr. 9663). See also CX 1976AI; Tr. 44234446), which were ads placed by witness Vardervelde seeking Holiday Girls.

432. Holiday Magic tells its distributors to place ads in local newspapers, as one of the quickest methods of mass recruiting, utilizing the ads appearing in the manuals:

The placement of advertisements in local newspapers is one of the quickest methods of mass recruiting.

But always make reference to the 'Holiday Magic Distributor Manuals' for the proper ads to be placed in the newspaper, 'How to Interview properly', and how to use 'Telephone BookIn Procedures.' (CX 1840Z59).

XLVI. Price Discrimination

433. Holiday Magic, Inc. sells Holiday Magic products directly to its General Distributors and its Master Distributors.

(a) See VII C and D.

(b) A Holiday Magic Instructor General at the time he testified, Kenneth Belton stated at Tr. 4963:

Q. Mr. Belton, as a Master distributor, did you purchase products from Holiday Magic?

A. Yes, sir.

Q. Do you recall what products you purchased from Holiday Magic?

A. Everything from an antibody (sic) lotion to lipstick to colognes, hair sprays, shampoo, many different items.

Q. These are the Holiday Magic cosmetic line?

A. And home care products such as floor wax and furniture polish.

Q. As a general distributor did you also purchase from Holiday Magic, Inc.

A. Yes.

Q. Would you tell us again what products you purchased from Holiday Magic as a General?

A. The same.

(c) GillespieTr. 937173'Holiday Magic did business with the Masters and Generals.'

GillespieTr. 9415'Masters and Generals normally purchased from the company.'

GillespieTr. 9419'Master buys from Holiday Magic.'

(d) Stipulation of Counsel at Tr. 2623:

HEARING EXAMINER BUTTLE: They will stipulate with you that masters and generals purchased their product from Holiday Magic; am I correct?

MR. WOLFSON: Yes, Judge * * *

HEARING EXAMINER BUTTLE: Mr. Mitchell, do you stipulate to that?

MR. MITCHELL: Sure, Your Honor.

(e) Statements in movie, Manuals, Bulletins:

(1) Physical Exhibit BMovie 'Formula for Happy Living' at Tr. 9807:

By the end of your third month with Holiday Magic, you will be pleased to discover that your first five outlets have reached the volume of \$9,000 each and, as you have done, they, too, become Master Distributors. At this point, they begin to purchase directly from the company.

Although you are no longer required to service them with product and they no longer need your service or your help, you begin to receive 2 percent of their volume.

(2) CX 77G:

Once a distributor reaches a volume of \$5,000 in any one calendar month, he remains at 55%. He is then classified as a master distributor and will buy directly from the company.

(3) CX 78Z1314 describes the 'ordering procedure for Master and General distributors.' No differences appear for the two artificially named echelons.

(4) At CX 78Z14:

NOTE: Masters and Generals deal directly with the Home Office, ordering in case lots only.

(5) CX 78T states as follows: General Distributor 'Can work wholesale or retail of both as he desires. Does not supply his Masters with product.' While a Master Distributor 'Buys product directly from factory to supply his Organizers and Holiday Girls.'

(6) The Corporate Team in the person of Mark Evans also stated at CX 85E: The position above the Organizer is that of the Master Distributor who works at 55% discount and purchases his merchandise directly from the factory.

(7) See also CX 106AK, entitled 'Masters and Generals Procedure Handbook,' dated Jan. 1968. The booklet shows that Masters and Generals are treated exactly alike in ordering and dealing with respondent Holiday Magic, Inc. CX 106H and CX 106I show the same order forms used by both

'echelons.' At CX 106C: 'Only Master and General Distributor's orders should be submitted to Holiday Magic. All other distributors purchase through their sponsor. * * * Masters and Generals order from Holiday Magic in case lots only.'

(8) CX 78Z56:

When your Direct Distributors become Master Distributors, you are no longer required to service them with products. They buy directly from the Company * * *

(9) CX 1351 is a letter from Holiday Magic to Master Distributor Crosby, dated Sept. 24, 1968:

As a Master Distributor you are going to be placing orders with our Distributor Accounting Department. Our utmost concern is processing all your orders quickly and efficiently.

Your distributor identification number * * * is permanent. Please use it in all correspondence and, above all, on each and every order.

Please don't forget to sign each of your orders.

An unsigned order or personal check will be returned to you, thereby delaying your order. (Same letter CX 1376A, CX 1390, CX 1443 (2/20/70)).

(10) CX 1382A, B at B: Holiday Magic letter to distributor on request for transfer to another General:

Since you are a Master distributor, you deal directly with the company. You promote your own programs, and you service the interests of those in your organization. If you do not belong to a council, we suggest you join a council in your area. This action would keep you in the center of business and promotional activities.

(11) CX 1FWandAug. 1965: Jan Gillespie saysthis office must have two (2) copies of all orders from Master and General Distributors.

(12) CX 28CWandNov.Dec. 1967:

Distributors will receive an updated statement of account with each order processed with our present new system * * *

(13) CX 28KWandNov.Dec. 1967:

Central Filing maintains master and general distributors' files, which contain all correspondence and orders for each distributor.

(14) CX 79Z14:

After it is assigned, the Master Identification Number must be correctly entered on all orders. Our files, bookkeeping, and shipping orders all require this number.

(15) See also Tr. 3096; Tr. 3442, CX 1896AZ3, Tr. 2887; CX 1880LP, Tr. 4074, CX 1911AF, CX 192ZAC, CX 1928ZK, CX 1931B.

434. Master and General Distributors use the same order forms, employ the same ordering procedures, and receive the same account statements from Holiday Magic on their orders:

(a) CX 79Z21Z25: Chapter entitled 'PROCESSING OF MASTERS' AND GENERALS' ORDERS.' There are no distinctions made between Masters and Generals.

(b) CX 79Z15: Master and General Distributor Order Form. Note that the identification number referred to is the Master Identification Number, and not the General Identification Number. At the bottom 'Masters order case lots. Retail Distributors may order unit lots.'

(c) Distributor order forms for both Masters and Generals appear in the record at CX 411, 412, 414, 416. Masters and Generals order on the same forms, but at the different prices and discounts indicated.

(d) CX 106J: This is the account for both Masters and Generals. Column 7 showing percent retail paid, in this case 45 percent reflects a Master order (see CX 106EF) wherein this 'DATA PROCESSING INVOICE' is explained. At No. 7, it reads:

Discount rate. Figures shown represent the percentage of the retail cost you are paying: i.e., 100% in this column indicates a no discount item. 45% in this column means you are paying 45% of the retail price, or 55% Masters' discount, etc.

435. Master Distributors do not order from or through an account of a General Distributor; they had their own accounts, and General Distributors receive copies of the Master's account orders along with a 10 percent override.

(a) Cf. CX 2053AM; CX 2054AL.

(b) CX 78'0': 10 percent override. This is the override that a General Distributor receives on his Masters' purchases. He receives this check monthly directly from the Home Office together with a copy of that Master's official monthly purchase record. He receives this override until the day that his Master becomes a General Distributor.

(NOTE: What need would there be for a copy of the Master's monthly purchase record if the Master really ordered through the General's account?)

436. Merchandise which is on 'back order' is shipped automatically when in stock (CX 19H; CX 78Z21).

437. General Distributors do not maintain inventory sufficient for Master Distributors. They sell only to Holiday Girls and Organizers, and the CRS or CDC provides for inventories at \$4,000 per Master and General (see Part XXX).

438. Master distributors purchase at a price which is 45 percent of the retail list price (55 percent discount off list) and Generals purchase at a price which is 35 percent of the retail list price (65 percent off list) (Tr. 6176; CX 2063CX 2113 and all supporting documents).

439. General distributors receive a price discount which is a 22.2 percent discount off the selling price to Master Distributors. (General pays 35 cents on the dollar, Master pays 45 cents on the dollar for the equivalent products. Difference of 10 cents; $10/45 = 22.2$ percent discount from Masters' cost.)

440. Master Distributors buy at a price which is 28.6 percent greater than the selling price to the General Distributors.

(General pays 35 cents on the dollar, Master pays 45 cents for the equivalent products; difference of 10 cents; $10/35 = 28.6$ percent of General's cost.)

441. Master and General Distributors are at the same functional levels of distribution.

(a) Masters and Generals sell at wholesale to Organizers and Holiday Girls: (Tr. 2452; Tr. 2318; Tr. 2803-2804; Tr. 2949; Tr. 3138; Tr. 3311; Tr. 4641; Tr. 2515; Tr. 4080; CX 2078AB; CX 2079AC; CX 2080AC.)

(b) Masters and Generals sell at retail to the consuming public. (Tr. 2518 2519; Tr. 2810; Tr. 3077; Tr. 3236; Tr. 3458; Tr. 3151; Tr. 3004; Tr. 3314; Tr. 5480; Tr. 5097; Tr. 4969; Tr. 5114; Tr. 7973; Tr. 8594; Tr. 5254; Tr. 4639; Tr. 78387939; Tr. 4481).

(c) Masters and Generals have their Organizers and Holiday Girls trained at the Holiday Magic councils, to which they pay dues. (Tr. 25202521; Tr. 2552; Tr. 41184119; Tr. 43124313; Tr. 4390; Tr. 4392; Tr. 5092).

(d) Masters and Generals maintain their individual inventories, either at their own place of business or at CDC or CRS locations, at which they pay dues. (Tr. 4378; Tr. 45004501; Tr. 4510; Tr. 4699; CX 2009A; CX 2007; CX 2022; Tr. 5279; CX 2062; Tr. 25252526).

(e) General distributors testified that they performed the same function as General distributors that they did as Master distributors. (Tr. 9910, 9830 Gay; Tr. 2887Rothman; Tr. 43104311Aldridge).

(f) Holiday Magic Masters' and Generals' manuals (CX 104, CX 112, CX 100, CX 109 and CX 110) indicate the functional characteristics and sameness for Masters and Generals.

(g) Holiday Magic provides the same manuals for Masters and Generals. (See CX 78F; CX 79F).

The purpose of this [Masters' and Generals'] manual is to provide Masters and Generals with procedures and techniques which will save time, experimentation, and expensive errors. Holiday Magic, Inc. expects each Master and General to be thoroughly knowledgeable in the methods used to build and sustain an effective Holiday Magic Cosmetic Program.

(h) See CX 368A: 'Generals, Masters and Organizers are all trained to do the same thing. They're all Organizers.' And CX 7623Z4: 'The most important principle that an Organizer must remember is that the immediate delivery of product is necessary. Failure to have an adequate amount of products on hand to service your organization will result in organizational stagnation. There is no short cut to immediate delivery.' And CX 33HW and 5/68 : 'Masters, Generals and Organizers supervise their Holiday Girls.'

(i) Sponsor trains his new distributors, not the General who is getting an override on the Sponsor's purchases.

(1) CX 104B: '* * * it must be remembered that the Sponsor [of] a new distributor is still primarily responsible to the new Distributor, and this responsibility is never delegated to others, regardless of geographical consideration.'

(2) At CX 104MO, the definition of Sponsor includes Generals, Masters and Organizers.

442. General distributors engage in their wholesale business activities in the metropolitan area city and surrounding suburbs of the city or suburb in which they live. Cf. Chicago Tr. 41644165; Tr. 4495; Tr. 4638; Tr. 5116; Tr. 7838; Tr. 79857986; Milwaukee Tr. 4791; Tr. 4810; Tr. 49554956; Tr. 5215; 5217; Tr. 4697-4698; Miami Tr. 3366; Tr. 2891; Tr. 3144; 3147; Tr. 2752; Tr. 2550; Tr. 3033.

443. Other Master and General distributors testified that they engaged in wholesale business activities from a radius of substantial numbers of miles from the cities in which they lived. Cf. (Tr. 52165217 (Schmidt 50 miles), Tr. 4811 (Lipscomb 20 miles), Tr. 50285029, 5052 (Boellen 25 miles), Tr. 49554956 (Belton 10 miles), Tr. 4698 (Andert 40 miles), Tr. 4292 (Shumaker 510 miles), Tr. 4658 (Bong 50 miles), Tr. 5116 (Hines 6 miles)).

444. Master Distributors engage in their Holiday Magic wholesale business activities in the metropolitan area city and surrounding suburbs of the city or suburb in which they live. (Florida Tr. 2451 (Muff), Tr. 2810 (Sedler), Tr. 2604, 2608 (Izzard), Tr. 3449 (Sutliff); Chicago Tr. 4116 (Hines), Tr. 4535 (Dobrenik), Tr. 4310 (Aldridge), Tr. 4372 (Vanadia), Tr. 7972 (Cylkowski), Tr. 7983 (Bosan), Tr. 4194 (Faktor); Milwaukee Tr. 5478, 5481 (Prah), Tr. 4997 4998 (Fischer), Tr. 5097 (Janssen)).

445. General distributors testified that they engaged in their wholesale and/or retail business areas in the same geographic or market area as General distributors as they had done when they were Master distributors. (Milwaukee Tr. 52165217 (Schmidt); Tr. 5025, 5038, 5052 (Roehlein), Tr. 4991 (Toepfer); Chicago Tr. 4496 (Justen), Florida Tr. 2885, 2888, 2891 (Rothman)).

446. Holiday Magic, Inc. makes available and sells its entire line of Holiday Magic products to Master Distributors and General Distributors: (See Finding 7, also CX 79Z21Z25, CX 411, 412, 414, 416, CX 79Z15, Tr. 2580 (Frank)).

447. Master and General Distributors engaged in direct wholesale sales activities (sales to Holiday Girls, Organizers and retail stores) in the same geographic areas.

See attached charts following finding 449 under column entitled 'wholesale' for Miami, Chicago and Milwaukee. For each city, there is a separate chart for Master and General Distributors. Those who operated at the wholesale level are indicated by the areas listed under the column entitled 'wholesale,' which show where they conducted their recruiting activities and where their respective Holiday Girls and Organizers sold. Compare the areas under the column entitled 'wholesale' for Generals with those under the column entitled 'wholesale' for Masters.

448. Master and General Distributors engage in direct retail sales activities to members of the consuming public in the same geographic areas.

See the same attached charts under the column entitled 'retail' for Miami, Chicago and Milwaukee. Compare the areas under that column for Masters with those areas listed under that column for Generals following finding 449.

449. Masters, Generals, Organizers and Holiday Girls engage in direct retail sales activities to members of the consuming public in the same geographic areas.

See the same attached charts for Miami, Chicago and Milwaukee. See also the areas in the charts for both Masters and Generals under the columns entitled 'wholesale' which show where Holiday Girls and Organizers sold and compare those areas with the areas listed under the columns entitled 'Retail' which show where Masters and Generals retailed.

Charts for Masters and Generals, separately, indicating where they conducted their wholesale and retail activities in the MiamiDade County area, their addresses, the periods of time that they were active as Masters and Generals, and the numbers of Holiday Girls and Organizers that they had selling in their organizations during the period 5/66 to 7/68 , are as follows:

MIAMIDATE COUNTY AREA

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Charts for Masters and Generals, separately indicating where they conducted their wholesale and retail activities in the Milwaukee Metropolitan area, their addresses, the periods of time that they were active as Masters and Generals, and the number of Holiday Girls and Organizers that they had selling in their organization during the period 3/70 1/18/71, are as follows:

METROPOLITAN MILWAUKEE AREA

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Charts for Masters and Generals, separately, indicating where they conducted their wholesale and retail activities in the Chicago Metropolitan area, their addresses, the periods of time that they were active as Masters and Generals, and the numbers of Holiday Girls and Organizers that they had selling in their organizations during the period 6/68 to 12/70 , are as follows:

CHICAGO METROPOLITAN AREA

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

450. Holiday Magic, Inc., sells the same products contemporaneously to Master and General distributors who are engaged in their business activities in the same market areas. (For contemporaneous salessee charts immediately following Finding number 451).

Miami(same products)

MastersCX 2066 (Porst), CX 2067 (Muff), CX 2069AB (Eversole), CX 2065A (Sutliff), CX 2063B (Izzard), Tr. 299 (Yanaros)

GeneralsCX 2064B (Braddock), CX 2069AB (Eversole), Tr. 3363 (Dudley), Tr. 2305 (Fechtel), Tr. 2580 (Frank)

Chicago(same products)

MastersCX 2105 (Faktor), CX 2085 (Wegner), CX 2092 (Vanadia), CX 2098 (Shumaker), CX 2110 (Aldridge), CX 2072B (Justen), CX 2107 (Bong), CX 2102 (Catanese), CX 2094 (Dobrenik)

GeneralsCX 2072B (Justen), CX 2110 (Aldridge), CX 2088, CX 2089B, CX 2090B (Mally), CX 2102 (Catanese), CX 2107 (Bong), CX 2094 (Dobrenik)

Milwaukee(same products)

MastersCX 2075B (Cederbaum), CX 2071B (Prah), CX 2077 (Boehlein)

GeneralsCX 2078B (Boehlein), CX 21142115 (Schmidt), CX 2119CD (Andert)

451. OrganizerJoan Maiorano purchased at a 30 percent discount products that were the same as those purchased from Holiday Magic by Masters and Generals in Milwaukee (CX 2081AC). She purchased these products indirectly from Holiday Magic through her sponsoring General's account at C.D.C. in Milwaukee. (See Sections VIIA and XXVI under Price Discrimination for indirect purchaser), CX 2081A, Tr.

5175, 5022. This witness retailed Holiday Magic products in the Milwaukee area in St. Francis and south side of Milwaukee (Tr. 5180, 5181). She also wholesaled Holiday Magic products through her Holiday Girls and Organizers in south side of Milwaukee, Cudahy and in St. Francis (Tr. 5180). She was active in both the wholesale and retail sale of Holiday Magic products in the period 4/70 to 10/70 (CX 2081A). Her expenses in selling Holiday Magic products were similar to those of Masters and Generals selling Holiday Magic products in the Milwaukee areas (Tr. 5182).

MIAMIDADE COUNTY AREA

Charts for selected Masters and Generals indicating a minimum of their dollar amount of purchases from Holiday Magic, Inc. while they were active as Masters and Generals in the MiamiDade County area during the period 6/66 to 1/68.

The following Masters purchased at a minimum the dollar amounts of Holiday Magic products indicated below at Holiday Magic retail value from Holiday Magic at 55 percent discount:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

FN* Witness' buyin portion (Tr. 2439).

FN** Witness' workin portion. For information on workin/buyin master, see Part VIIIsub. C.

FN*** An individual may become either a 'workin' master or a 'workin/buyin' master by purchasing \$5,000 of Holiday Magic products at Holiday Magic retail value in any one given month at a 55 percent discount. He may also become a 'buyin' master by purchasing \$5,000 of Holiday Magic products at a 55 percent discount. (See CX 79H, CX 79AZ98; Tr. 2542, 2999, 9574, 95919592; see also Part VII, subsection C).

MIAMIDADE COUNTY AREA

The following Generals purchased at a minimum the dollar amounts of Holiday Magic products indicated below at Holiday Magic retail value from Holiday Magic at a 65 percent discount during the period 6/66 1/68.

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

CHICAGO METROPOLITAN AREA

Charts for selected Masters and Generals indicating a minimum of their dollar amount of purchases from Holiday Magic, Inc. while they were active as Masters and Generals in the Chicago Metropolitan area during the period 6/68 12/70 are hereinafter set forth and explained.

The following Masters purchased at a minimum the amounts of Holiday Magic product indicated below at Holiday Magic retail value from Holiday Magic at 55 percent discount:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

FN* An individual may become either a 'workin' master or a 'workin/buyin' master by purchasing \$5,000 of Holiday Magic product at Holiday Magic retail value in any one given month at a 55 percent discount. He may also become a 'buyin' master by purchasing \$5,000 of Holiday Magic product at a 55 percent discount. (See CX 79H, CX 79AZ98; Tr. 2542, 2999, 9574, 95919592; see also Part VII, subsection C).

CHICAGO METROPOLITAN AREA

The following Generals purchased at a minimum the amounts of Holiday Magic product indicated below at Holiday Magic retail value from Holiday Magic at a 65 percent discount during the period 6/68 12/70:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

MILWAUKEE METROPOLITAN AREA

Charts for selected Masters and Generals indicating a minimum of their dollar amount of purchases from Holiday Magic, Inc. while they were active as Masters and Generals in the Milwaukee Metropolitan area during the period 3/70 1/18/71 are hereinafter set forth and explained.

The following Masters purchased at a minimum the amounts of Holiday Magic product indicated below at Holiday Magic retail value from Holiday Magic at a 55 percent discount:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

FN* An individual may become either a 'workin' master or a 'workin/buyin' master by purchasing \$5,000 of Holiday Magic product at Holiday Magic retail value in any one given month at a 55 percent discount. He may also become a 'buyin' master by purchasing \$5,000 of Holiday Magic product at a 55 percent discount (see CX 79H, CX 79AZ98; Tr. 2542, 2999, 9574, 95919592; see also Part VII, subsection C).

MILWAUKEE METROPOLITAN AREA

The following Generals purchased at a minimum the amounts of Holiday Magic product indicated below at Holiday Magic retail value from Holiday Magic at a 65 percent discount during the period 3/70 - 1/18/71:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

452. Master Distributors have the same or similar expenses as do General Distributors in connection with their Holiday Magic distributorships.

MiamiExpenses which both Masters and Generals have in common in the Miami Dade County area are telephone, advertising, automobile, council dues, bank charges, travel expenses, freight, sales aids, taxes and licenses, and office supplies as shown by their profit and loss statements.

MastersCX 1902AB (Sutliff); CX 1847 (Muff); CX 1875A (Porst); CX 1890 (Sharpe).

GeneralsCX 1847 (Muff); CX 1856C (Frank); CX 1892C (Dudley).

ChicagoExpenses which both Masters and Generals have in common in the Chicago Metropolitan area are office supplies, telephone, advertising, auto, refunds to Holiday Girls and Organizers, council dues, freight, bank charges, training, and sales aids as shown by their profit and loss statements.

MastersCX 1973A (Vandervelde); CX 1926A (Catanese); CX 1988 (Dobrenik); CX 1921 (Wegner); CX 1951AC (Shumaker); CX 1930B (Faktor); CX 1936A (Aldridge).

GeneralsCX 1926B (Catanese); CX 1994B (Bong); CX 1989A (Dobrenik); CX 1934B (Aldridge).

MilwaukeeExpenses which both Masters and Generals have in common in the Milwaukee Metropolitan area are office supplies, telephone, advertising and promotion, refunds to Holiday Girls and Organizers, council dues, CRS or CDC dues, bank charges, travel expenses, freight, sales aids, auto, entertainment and training as shown by their profit and loss statements.

MastersCX 2014 (Toepfer); CX 2022 (Fischer); CX 2062 (Prah).

GeneralsCX 2028B (Belton); CX 2014 (Toepfer); CX 2005 (Lipscomb); CX 2007 (Cederbaum); CX 2002B (Andert).

453. The Holiday Magic wholesale and retail cosmetic business is one which is characterized by low profit margins for Masters and General Distributors.

See individual charts immediately following for Miami, Chicago and Milwaukee. On each chart, low or negative profit margins are shown for Masters and Generals from whom profit and loss statements were taken. On the bottom of each of the three charts is a table indicating when Distributor was active as a Master and as a General.

Holiday MagicD. 8834

A Tabulation of Profit and Loss Statements Taken From Federal Tax Returns of

Individuals Trading in Holiday Magic Products in the Miami Area

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

454. Holiday Magic Master and General Distributors for the most part sell their products to their Holiday Girls and Organizers at 30 percent discount from list price. (See VIIA, B; Tr. 2452, 2753, 2804, 2919, 3311).

455. Since Master Distributors pay 45 percent of the list price for the products they buy from Holiday Magic, and sell at 70 percent of the same list price at wholesale to their Holiday Girls and Organizers, their gross income on the wholesale sale of Holiday Magic products, before expenses, is 25 percent of list price.

(70 percent received less 45 percent paid equals 25 percent gross income.)

456. Since General Distributors pay 35 percent of the list price for the products they buy from Holiday Magic, and sell at the same 70 percent discount to Organizers and Holiday Girls at wholesale, their gross income on the wholesale sale of Holiday Magic products, before expenses, is 35 percent of list price.

(70 percent received less 35 percent paid equals 35 percent gross income.)

457. Since General Distributors enjoy a 35 percent of list price gross income on the wholesale sale of cosmetics and Master Distributors have only a 25 percent gross income on their wholesale sales of cosmetics, Generals as a practical matter have a 40 percent greater gross income than do their Master Distributor counterparts, on equivalent volumes of merchandise sold at wholesale.

(35% - 25% = 10 difference; 10%/25% = 40%)

458. The 22.2 percent discount at which Holiday Magic sells to its General Distributors is not available to Master Distributors (Tr. 2529, 2308, 2579, 2745, 2911).

459. Master Distributors may qualify for the General's discount and General position only by meeting the conditions of paying a release fee of from \$2,500 to \$4,500 and by recruiting and sponsoring a potential competitor as a Replacement Master (see VII D).

460. No cost justification defense was interposed or offered by respondents with respect to the favored buying status of the General Distributor.

461. The 10 percent override payment by Holiday Magic, Inc. to those General Distributors who recruited or sponsored Master Distributors, or who were given Replacement Master Distributors, is a payment to the General Distributor of the extent to which the nonfavored Master Distributor is disfavored by his own direct purchaser, and thereby compounds the price discrimination to Master Distributors. The 10 percent override is thereby inexorably linked to the sale of products to nonfavored customers (see Part XIII).

462. The 10 percent override payment to General Distributors is an indirect price discrimination in the 'net' price of products sold to Masters and Generals (see Part XIII).

463. There is no cost justification or other evidence sufficient to establish that the said overrides were for services incident thereto.

464. (a) Respondents do not know which distributors are active and which are inactive (Tr. 3892). At best, they can ascertain the date of last purchase of product from Holiday Magic (Tr. 9699, 9742) or what its turnover is (Coults Tr. 9760).

(b) No reports are filed or required to be filed either by Masters or Generals in connection with any services allegedly performed (AlexanderTr. 9633, 5666 67), nor do records of any kind exist to reflect the number of hours worked by a distributor (AlexanderTr. 5666) or a distributor's sales on down through his organization (AlexanderTr. 5667).

(c) Respondents take no action when informed that General Distributors are not in contact with Master Distributors over whom they received the 10 percent override (see Part XLII).

(See testimony of Mary Guard at Tr. 1047810487.)

(d) General Distributors who have no Master Distributors over whom they can enjoy an override get favored purchasing status as a General (LipscombTr. 4814).

(e) Masters and Generals receive the same business training from Holiday Magic, Inc. (see XXVII and XXVIII). ,\$(f) It is the 'sponsor' who is responsible for the training of the new distributorwhether the sponsor be a General, Master or Organizer (CX 104B, MO). For this reason, Organizers also attend Instructor General School (CX 137A, CX 163B, CX 156B, CX 49H, CX 65C, CX 146G, CX 165H, CX 505B, CX 36D.)

465. General Distributors receiving the 10 percent override are as follows: CX 2076, CX 2116, CX 2117, CX 2074, CX 2109, CX 2113.

466. Holiday Magic Distributors at all levels, i.e., General, Master, Organizer and Holiday Girl, retail products directly to the consumer:

CX 91Z82 (Instructor Manual):

I am sure that some of you ladies and gentlemen here longest may be Organizers, Masters and even General Distributors. However, remember that everyone in Holiday Magic retails product and must learn from the viewpoint of a Holiday Girl.

CX 91Z89: 'Holiday Girl' Definition:

Any lady that sells Holiday Magic cosmetics. She could be a Retailer, Organizer, Master or General Distributor. She could be selling on routes, beauty salons or seminars. She could be full time or part time.

CX 40CWand 12/68:

Approximately 50% of all Holiday Magic distributors are men and they might be more comfortable selling home care products than cosmetics.

CX 152NFamily News10/17/69:

We'd like all Holiday Girls to become General Distributors so that they can receive a 65% commission on every sale and buy their own cosmetics who lease. And each time you advance a Holiday Girl to the General position, you earn at least \$4,099. Think about it!

467. Holiday Girls and Organizers purchase their products directly from their Masters or Generals, but are indirect purchasers of Holiday Magic, Inc. with a purchasing price of 30 percent discount off retail price; see VII A; also Tr. 2435, 2450.

468. Since Masters and Generals buy the same products from Holiday Magic, Inc., and since Organizers and Holiday Girls must obtain their products directly from Masters and Generals, Holiday Girls and Organizers purchase the same products in directly from Holiday Magic, Inc. from the Masters and Generals from whom they buy directly. MilwaukeeCX 2081BC (Macorano), CX 2078AB (Boehlein's sales to Holiday Girls or Organizers)

For illustration of where Masters and Generals sold at wholesale to Holiday Girls, Organizers and retail outlets and at retail, in the Miami, Chicago and Milwaukee areas, see the attached maps. For each area, there are three maps. One entitled 'Wholesale,' a second entitled 'Retail' and a third entitled 'Residences/Places of Business.'

The map entitled 'Wholesale' shows where the Holiday Girls, Organizers and retail outlets of Masters and Generals sold. The map entitled 'Retail' shows where the Masters and Generals themselves retailed directly to the consumer. The third map entitled 'Residences/Places of Business' shows where the Masters and Generals lived and/or had their places of business, from which they conducted their Holiday Magic activities. The Miami area maps are designated A 1, A2, and A3, the Chicago area maps are designated B1, B2 and B3 and the Milwaukee area maps are designated C1, C2 and C3. A1, B1, and C1 are the 'Wholesale maps' for the Miami, Chicago and Milwaukee areas, respectively; A2, B2, and C2 are the 'Retail' maps for the Miami, Chicago and Milwaukee areas, respectively; and A3, B3 and C3 are the 'Residences/Places of Businesses' for the Miami, Chicago and Milwaukee areas, respectively.

For each market area, by comparing the map entitled 'Wholesale' with the map entitled 'Retail,' it can be seen that Holiday Girls and Organizers retail in the same areas as do Masters and Generals. For example, for Miami, compare map 'A1' with map 'A2.'

On each map there is a table which lists the Masters and Generals and the time periods in which each actively pursued his distributorship, either as a Master or as a General. Immediately opposite the name

of each Master and General is a symbol, such as G1, G2, etc., for each General and M1, M2 etc., for each Master. These symbols appear again in the specific geographic areas in which a particular Master or General conducted his Holiday Magic sales activities. Radial arcs and lines engulfing entire areas also designate the geographic areas of business conduct of the distributors so designated.

The geographic area charts also show the specific areas in which Masters and Generals conducted their wholesale and retail activities.

On the Milwaukee maps (C1, C2 and C3), the wholesale and retail activities of Organizer Joan Mariano (O1) depict in similar fashion her wholesale and retail sales activities.

A1 through A3

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

B1, B2

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

C1 through C3

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

XLVII. Holiday Magic's Lack of Information

469. Holiday Magic, Inc. claims it does not know what the turnover ratio is of its Holiday Girls (CoultasTr. 9758).

470. Holiday Magic, Inc. does not know if it has a greater or lesser turnover than the Avon Company (CoultasTr. 9759).

471. Holiday Magic, Inc. has no record of the turnover of its Master Distributors and General Distributors (CoultasTr. 8760).

472. Al Pangerl, president of Holiday Magic, Inc., and the number one producer for three years, never heard of a single Master Distributor who earned \$72,000 a year, as represented to be reasonable in the Opportunity Meeting scripts (PangerlTr. 9613).

473. Al Pangerl, president of Holiday Magic, inc., and the number one producer for three years, never heard of a single General Distributor, including himself, who made \$49,000 a year by attending one Opportunity Meeting a month, represented as being reasonable in the Holiday Magic Opportunity Meetings (PangerlTr. 9615).

474. General Distributors do not report to Holiday Magic, Inc. on the inventory of product that actually reaches the consumer (PangerlTr. 9633).

475. Holiday Magic, Inc. never informed its distributors at what levels sales had to be or in what amounts consumer purchases should be in relation to purchases (PangerlTr. 9635).

476. Holiday Magic's secretary and comptroller doesn't know the relation of inventory to deposits on future sales of Holiday Magic (LipskaTr. 10410).

477. Holiday Magic, Inc. doesn't know the effect of the advertising that they do (LipskaTr. 10396).

478. Holiday Magic, Inc. has no way of determining whether Generals are working with the Masters over whom they receive the 10 percent override (Guard Tr. 1047810487; AlexanderTr. 55305531).

479. Holiday Magic, Inc. doesn't know what percentage of its business is to Master Distributors and what percentage of its business is to General Distributors (LipskaTr. 9257).

480. Holiday Magic, Inc. and its vice president of sales do not know how many active Holiday Girls or Masters there are in the country (HabuaryTr. 6106).

481. Holiday Magic, Inc. doesn't know what percentage of its override payments are at the 10 percent and the 1 percent levels (Tr. 9258).

482. Holiday Magic, Inc. doesn't know and keeps no records of the retail sales of its products at the consumer level (Tr. 1028110282, 10396).

XLVIII. Holiday Magic's Program in Operation Examples of Exploitation and

Deception

483. Hereinafter set forth are excerpts of the testimony of four distributor witnesses with regard to the specific methods used to induce participation in the Holiday Magic program. Regardless of whether the approach is uniformly typical in every instance, the entire operation of the program as heretofore found is conducive to this approach of exploitation and deception for which respondents cannot avoid direct or indirect responsibility.

Marvin McKinnon (Tr. 40554069):

So I walked in there and I sat down. This man bounced up on the stage and he started to talk about how to introduce yourself to people, and in introducing you into the program, and how to make money.

* * * So anyway, he spoke for a long time, like an hour and a half or so and then they had a break and the second half was a different man.

* * * And then this guy he gave all the ways of making the money. The first guy gave a talk about the company, and the second guy gave the spiel on making the money. Then I was enlightened as to what I was seeing. I was seeing a cosmetic company and how to make money.

* * * On the way home, naturally, I just couldn't help saying, 'Jesus, it looks unreal. How can it be possible? Gee, if a guy could just make half that. It really looks easy.'

* * * We went back to the meeting with four other guys. We bounced into the room and we hit the lights and on comes this movie about this man Patrick, and the success, it is there for you, and gee, it was unbelievable.

So then they got this guy up there, Tony Milano, he grabs a piece of chalk, he goes bouncing up on the stage, he says, 'Now, I am going to show you how to make money.' He gets up there and puts a bunch of circles up there. He says, 'This is you,' and he looks right at me.

* * * I peddled milk up and down the streets with him. He said this is my bag, he is talking right to me. After he gets done I see where I can make a hundred thousand dollars a year. I see Tony, he must be making it to give up his milk route.

* * * After the meeting was over, you know, I just admired that guy. I walked up to him out in the hall. I said, 'Tony, I didn't think you could do it. How did you learn all of that?' He says, 'It just comes to you naturally after you learn it.' I said, 'Boy, I'd like to be able to do that.' He says, 'You can.'

* * * so he says, 'Are you going to come into the program?' I said, 'If it is anything what it looks like, how can I stay away?' I said, 'Jeez, it looks great.'

* * * I said, 'Yes, I am going to come into the program.' He says, 'Come in under me.' I said, 'I am going to be in a bind here. Ethically, to be real couth about it, I should come in under the guy that brought me down.' He said, 'Well, do what you want. I can do you a hell of a lot more good than he can do you. I have been in it for four years.'

* * * I gave him the 2,500 bucks and the next day I get a phone call. He said, 'Mac, how would you like to be a general distributor?' So I am naive about this whole program. All I can see is a whole lot of money. So he says to me, 'How would you like to be a general distributor?' I said, 'Jeez, Tony, I didn't think you thought that much of me,' because I knew if you got to be a general you had it made. He said, 'Yes, all you got to do is bring in another 2,500 bucks.' I said, 'Jeez, how in the hell am I going to do it?' He said, 'Don't worry about that. You will get your money back in a short while.' I said, 'Oh, boy, I don't know how I can cut that.' 'Get the 2,500 bucks, come down, I will make you a general.'

Q. Did you give the second 2,500 to Tony Milano?

A. Right.

Q. Did you become a general distributor?

A. Right then and there. I was a general. As far as I was concerned, I was a general.

He went downstairs, he punched out my name on a little round HM bag. I got it at home yet. I paid 5,000 bucks for that baby, made out of plastic.

Ronald McCauley (Tr. 38963981):

When he approached me, he asked me how I was doing. I told him I was doing fine. He said he had a great opportunity and would like me to come to an opportunity meeting where I could make fabulous sums of money in a wholesale franchise business, and I told him that I am not interested in a franchise business at the time.

So the following weekend he approached me again and said that the company he was affiliated with, Holiday Magic, it's a chemical company, and they deal in wholesale distributorships in cosmetics.

* * * I went to the Holiday Magic council, * * * in Southland, Michigan. I went to the basement of the Chrysler Financial Building where they had set up an opportunity room, and they had a cosmetic room and a cafeteria, and on the second floor they had the council offices. When I went to the opportunity meeting, there was a lot of commotion around the door to get into the room and a large table where you had to register. Then after you registered you were asked to go into the room. I went into the room where I would estimate there was maybe 200, 300 people there.

There were Holiday Magic banners which were hung from the walls and a picture of William Penn Patrick * * * [The banners said] Holiday Magic Cosmetics and welcome to Holiday Magic. These were also displayed in the opportunity room.

I was inside the room, and I was seated along with Tom Henderson at my side. The room was quite crowded, and people were standing. At the time I didn't know the gentleman, but it turned out to be Lance Manning, who was assistant to Paul Schultz, the director of the council, got up and asked 'Will all generals and masters leave the room so we have enough seats for our guests?' The generals and masters got up and left the room, and then Lance got up again and said, 'Would all organizers please leave the room for seats for our guests?' At this time Tom Henderson said, 'You have to excuse me. It's like this all the time. I have to leave. Stay seated. When the opportunity meeting is over, I will come back.' I remained seated, and shortly after a woman got up 23, 24 years of age. Her name was Kathy, I don't know her last name. She was one of the local [Master] distributors at the council.

She used an attention getter like 'Hi, everybody.' 'Hi, my name is Kathy. I am with Holiday Magic. What you are about to see tonight is two films, one entitled 'The Holiday Magic Story' and the other one is a film on the opportunity of coming into Holiday Magic.' So she got off the podium, the lights went out, and the film started.

After the two films were over, she then got up and introduced a gentleman by the name of Tony Milano, referred to as the poor milkman. He had a milk route, went to Holiday Magic, and became very successful in his attempts with Holiday Magic.

So he started his chalk talk on basics, the different financial levels that you could buy into this Holiday Magic and the different ways of recruiting people, like a Holiday Girl, organizer, or bringing other masters in, then becoming a general, promoting masters to generals, and your overriding commissions at the time.

After Tony Milano finished his talk, he said 'Thank you very much. At this time I will turn you over to your sponsors.' The door flew open, and they all came running into the room.

I had to literally chase Tom Henderson around for about three weeks just to get my [organizer] onepack.

Then after I got my one pack, he proceeded to ask me about becoming a master distributor. I told him that I could do it by getting loans and that, but presently I want to work as an organizer to get my training, supposedly. So he sent me to these classes, business training they called it, which was exactly the same things as the film. It was a manual put out, step by step, on exactly what this film was about, the four positions of Holiday Magic, the financial levels.

[a week later] we went back into the council in the basement again, * * * We sat in at the opportunity meeting and related what we learned over the weekend to the film and the different closing techniques that the people were using in the room at that time.

As I stated before, we talked about the four levels of Holiday Magic and the monies that were involved, how to make a diagram properly, to use the closeout techniques, prices bold circle marks.

The diagram is four levels of Holiday Magic starting with the Holiday Girl, organizer

The technique of using a cloudtype of line around the cost of the diagram had a psychological effect on the person so it was told to me by Dale Manor and Paul Schultz, that it has a tendency to draw away

from the diagram and thus remove the cost away from the person's mind where he will stay at the bold marks on the paper.

Then in March, a date unknown, I did, in fact, meet the Sales Acceleration team, Terry McVey, Kathy Francis, Larry Halt, and Bill Dempsey.

Kathy Francis came in, she talked to me. She said, 'Ron, I understand that you want to become a Master.' I said, 'Yes.' She said 'I know you will be very pleased, that you can do the job. The two other fellows that you will meet are highly successful. They are very dynamic, and you will enjoy the group.'

Kathy took me into another room, which was on the second floor of the Chrysler Financial Building, the council itself, which Larry Halt was in there. He told me to sit down, and the door was shut behind me so Larry and I were in there by ourselves.

We proceeded to discuss the reason, first of all, why do I want to become a master distributor. 'Because,' I told him, 'I was not making great sums of money at an organizer level, and I wanted to become a master where I could make large sums of money.'

Mr. Halt said, 'I don't think you have got the guts to do it,' quote, unquote, and I said, 'I believe I can do it.' I asked him, 'What makes you think that I can't?' He said, 'If I tell you to walk through this wall, would you do it?' I said, 'Why should I?' He said because I done it, and for that reason you should do it.

So he said, 'If I tell you its good, you will do it?' I said, 'All right, if this is the conclusion you drew from it,' because I felt that he knew what he was talking about, and I didn't have any knowledge of exactly what the Sales Acceleration team was about. All I know is I had to pay attention.

Then he smiled, and he said, 'Fine, let's go see Bill Dempsey.'

I walked in and he said, 'Sit down' rather roughly. So I sat down.

*** He said, 'You know, you have got to keep the image of Holiday Magic up.' I said, 'I will do my best to keep the image of Holiday Magic up.' He said, 'You have got to be enthusiastic at all times.' I said, 'I will be enthusiastic at all times.' He said, 'The way you dress, the car you drive, all reflect on Holiday

Magic.' I said, 'In what way do you mean?' He said, 'The suits that you wear, exactly, the suit you are wearing here. Yes, look at the suit you wear valued against what I wear.' I said, 'Yes, well, what's wrong with this here?' He said, 'It's just not the image of Holiday Magic,' the suit that I was wearing. He said, 'What type of car are you driving?' I said, 'Well, I am driving a 1968 Bellaire, Chevrolet Bellaire.' He sort of made an expression with his face as if to say, is that all, or it's pretty cheap. He said, 'What type of car would you like to own?' I said, 'I would like to own a new 1969 Corvette, of course.' He said, 'Why don't you go out and get one? With Holiday Magic, with all the dough you make, you will be able to own any car that you want whether it be a Cadillac or a Corvette.'

He said, 'Will you get that \$2500?' I said, 'Yes, I will get the \$2,500 to become a Master.' He took two large stamps on his desk, one said 'accepted' and one said 'rejected.' He took the 'accepted' one and stamped this paper. Then I was asked to leave the room.

I went to Manufacturers Bank. They wouldn't give me the loan because I had the other outstanding loan when I went organizer.

I will get the money within two or three days and have it over to you.' They said, 'Make sure it is payable to Holiday Magic, Inc., in a cashier's check.'

The question that was posed to me [by Dale Manor] is now that you became a master, how soon do you think you could get your \$2,500 to go general. My reply was, 'As soon as I pay off my debts.'

He stated that I could go out by asking my parents to mortgage their home, cash in my life insurance policies, sell cars, sell my car, dispose of any other properties that I may own, going out and getting, contacting so many people, getting additional money from them. These were the avenues that he suggested.

My response was, again, I feel that I will not, I cannot do this until I pay off the debts that I already owe.

Bill Dempsey and Fred Pape used the large sums of money approach as a closing technique, as an example [in teaching how to close prospects].

This is what they said. Carry large dollar bills in your pockets, hundreds, fifties, and when you approach somebody, let's say, on the street and you know them, you would take out your wallet, like so (indicating), and you would have the money, say, in your wallet with the large bills showing, and your business cards like so (indicating), so it was readily available. He would pull out his business cards and hand it to him and say, 'I am in the franchise business. Why don't you give me a call?' By using this, it is an attention getter, to quote what they said.

* * * * *

The other one is stopping your car in a, on the road and really blocking traffic, as they would say, you see somebody on the curb, again an attention getter, have them get into the car or something. Getting a tape deck put into your car and put a sales orientation tape in it. As you drive to the council meeting, you play this and the person would hear it.

This is what they were talking about and how to overcome objections or boomerang the question back or the suggestive nodding of the head.

I told them that I couldn't even pay for the debts incurred now to become a master, let alone get another \$2,500 to go general. They posed that old question, 'if your life depended on a \$5,000 operation, would you, in fact, get this \$5,000?' I said, 'Yes.' They said, 'Then, believe me, your future depends on this. You go out and get the \$2,500 to go general.'

I met with them one week later. They gave me an alternative of one week or I would be out of Holiday Magic.

Jane McCrory (Tr. 10801136):

During the month of August, 1965 opportunity meetings were being presentat at the Eugene Hotel * * * There was a large blackboard. There was a canned speech of the opportunity meeting presented. There was a film presented. There was an opportunity to use the makeup. And then there was a coffee time when we could sit about a table * * * and * * * ask additional questions.

* * * All four positions of the Holiday Magic organization were presented. A Holiday Girl was told and explained. That was the lowest position of Holiday Magic. The Holiday Girl paid \$31 for her kit at that time and would earn a thirty per cent commission for selling the cosmetic.

* * * The next position was the Organizer, that cost \$60 and the Organizer had the right to hire Holiday Girls to work under him. If he had a good Holiday Girl and she was able to sell a lot of cosmetics, he, of course, got a percentage of that.

The next line was the mastership and a master could hire both organizers and Holiday Girls. The master also had a right to buy directly from the company at a 55 percent discount.

We all wanted to become a general, then we could buy the cosmetics at a 65% discount. The general, of course, bought directly from the company, and they, in turn, got new masters, new organizers, and new Holiday Girls. And the way that a person could make money was by bringing in new masters and new generals, this was the way. And to become a general, you had to replace yourself as a master, you had to bring in a new master before you could become a general.

This was the way I had hoped to become a wealthy woman. I never wanted to retail cosmetics. I hoped that I could hire enough organizers and other people under me that there would be enough turnover in the cosmetic business that I would never have to retail it.

* * * In order to become a General, one had already, one was already a master, they had already put \$2,500 into the company. When they wished to become a general, they had to obtain another master to replace themselves. They had to put in an additional \$2,500.

* * * * *

Q. How did you expect to make money?

A. Because of bringing in other masters and creating a line for myself * * * You got a cut from everyone, you see, that was underneath your own line * * * And those above me got a cut from everyone who was under me also, so the top person was just always getting money.

* * * I met Mr. Bailey several times * * * One thing in particular that I remember that he did, there was a large group attending this opportunity meeting * * * and I had taken several people, and after Mr. Bailey got up and told what a wonderful opportunity Holiday Magic was he pulled out a huge roll of currency out of his pants' pocket and ended his speech this way, walking down the aisle and stating, * * * 'If you people are contented to make a average salary such as you are now when you can make money like this,' and then showing this huge roll of bills, 'why, then be that satisfied, but for me, I want to make this kind of money.' So it was certainly, and I've never forgotten that, and I thought, well, that's just about, well, what he was trying to say, well, you're peons, and look at me, I am such a big person. I thought it was disgusting and out of order and it was just one more little thing that I disliked about Holiday Magic to have executives of that type that would do such a trick.

* * * the cosmetic is very good, but the program was what interested me. They had the idea that you could make money off of other people's efforts, which at the time was very interesting. To me now it is very morally wrong to make money in this way. I am ashamed that I ever even thought of it in the first place or would allow myself to do it, but at the time I would admit that I was as guilty of it as anybody else. I thought it was a wonderful opportunity to make a lot of money for myself, and I'd never do it again.

George Shephard (Tr. 19051950):

We had two or three meetings and created a lot of interest in Eugene immediately, and Fred was there and gave, Fred Pape was there and gave opportunity meetings, gave two or three, as I remember, the first week. He came back to San Francisco and went back the following week, I believe it was, when we became general distributors, and we had two people who were going to master at that time. And the way the program works, you have to replace yourself to be a general distributor, and then the next one either goes to the general or your general and keeps him. And I don't remember what the percentages were, but it is beneficial to go general if you are going to have an organization of any size.

* * * We brought Pearson in, the number one reason was to give opportunity meetings, because I was associated in other business with him. The way it wound up was that Pat would do the training after we signed them up. Dave would give the opportunity meeting, and I would work on signing him up. The only opportunity meetings I ever gave was when I went out of town or was by myself, or was put in a position where I had to give an opportunity meeting.

* * * We had opportunity meetings in Eugene, and we had, through the direction of Mr. Pape, set up offices and opportunity meetings at that Eugene hotel, and that's where we did all of our training and our recruiting, our organizing, everything was done at the Eugene Hotel. We had offices on the second floor, and we held all of our meetings in the meeting rooms downstairs.

The people in the organization, on a whole, were not successful in the program, and I could not go out and look these people in the eye and keep trying to work with them because there were many problems. They were not as successful as they thought they were going to be, and we had lots of problems in Eugene with organizers and Holiday Girls because of the size of our organization, and we just had a lot of problems in our office.

Well, the first problem that came up immediately, and we kind of ironed that out, but it became more of a problem when outsiders would come into the territory, and I mean outsiders like if someone, say, in Seattle came down and signed someone up in Eugene, and we were not aware of it, then, first of all, we had problems immediately with the beauty shops * * *

Say we had probably fifteen people at our first meeting, and by the end of the week when we gave meetings, during the week, that first week, say, we had twentyfive or thirty people in the organization, and they were all out calling on the twentyfive or thirty beauty shops, and we got complaints and calls from this, and so we ironed this problem out right away and we deleted that from our program, except they still read it in the book, but we had other problems.

* * * A good example would be that a person by the name of Hackett from San Francisco signed up some of his relatives up in Eugene, and they went out and called on these beauty shops, like it says you can, and then again these beauty shops called us and said, 'look, we told you not to call on us anymore,' not that some of them weren't already taking the product, they just got tired of all the different salesmen coming in, and then towards the end we had at one time about a hundred and fortyfive organizers, because there was that many at a training meeting that we had at the Eugene Hotel, and we

had a population of I think around 75,000 at that time, and we had problems recruiting because of the amount of people. They would see this amount of people, and I think this is the reason people like my brother went to Montreal, and Dave Shulda, for instance, another example on that, Dave Shulda and Dick Tarton, they would not master until they got all of their affairs in shape, so they would go to Hartford, Connecticut.

Q. You mentioned you had 145 organizers. Do you know where these organizers were operating?

A. Well, most of them were in the Eugene area. It was a training meeting that we had in Eugene. I say organizers, that's the people that were at that particular training session, it could be some master distributors there, general distributors and organizers. There were no Holiday girls there, as such.

I was their general distributor, and I knew how much they were buying, so I knew that they couldn't make a living at it, and so many people are unable to recruit, well, some people can recruit and some can't, but they looked at our organization, which was big, and they thought we were very successful because of the way we portrayed it, which after a while they thought was deceiving and all of these things together just made it a bad situation for me to go out and talk to somebody, because a lot of them were my friends.

We set up our offices in the hotel, and we put on every air that we could of being successful, which wasn't necessary, because we were signing a lot of people and we were rotating a lot of money, you see. And other people just were not capable, I only knew, at that time, three or four other people in Holiday Magic that had an organization that was turning that kind of money, but yet you portrayed the idea that this was possible, which it is possible.

Well, in six months, from March 1st to October 31st, our gross sales or gross income was \$52,000. The net on that figure was sixty, and so what I am saying is we turned a lot of money, but it didn't stick because of rent at the hotel that was almost eighteen hundred dollars, for our offices alone, not including the rooms downstairs.

HEARING EXAMINER BUTTLE: How many people did you have in your organization?

THE WITNESS: About 45 masters and eight or nine generals. I am not real sure.

CONCLUSIONS

I. Evidentiary and Legal Evaluation of the Inherent Nature of the Marketing

Plan under Counts I and II.

The evidence established by complaint counsel and in accordance with the findings herein, indicates conclusively that initially and thereafter the respondent Holiday Magic's program emotionally impressed and lured a substantial number of unsuspecting participants into believing that efforts at unlimited recruiting of distributors horizontally as well as vertically without regard to product market flow to the consumer level consistent with the number of distributorships would afford bountiful wealth if they were sufficiently inspired, motivated and explicitly adhered to the tenets of the program prescribed by Holiday Magic.

It was true that some participants, particularly after the lure was moderated in a slight degree, subsequent to Federal Trade Commission investigation, entered the program less ambitiously either full or part time and were satisfied with a profit return of less dimensions than appears to have been presented. Nevertheless, this does not justify a marketing device similar to a lottery inherently deceptive regardless of the satisfaction of some participants with the representations and their results in the program participation. Such satisfaction is not an issue. In fact Holiday Magic's unconscionable program of motivation appears to have been geared to emotionally stimulate and deceive many participants into believing they must acquire a mental attitude of unquestioned adherence and satisfaction with the so-called marketing plan. Some, as a result thereof without apparent justification, testified they were satisfied with their results in relation to the effort they expended. Others recognized the deception because of their admitted failure and testified to the contrary. It is apparent, therefore, that what such witnesses testified to is less significant probatively than a reasonable interpretation of every facet of the entire plan in operation and representations made in its furtherance as documented. This is perhaps a laborious method of evidentiary evaluation. Of the most importance, however, is what the plan is and not how witnesses have characterized it. For example some complaint counsel witnesses conclude the plan to be a 'head hunting' rather than a marketing device and respondents' experts conclude the program is a 'valid marketing plan.' Neither conclusion is particularly enlightening in resolving the issue of the plan's precise nature or the inherency of any deception.

Respondents advocate Holiday Magic is similar to all American business structures in recruiting lower level personnel consistent with sales, the higher levels receiving a larger gross than those at lower levels. The argument overlooks evidence that distributor recruitment both horizontally and vertically was virtually limitless and unrelated to sales or product market flow at the consumer level. This is established conclusively because representatives of Holiday Magic had no information as to what the product market flow was to the consumer level after seven years of operation. Unlimited recruitment horizontally and vertically without attempting to devise a realistic ratio between distributorship recruitment and movement of the product into the hands of consumers, suggests that regardless of some product market flow and the good quality of the product the latter is an incidental device to give plausibility to an endless chain of recruitment and pyramiding of distributorships in the nature of a lottery. Training courses also afforded the same deceptive plausibility to plan under which profit through recruitment exceeded profit through direct sales. In other words a good product, some sales thereof and training courses, devoted essentially to product application, motivation, emotional selling with a view to enticing participants to climb the distributorship ladder of success through the medium of greater recruitment profits is merely a subtle device to obscure the real purpose of the plan to make

large amounts of money through pyramiding recruitments in the nature of a lottery contrary to any reasonable standards of fair trade practice devoid of inherent deception and exploitation.

The inherent unfairness of such schemes in contravention of public policy has been described by the Wisconsin Supreme Court in *Twentieth Century Company v. Quilling*, 130 Wisc. 318, 110 N.W. 173, (1906), at p. 176.

We are unable to regard such a project as a legitimate business enterprise. How large would be the number of purchasers who would be induced by the prospect of large returns for little labor to join the scheme it is impossible to say or even speculate. Each purchaser would be desirous to get back at least as much as he had invested. In order to do this, the first purchaser under the most favorable circumstances would have to sell rights aggregating \$1,000, the second purchaser would have to sell rights aggregating \$2,000, and thus the necessity of finding victims would increase in geometrical progression until the purchasers who are in the tenth place from the original purchaser must, in order merely to reimburse themselves, find others who would pay more than half a million dollars. Of course, it is not likely that the scheme would last so long as this, but however long it lasts, it will infallibly leave a greater or less crowd of dupes at the end with no opportunity to recoup their losses because the bubble had at last burst. It contemplates an endless chain of purchasers, or rather, a series of constantly multiplying endless chains, with nothing but fading rainbows as the reward of those who are unfortunate enough to become purchasers the moment before the collapse of the scheme. While contemplating large gains to the original promoters and early purchasers, it necessarily contemplates losses to the later purchasers; losses increasing in number with the greater success of the scheme.

The Holiday Magic scheme shares exactly the same rationale as the scheme in *Quilling*: In *Holiday Magic*, we have seen that a participant at the General level had invested at least \$2500 in order to become a Master and another \$2500 as a release fee to become a General. By recruiting his first Master, he gets \$500 of the buyin as a 10 percent override, and when this Master goes General he gets the release fee of \$2500 back. He now also has a replacement Master to get to go General, which if he does, will produce a second \$2500 release fee to him or a full return on his investment, merely by recruiting two Generals.

If each purchaser sought only to get his money back by recruitment and nothing more if he limited himself to only two Generals, the plan would work as described in *Quilling*. Each General recruited at lower levels would find that a multitude of two would have to be recruited at each succeeding level a geometric progression with 'two' as the multiplier.

In *HM Distributors of Milwaukee, Inc. v. Dept. of Agriculture*, 198 N.W. 2d 598 (1972) the same Supreme Court of Wisconsin stated, in litigation challenging the Wisconsin Rule prohibiting 'chain distributor schemes,' brought by *Holiday Magic's* Council, that:

The trial court in the case held: 'Schemes which can cause the loss of money and the victimization of third persons clearly fall within the term 'unfair trade practices' * * * The authority granted to the

Department to regulate 'unfair trade practices' was properly exercised within its statutory authority.' We agree, and, as a postscript, repeat what this court, many years ago, [in Quilling] had to say about the chain letter idea used as a trade practice:

* * * the real arrangement was a joint scheme to make money by selling similar nominal territorial rights to others who should also, become parties to rights to still others, and so on. * * *

* * * it will infallibly leave a greater or less crowd of dupes at the end with no opportunity to recoup their losses because the bubble has at last burst. It contemplates an endless chain of purchasers. * * *

Such an enterprise we regard as contrary to public policy and void. * * *

Thus, regardless of disclosure, an endless chain scheme necessarily contemplates exploitation of others and violates elemental considerations of fairness. [FN6]

In *State of New York v. ITM, Inc.*, 275 N.Y.S.2d 303, (1966), the New York State Supreme Court [trial court] had before it a marketing plan like Holiday Magic in that commissions were paid whenever prospects would enroll. The Court said at p. 315:

* * * somewhere along the line, the plan had to fail as a matter of economic feasibility and mathematical certainty. No matter the junction at which this was reached, the number of latest participants would grossly exceed the sum of the participants of all prior rounds. It is patent that by far the greater number of participants could earn no commissions.

This is the vice and quicksand nature of 'endlesschain' transactions. And it is so apparent that the promoters must be charged with knowledge of the fraud inherent in it.

The very scheme itself bears evidence upon its face that it is a fraud and a snare, and yet so cunningly devised that, in the hands of a sharp, shrewd, and designing man, hundreds of the unwary have been defrauded; and the courts should set their seal of condemnation upon it, and pronounce it, as it is, a contract void on the ground of public policy.

While the futility of the 'endlesschain' plan is obvious to the promoters, it is not apparent to the consumer participant. That enrollment within the first four rounds can earn commissions is entirely possible and credible.

Taking the Holiday marketing plan as it has been represented by respondent to prospective distributors at its Opportunity Meeting procedures and how it does work in theory, not as a misrepresentation of the plan but as an accurate description of how the plan can and does operate, we have the following situation: Each distributor recruited into the Marketing scheme as an Organizer in turn recruits five other distributors each month, and so on. This is nothing less than a representation of a geometric progression of five. [FN7] Respondents have drawn it in their manuals for a three month period. It

appears elsewhere herein in their manuals for a three month period. It appears elsewhere herein in the findings. By extending the operation to a twelve month period, we are faced with the following:

Starting point: 'you'

First Month: You + 5

Second Month: You + 25 + 5

Third Month: You + 125 + 25 + 5

Fourth Month: you + 625 + 25 + 5

Fifth Month: You + 3125 + 625 + 25 + 5

Sixth Month: You + 15,625 + 3125 + 625 + 25 + 5

Seventh Month: You + 78,125 + 15,625 + 3125 + 625 + 25 + 5

Eighth Month: You + 390,625 + 78,125 + 15,625 + 3125 + 625 + 25 + 5

Ninth Month: You + 1,953,125 + 390,625 + 78,125 + 15,625 + 3125 + 625 + 25 + 5

Tenth Month: You + 9,765,625 + 1,953,125 + 390,625 + 78,125 + 15,625 + 3125 + 625 + 25 + 5

Eleventh Month: You + 48,828,125 + 9,765,625 + 1,953,125 + 390,625 + 78,125 + 15,625 + 3125 + 625 + 25 + 5

Twelfth Month: You + 244,140,625 + 48,828,125 + 9,765,625 + 1,953,125 + 390,625 + 78,125 + 15,625 + 3125 + 625 + 25 + 5

The distributors recruited as Organizers in the Opportunity Meeting presentation do not remain Organizers for as the plan and the script and all the witnesses pointed out, Organizers who successfully recruited the five Distributors who in turn recruited the twentyfive Distributors had long since become workin Masters automatically and only by virtue of the sale or organizer kits to the new organizers. Therefore, the numbers charted on the above reference are actually Masters and not Organizers, and as such do not buy product from one another. The plan truly depicts geometrical increases at horizontal levels, even for Organizers. But even if they do not automatically become Masters by recruiting Organizers the record shows that one Organizer in four does become a Master.

Although the Holiday Magic Opportunity Meeting presentation of its marketing scheme stops at three months, it is clear that the plan itself doesn't, for someone had to bring another person in previously. A

trace of the distributors at the Master and General level only from the State of Illinois should quickly dispell any arguments that the plan stops or is intended to stop after three months.

The replacement master situation in becoming a General is equally bad, for if we limit the recruitment of a General Distributor to just two Generals, the amount necessary to get their investment back, would require a geometrical progression of 2, which will produce the number of 4,096 Generals at the twelfth month and a grand total of 7,931 at the end of twelve months, and multiples of two thereafter each month, the same ratio as described in Quilling. One factor, of course, as described in Quilling is the amount of the investment required, and for the Master level it is \$4500, so that there is a resulting total of \$9,000 per General Distributor, or \$66,519,000 after one year from 'just' two Distributors per General (not even two per month).

In *Fabian v. United States*, 358 F.2d 187 (8th Cir. 1966), involving mail fraud prosecution, the Court dealt with a referral selling plan of stereo equipment which it described as follows at pp. 189190:

Each stereo purchaser would receive an 'Owner's Dividend Certificate' which provided that \$15.00 would be paid for the name of each prospective customer (subject to credit qualifications), who agreed to a sales demonstration, regardless of whether a sale resulted. In addition, the prospective customer would receive \$5.00 merely for listening to the sales presentation which was not contingent upon the purchase of a set. Customers were informed that they could earn a set by referring twenty-six names, which could be submitted over a two year period. Most purchasers understood that there was no limit to the number of names they were allowed to refer, so that all referrals over twenty six would result in profit. The referral plan was represented as a substitute for expensive advertising and a means of introducing the product to the community. Also, customers were told that the sets would later be sold through a retail outlet * * *.

The Court observed in a footnote to its statement that there was evidence that the method of selling was intended as a short term introductory approach only, preliminary to establishing a retail outlet. The Court states at p. 194:

The referral plan cannot succeed even if used for only a short time unless at some point customers subsequent to the first one are not allowed to earn the set. As the Government brought out at the trial, once the plan is set in motion, the referrals spiral due to the principle of geometric progression. If each person who purchases a set can earn it by referring names, no profit will be made; hence, no funds would be available to satisfy referral commitments. The only method of halting the progression is to withhold the referral privilege for customers who were obtained by referral.

This is the simple solution to the problem involving plans capable of expansion by geometric progression. They can be stopped by not permitting the recruits to in turn do the recruiting (or referring). It is not the recruiting that makes this a scheme which can increase geometrically it is recruiting coupled with a passing on of the right to recruit or permitting unlimited geometrical progression or an unlimited universe.

Blachly v. United States, 380 F.2d 665, 5th Cir. (1967), involved another prosecution for violation of the mail fraud statute. The Court pointed out that the plan involved a scheme to defraud even though there may be no specific misrepresentations. 'All that is necessary is that it be a scheme reasonably calculated to deceive persons of ordinary prudence and comprehension [citations omitted].' The Court applied these precepts to the plan and found that as conceived by the parties and as represented to the purchasers, the plan could not possibly work.

With regard to the plan, the Court stated at p. 672:

Representations, both oral and written, were made to prospective purchasers, that the water softener could be acquired by them with 'no cash investment' that through commissions that would be earned by the purchaser as a result of the unlimited referral sales, both original and secondary, it would 'pay for itself' and perhaps make an additional profit. This was a key inducement to the purchaser to submit as many referred names as possible since in theory at least, this would increase his referral commission earnings to achieve the maximum return. Yet only in theory is the scheme the least bit sound. Its operation could achieve success only in a theoretical unlimited universe. The mail fraud statute and inescapably Judges, * * * must deal with the practicalities of the outside business and social world. As a practical matter, the inherent and patent impossibility of such a plan working is plain. [footnote omitted] Its impossibility is manifested by the amazing letterspread potential achieved with each successive step in the referral sequence. The number of references spiral in a geometric progression* so that, as pointed out by the Government, 'In a small city such as Morgan City, in which the defendants operated, not to mention the smaller towns and villages, the saturation point of prospective purchasers of the water softeners would quickly be reached. Relatively few sales of the water softeners would be made and few commissions would indeed be earned by the victims of the scheme.' [Footnote omitted]

In a nutshell, the vice of this referral scheme was two fold. The first was the strong representation, most frequently expressed and always implied, that from the referral commissions the purchaser would not have to pay for the machine being bought and might even make a profit. The second was the demonstratable impossibility of the first being achieved. [footnote omitted] Referral selling schemes like this have been uniformly condemned by the Courts.** Contrary to Blachly's assertions, whether any of the victims of the scheme suffered a material loss is immaterial, for success of the scheme is not essential to completion of the offense. [citations omitted] Thus, although the burden is on the Government to establish the essential elements of the offense, * * * this does not entail or require proving that the victims of the scheme were actually defrauded or that they suffered damage or pecuniary loss. * * *

Besides the inherent impossibility of the Plan, the method used in its execution also serves to condemn this scheme. * * *

The record in the matter at bar is replete with instances of Distributors successful and not successful-bringing scores of persons to Opportunity Meetings, and approaching hundreds more. The multiplier of 15 was found a valid device in Blachly because this was an 'ultra conservative' figure of the number of

references not of the number of participants. It is reasonable therefore, as the Quilling Court pointed out, that:

Any contract which contemplates or necessarily involves the defrauding or victimizing of third persons as its ultimate result must be *contra bonos mores*.

The Supreme Court of the United States approved enjoining such situations in *Public Clearing House v. Coyne*, 194 U.S. 497, 24 S.Ct. 789 (1903) at 796, when it did not even consider it necessary to enter into the details of the plan before it where, as here, success depended upon a constantly increasing number of participants. The Court stated that such schemes are doomed to failure, and added 'Indeed, we think that no scheme of investment which must ultimately and inevitably result in failure can be called a legitimate business enterprise.'

In *State ex rel Turner v. Koscot Interplanetary, Inc.*, 191 N.W. 2d 624 (1971), the Supreme Court of the State of Iowa upheld the constitutionality of its statute outlawing pyramid sales plans and referral selling, such as is employed by Holiday Magic, Inc. in a most emphatic denunciation.

The Court first described the plan that it was confronted with at pp. 627-628 as follows:

An examination of the Koscot program discloses it is fundamentally a sugar coated merchandise sales plan.

A 'beauty advisor' initially pays \$10 and for this receives her 'starter kit' of Koscot products to be refurbished as required. Any person buying in as a 'supervisor' remits \$2000 for which he receives \$1500 worth of cosmetics and \$500 hair fashions, retail value. A distributor pays \$5000 for which an opening Koscot inventory is supplied.

Those buying in at each of the above three levels are, of course, expected to sell Koscot products to others.

As a merchandise sales inducement, Koscot promotes a 'get rich quick' position scheme. Under this arrangement defendants have been and are selling merchandise and positions to many residents in Iowa.

Product sales and the selling of positions are effected via use of the aforesaid 'multilevel distributorship-supervisor pyramid sales techniques' through which individuals considering position purchases are induced to buy upon the assurance that once 'bought in' they will have the right to bring or refer other prospective merchandise position buyers to the company and receive payment from Koscot for each such referral.

Product and position sales are advanced through the use of what defendants term 'golden Opportunity Meetings' where local distributors present the Koscot sales and distributorship supervisor program to individuals who have evidenced an interest in buying a merchandising job. The presentation procedure

used at these meetings ordinarily follows quite closely that contained in the sales pitches set forth in Koscot's publication, identified as 'The Distributor's Training Manual.'

Sales presentations are there usually made to prospective customers brought by other individuals who have already purchased, either as a 'supervisor' or 'distributor', because they have been orally promised payment, as aforesaid, for each like position sold on referral. Koscot strongly recommends all presentations at local 'Golden Opportunity Meetings' be in accord with the written procedures contained in the manual.

Under the sales program employed by defendants every new supervisor or distributor must be referred or sponsored by an existing position holder. When a prospect referred to Koscot later buys in, the referring party is promised a portion of the amount paid by such purchasing party. Newly obtained supervisors and distributors are required to initially pay \$2000 and \$5000 respectively.

More specifically, as best we can determine, the reimbursement to a supervisor referring another individual, who in turn buys a supervisor post, is \$500 out of the new member's \$2000 purchase price. Payment to a distributor who refers another buying individual into Koscot as a supervisor is \$500 out of the new member's \$2000 payment, plus a ten percent override commission, making a total of \$700 to be received by a distributor for securing an additional supervisor. When a distributor has sponsored a supervisor into the company and the new supervisor later purchases a distributor's position for an additional \$3000, the fee then paid to the referring distributor is \$1950. Since a supervisor must replace himself before buying up to a distributorship, the referring party will receive an additional \$200 whenever the sponsored supervisor finds a replacement.

There are other intricate referral payment incentives involved but the foregoing will instantly suffice.

In brief, the sales pitch employed by defendants discloses, individuals are induced to buy into their program through use of the foregoing presentation, with an attendant glowing assurance that the prospect can easily earn \$34,000 each year merely by obtaining other Koscot merchandise and position purchasers.

The written contract between Koscot and those who buy does not, as aforesaid, include any part of the promised payment for securing additional supervisors or distributors.

When an individual buys in as supervisor or distributor he must make payment by certified or bank check payable and always delivered to Koscot. All remittances to referring position holders, supra, are made from Koscot's Florida offices.

Merely by substituting Koscot for Holiday Magic, Beauty Advisor for Holiday Girl, Supervisor for Master, Distributor for General, and Golden Opportunity Meeting for Opportunity Meeting and except for the dollar differences, one is instantly presented with similarity to the Holiday Magic plan.

The Court continued at pp. 630632:

Although the term 'fraudulent conduct' is not subject to a precise definition, it does include 'referral' or 'pyramid' sales arrangements by which people are induced to buy upon the representation they can reduce or recover their purchase price, or earn untold profits by referring other buying prospects to the seller. [citations omitted]

Despite the thinly veiled cloak of respectability with which Koscot has attempted to clothe its pyramidal merchandise sales promotion scheme, the badge of fraud clearly shows through.

[T]he Act, in effect, makes such sales unlawful, per se regardless of any contract terms between seller and buyer.

Unquestionably the legislature thereby intended to protect the public against unscrupulous and deceptive merchandise selling practices. More specifically the legislative purpose was to, among other things, brand all pyramiding referral merchandise sales schemes as a cancerous vice against which the public should be protected and for that reason suppressed.

A per se approach based on inherent deception to pyramid selling such as that engaged in by Holiday Magic, Inc. has been adopted by a number of states, among them the following:

Minnesota.

Minnesota Laws of 1971, s 325.79, Subd. 2(2)(a) provides:

With respect to any sale or lease, it shall be illegal for any seller of lessor to operate or attempt to operate any plans or operations for the disposal or distribution of property or franchise or both whereby a participant gives or agrees to give a valuable consideration for the chance to receive something of value for inducing one or more additional persons to give a valuable consideration in order to participate in the plan or operation, or for the chance to receive something of value when a person induced by the participant induces a new participant to give such valuable consideration including such plans known as chain referrals, pyramid sales, or multilevel sales distributorships.

California.

Penal Code s 327:

Every person who contrives, prepares, sets up, proposes, or operates any endless chain is guilty of a misdemeanor. As used in this section, an 'endless chain' means any scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant. Compensation, as used in this section, does not mean or include payment based upon sales made to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme.

Wisconsin.

Chapter Ag. 122: CHAIN DISTRIBUTOR SCHEMES:

Ag. 122.01. Unfair trade practice. The promotional use of a chain distributor scheme in connection with the solicitation of business investment from members of the public is an unfair trade practice under section 100. Wis. Stats. When so used the scheme serves as a lure to improvident and uneconomical investment. Many small investors lack commercial expertise and anticipate unrealistic profits through use of the chance to further perpetuate a chain of distributors, without regard to actual market conditions affecting further distribution and sale of the property purchased by them or its market acceptance by final users or consumers. Substantial economic losses to participating distributors have occurred and will inevitably occur by reason of their reliance on perpetuation of the chain distributor scheme as a source of profit.

Ag. 122.02. Definitions. (1) 'Chain distributor scheme' is a sales device whereby a person, upon a condition that he make an investment, is granted a license or right to recruit for profit one or more additional persons who are also granted such license or right upon condition of making an investment and may further perpetuate the chain of persons who are granted such license or right upon such condition. A limitation as to the number of persons who may participate, or the presence of additional conditions affecting eligibility for the above license or right to recruit or the receipt of profits therefrom, does not change the identity of the scheme as a chain distributor scheme.

(2) 'Investment' is any acquisition, for a consideration other than personal services, of personal property, tangible or intangible, for profit or business purposes, and includes, without limitation, franchises, business opportunities and services. It does not include real estate, securities registered under chapter 551, Wis. Stats., or sales demonstration equipment and materials furnished at cost for use in making sales and not for resale.

(3) 'Person' includes partnership, corporations and associations.

Ag. 122.03. Prohibition. No person shall promote, offer or grant participation in a chain distributor scheme.

Ag. 122.04. Statutory exemption. This chapter does not apply to banks, savings and loan associations, insurance companies and public utilities to the extent exempted from department regulations under section 93.01(13), Wis. Stats.

Effective April 1, 1970.

Virginia.

Title 59.1

Chapter 4

s 59.167.1. Pyramid promotional schemes; misdemeanor; definitions.

Every person who contrives, prepares, sets up, operates, advertises or promotes any pyramid promotional scheme shall be guilty of a misdemeanor.

For the purpose of this section:

- (a) 'Pyramid promotional scheme' means any program utilizing a pyramid or chain process by which a participant gives a valuable consideration for the opportunity to receive compensation or things of value in return for inducing other persons to become participants in the program;
- (b) 'Compensation' does not mean payment based on sales of goods or services to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme; and
- (c) 'Promoter' shall mean inducing one or more other persons to become a participant (1970, c. 750).

s 59.167.2. Same; contracts void.

All contracts and agreements, now existing or hereafter formed, whereof the whole or any part of the consideration is given for the right to participate in pyramid promotional scheme programs, are against public policy, void and unenforceable. (1970, c. 750.1)

s 59.167.3. Same; injunction

Any Commonwealth's attorney may petition a court of competent jurisdiction to enjoin the further prosecution of any pyramid promotional scheme as defined in s 59.167.1, and to appoint receivers to secure and distribute in an equitable manner any assets received by any participant as a result of such scheme, any such distribution to effect reimbursement, to the extent possible, for uncompensated payments made to become a participant in the scheme. The procedure in any such suit shall be similar to the procedure in other suits for equitable relief, except that no bond shall be required upon the granting of either a temporary or permanent injunction therein. Any person who organizes an endless

chain scheme and, either directly or through an agent, promotes such scheme within the Commonwealth shall be deemed subject to the personal jurisdiction of such court of competent jurisdiction under chapter 4.1 (s 8 81.1 et seq.) of Title 8, and shall be liable for reasonable costs and attorney's fees in such suit. (1970, c. 450).

Iowa.

Section 713.24(2b), 1971 Code:

The advertisement for sale, lease or rent, or the actual sale, lease, or rental of any merchandise at a price or with a rebate or payment or other consideration to the purchaser which is contingent upon the procurement of prospective customers provided by the purchaser, or the procurement of sales, leases, or rentals to persons suggested by the purchaser, is declared to be an unlawful practice rendering and obligation incurred by the buyer in connection therewith, completely void and a nullity. The rights and obligations of any contract relating to such contingent price, rebate, or payment shall be interdependent and inservable from the rights and obligations relating to the sale, lease, or rental.

There is nothing profound or unique in the concept of an inherently fraudulent practice, and the Federal Trade Commission in an advisory opinion in 1967 recognized this. The public record states only that:

The Manufacturer proposed to appoint as independent distributors such persons as would buy the requisite amount of inventory. Initial sales to such distributors would be at 33 1/3 % off the manufacturer's suggested prices for his products. Incentive bonuses, computed at from 5% to 60% of the value of their purchases, increasing as the value of purchases increased, would be paid from time to time to the distributors. Distributors would be encouraged to recruit additional distributors who would also make a capital investment in inventory. A recruiting distributor would be given a 10% to 12% override on the dollar volume of purchases of any distributor whom he had recruited.

On these given facts, the recruiting distributor makes money eventually on persons that he has recruited, unlike Holiday Magic, where the Distributor makes money on persons he recruited as well as the persons recruited by persons that he in turn recruited, ad infinitum.

The Commission was of the view that the plan aforesaid would violate Section 5:

The marketing plan is not primarily designed as an offer to knowledgeable businessmen, competent to weigh and evaluate commercial risks. It is designed, rather, to appeal to uninformed members of the general public, unaware of and unadvised of the true nature of the risks run persons with limited capital who are led to part with that capital by promise and hopes which are seldom, if ever, fulfilled. A particular vice of the plan is that part which provides override bonuses for recruited distributors. Implicit in such an arrangement is the promise, rarely if ever kept, that the recruiting distributor can, without himself working, profit greatly from the work of others.

The Commission also stated with respect to price discrimination that:

because of the nature of the plan it was almost inevitable that every wide differences in prices would be charged customers, some of whom would, by reasonable assumption, be competitive with others. These differences would be so great that the anticompetitive effects made unlawful by the amended Clayton Act would almost certainly follow. (Advisory Opinion No. 155.) [72 F.T.C. 1057.]

The authority of the Commission to prevent lottery methods of merchandising in interstate commerce is well established. In addition to direct action against such practices, the Commission can also prohibit the distribution in interstate commerce of punchboards and other devices intended to aid and encourage merchandising by gambling and has done so under the finding of 'lottery,' as per se unlawful.

Modernistic Candies, Inc., et al. v. FTC, 145 F.2d 454 (7th Cir. 1944); Deer, et al. v. FTC, 152 F.2d 65 (2nd Cir., 1945); Chas. A. Brewer and Sons v. FTC, 158 F.2d 74 (6th Cir., 1946); FTC v. R. F. Keppel & Bros., Inc., 291 U.S. (1934).

Normally, and in the earlier interpretations of a 'lottery,' violation of Section 5 of the Federal Trade Commission Act by means of lottery methods of merchandising depended upon proof the elements of consideration, chance and prize. If any of these three elements was lacking, the plan was not considered a 'lottery,' and the action would fail. Cf. United States v. Rosenblum, 121 F. 180 (2nd Cir., 1903). It appears, however, that the courts are now permitting the Commission to extend its jurisdiction over methods of merchandising in which all of the above three elements of the classical definition of a lottery may not be present. Under this judicial extension of what has been declared to be the public policy of the United States against marketing goods by taking advantage of the consumer's propensity to take a chance, * * * a device calculated to appeal to gambling instincts may be a violation of Section 5 even though technically not a lottery. Gerson v. FTC, 325 F.2d 93 (7th Cir., 1963); J. C. Martin Corp. v. FTC, 346 F.2d 147 (3rd Cir., 1965); Bear Sales Co., Docket No. 8627 (1965) [68 F.T.C. 37].

Accordingly, the marketing plan of Holiday Magic must be interpreted to be a violation of Section 5 as a device calculated to appeal to the gambling instinct or prospective businessmen (customers). Whether it is merchandising by the classical lottery situation, or through a more sophisticated appeal to the gambling instincts in man, which this Complaint terms in the nature of a lottery, such merchandising is still subject to the same deceptive standards which the courts have heretofore declared to be illegal. [FN8] There has been no recognition by the Commission or the courts of any change in the moral climate of the business community in this respect. Dandy Products Inc. v. FTC, 332 F.2d 985 (7th Cir., 1964) cert. denied, 379 U.S. 961 (1965); Bear Sales Co., Docket No. 8627 (1965) [supra].

Even in Marco Sales Corp. v. FTC, 453 F.2d 1 (2d Cir., 1971) in which the Court remanded a lottery case to the Commission for explanation as to why the case was proceeded against by cease and desist order when the Commission at the same time seemed to be regulating games of chance, at least in the retail grocery and gasoline industries, the Court understood and commented that the basic proposition of a lottery as being unlawful is supported by all Courts of Appeal, and that such decisions are largely the business of the Federal Trade Commission

It was concerned, however, because it seemed the punchboard situation in Marco, costing only 39 cents, was not materially different from games of chance, which are not lotteries because the element of consideration is absent.

The three elements of a lottery; prize, consideration and chance are present in the case at bar. Nothing more is needed, and all three elements constitute a lottery.

A. Prize

The prizes in the Holiday Magic plan are the overrides and commission, discounts, finders fees, release fees and refunds which Distributors receive from other Distributors and from the company. The prize, however determined, is there. If based upon legitimate business effort and not lot or luck, the element of 'chance' will fail.

B. Consideration

Consideration is present in the amount of money paid in by the various levels of Distributors initially, and as part of the plan continually, whether for product or otherwise.

C. Chance

The element of chance is present in abundance in the Holiday Magic scheme. It is the lure of an uncertain prize over which the participant has little or no control that essentially attracts the consideration for the involvement in the Holiday Magic marketing plan and its monetary prizes, rather than the opportunity to enter into a business of distribution of cosmetics. We have seen respondents' expert witness on motivation draw a distinction between marketing factors in the Holiday Magic scheme for a prospective Distributor, and the prospective salesman in other fields. The circumstances that the superficial attributes of classic lottery schemes, e.g., pull tabs, punchboards, drawings, etc., are not present should not serve as a distraction from fundamentals. One of the earliest cases concerning the type of selling activities which constitute an unlawful lottery was *Public Clearing House v. Coyne*, 194 U.S. 497 (1904). In that case defendant was a fiscal agent for an organization in which each member, on joining, paid a \$300 enrollment fee and agreed to pay \$1 per month for five years and to cooperate by inducing others to become members. Under the plan the member was to receive a pro rata share of the total amount realized from all enrollments at the date he was entitled to a realization (less 10 percent which was to be retained by the defendant) based upon a table of growth rates. For example, if the fund grew at the rate of 15 to 1 the total realization of the member at the end of five years would be at the same rate of increase, i.e., he would receive \$900 for his \$60 paid in; if the growth rate was 10 to 1, he would receive his money back less 10 percent. Thus, the amount of money paid to a member was dependent upon the payments of new members recruited as well as upon the payments of members who would drop out before the end of five years and whose money would remain in the fund.

Implicit in the scheme was its pyramid nature since a member could not expect to break even unless the number of new members expanded beyond the number of old members. As membership telescoped away from an old member, his control and participation in the recruiting process waned. In these circumstances, the Supreme Court found that chance permeated the entire plan since the amount of return depends so largely, and indeed almost wholly, upon conditions which the member is unable to control. The plan was, therefore, held to be a lottery.

The Supreme Court in *Coyne* decided that the key to chance in the lottery need not be that which is normally thought of as a lottery, at p. 512:

That they were not engaged in conducting a lottery in the sense in which that word is ordinarily used is entirely clear, since this involves fixed prizes and the allotment of the prizes to the holder of numbered tickets which are drawn from a box. In such case the word lot or chance attaches only to the name or number of the ticket drawn, and not to the amount of the prize, but the statute covers any scheme for the distribution of money by lot or chance, * * * as defined by Webster, is meant 'something that befalls, as the result of unknown or unconsidered forces; the issue of uncertain conditions; an event not calculated upon; an unexpected occurrence, a happening; accident, fortuity, casualty.'

And the Supreme Court held:

We do not consider it necessary to enter into the details of the plan, which is a somewhat complicated one, and the success of which obviously depended upon constantly and rapidly increasing the number of subscribers or cooperators. The only money paid in was a small enrollment fee of three dollars and a monthly payment of one dollar for five years. The return to the subscribing member, which is called a realization, is not only uncertain in its amount, but depends largely upon the number of new members each subscriber is able to secure, as well as the number of members which his cooperators are able to secure. The return to members who have been able to secure a large number of other members, and to pay their own monthly dues, may be very large in comparison with the amount paid in, but the amount of such return depends so largely, and indeed almost wholly, upon conditions which the member is unable to control, that we think it fulfills all the conditions of a distribution of money by chance.

Holiday Magic's plan works the same way. The General Distributor gets a return in the recruiting activities of his Masters, their replacements and their replacements recruiting activities, ad infinitum. The return is not limited to profit from the sale of products. Overrides and release fees are the prizes inherent in Holiday Magic's lottery.

For example, if General 'A' recruits Master 'B' and 'B' wants to become a General, he recruits Master 'C,' and Master 'C' recruits Master 'D,' etc. each time one of these becomes a General, General A gets the release fee of \$2500 to \$4500.

Not only does General A get the release fee every time the Master who brought in a replacement Master goes General, but he gets override of 10 percent on their purchases as Masters, and 1 percent

on their purchases as Generals, as well as 1 percent on the purchases of other Masters in the old replacement Masters organization.

The rationale of Coyne was the basis for a decision by the Tenth Circuit in *Zebelman v. United States*, 339 F.2d 484 (10th Cir. 1964). In that case, upon purchasing an automobile, the buyer could become an 'automobile owner representative.' The purchaser could then submit by letter to defendant Zebelman the names of persons whom the original purchaser considered to be prospective buyers and who might be induced or persuaded to become participants. For each one of the persons whose name was submitted, and who purchased an auto and became a participant, the defendant was to pay the original purchaser \$100 in cash. Defendant was also to pay the original purchaser \$50 in cash for each person whose name was submitted by the new participant and who purchased an auto and became a participant himself. The court said:

It may be conceded that the original purchaser has control over the payment of the \$100 since, to get it, he must submit the name of a person who will purchase an automobile and become a participant in the scheme. Because he can control this phase of the scheme, the receipt of the \$100 is not dependent upon chance. But as the original purchaser has no control over the payment of receipt of the \$50 since it is the person whose name he submits who must locate another buyer. Insofar as the original purchaser is concerned, the procuring of this buyer is dependent, at least in part, upon chance and by the terms of the [mail lottery] statute that is all that is needed.' 339 F.2d at 486.

The most common type of twolevel referral plan is the situation in which the seller offers to pay the buyer an additional sum of money for each sale made to the second level of prospective customers. Not only does the buyer take all the chances under the first level of the plan, but assuming the second level is reached, the original buyer must rely upon blind chance with respect to the number of names referred to the seller and/or the number of sales that result from such referrals. At that point he most likely has no knowledge as to who, if anyone, is being referred and thus any remaining influence over his ultimate earnings is nonexistent. Such a twolevel referral plan was held to be lottery in violation of the mail fraud statute (18 U.S.C. §1302) in *Zebelman*.

The Holiday Magic Scheme easily fits the mold of a twolevel referral plan. General 'A' recruits Master 'B' and Master 'B' becomes a General and gives 'B' to 'A' so that when 'C' becomes a General, he pockets a release fee plus the accumulated 10 percent override. The twolevel referral continues when 'D,' who was recruited by 'C' becomes a General.

A fortiori, a third or fourth level referral selling scheme, which is also part of the Holiday Magic marketing plan, is indefensible.

In *Sherwood & Roberts Yakima, Inc. v. Leach*, 409 F.2d 160 Wash., (1965) appliances were sold at inflated prices, but the purchaser received the privilege of referring potential customers to the seller. The seller promised to pay \$100 for each sale to a prospect whose name was submitted to whom the seller's salesman made a presentation. The purchaser was also to send a card to each prospect he selected,

stating 'a friend will call about a fabulous program,' but did not describe the program. The Washington State lottery statute prohibited lotteries defined as:

* * * a scheme for the distribution of money or property by chance, among persons who have paid or agreed to pay a valuable consideration for the chance, whether it shall be called a lottery, raffle, gift enterprise, or by any other name * * *

And the court held that the scheme did indeed constitute a lottery:

Assuming that respondents in fact used skill or judgment in selecting the referrals, the trial court properly held that chance permeates the entire scheme. The court found that [those respondent] took a chance that the referrals might not be interested; that the salesman might not adequately make his presentation; that the referral might have already been referred by someone else; that the market might be saturated; and that the salesman might not even contact the referral. In addition, the trial court noted that [those responding] have not control over the general operation after they gave the names of referrals. In fact, respondents were told not to contact the referrals before * * * salesman made his presentation, and respondents were told to emphasize the moneymaking program in case the referrals contacted them.

It is inherent in referral selling that purchasers such as respondents be without control. Sooner or later, the market, unknowingly to the purchasers, will become saturated. This principle is the same as in the chain letter scheme. The case at hand is a classic example.

This decision was cited as persuasive in *Commonwealth v. Allen*, 404 S.W. 2d 464 (Ky. 1966). The scheme was almost identical to the one in *Leach*, and the Kentucky lottery statute was likewise almost identical to Washington's.

Two months after the *Allen* decision, a New York State Supreme Court, decided *State by Lefkowitz v. ITM, Inc.*, 275 N.Y.S. 2d 303, involving a scheme virtually identical to those in *Leach* and *Allen*. In holding that the scheme constituted a lottery under New York law (virtually identical to the Washington statute), the court cited *Leach*, *supra*, and *Public Clearing House v. Coyne*, *supra*. The New York court made clear what is found objectionable about the scheme in its discussion of the fraud aspects of the case:

Depending on the size of the sales force available to respondents, and the territory available to them, somewhere along the line, the plan had to fail as a matter of economic feasibility and mathematical certainty. No matter the junction at which this was reached, the number of latest participants would grossly exceed the sum of the participants of all prior rounds. It is patent that by far the greater number of participants could earn no commissions.

This is the vice and quicksand nature of 'endless chain' transaction * * *. [emphasis added]

Respondents in the case at bar have promulgated a scheme which has all the earmarks of a lottery, as exemplified by the above cited cases. Potential customers are lured to 'opportunity meetings' by the promise of vast profits. The manner in which these profits are to be made is left unspecified until the potential customer is actually present at the 'opportunity meeting.' Then a pitchman delivers a carefully designed presentation, prepared by Holiday, Magic, Inc. If a customer buys in at any level, he or she is urged to obtain other prospects, is given financial rewards for bringing others into the organization and the Distributor who recruited the man receives additional rewards on the latter's recruitment.

At the level of General, which a customer may reach by paying a consideration of from \$5,000 to \$9,000, the participant receives a financial prize for every Master introduced by a Master under his sponsorship. Thus the question as to whether or not a General will make a profit from the recruiting, sponsorship or 'closing' of new Masters is not within the control of the individual General, but is a product of chance. Often his own recruits are recruited and closed by the corporation.

No participant at any level can accurately assess the degree of saturation of a given geographic area, either for products or distributorships. Yet it is obvious that a given area can only produce a finite amount of capital funds with which to purchase products or distributorships.

The question of who recoups outlays of capital funds, who receives more than the original investment, and who loses all or part of the original investment is decided by the chance considerations and not simply the judgment and skill of the participant.

To have a chance of success, a participant must have two skills: (1) The ability to persuade people to buy Holiday Magic products and sign Holiday Magic marketing contracts; and (2) The ability to select solvent people who are able to effectively exercise, or can be trained to effectively exercise skills (1) and (2). Even a person who possesses these skills to an extraordinary degree can and will fail if the market to which he has access is eventually saturated, or if through unlimited progression the persons he brings in do not possess the skill of recruiting or finding others who possess the recruiting skill, and he has no way of determining whether it is saturated when he becomes a participant. The Holiday Magic marketing plan is thus 'permeated with chance' and is in the nature of a lottery.

The evils of endless chain selling schemes have long been recognized. In *Twentieth Century Co. v. Quilling*, 130 Wisc. 318, 110 N.W. 174 (1906), which involved a scheme in which territorial rights to sell a product were sold to persons who would in turn sell similar territorial rights to others, and so on ad infinitum, the court observed at p. 176 that the endless chain mechanism ' * * * necessarily involved the defrauding or victimizing of third parties as its ultimate result * * * ' and declared it to be contrary to public policy. A similar scheme was held to be a lottery in *Kent v. City of Chicago*, 301 Ill. App. 312, 22 N.E. 2d 799 (1939), where the court announced at p. 801:

* * * the controlling fact in the determination of whether a given scheme or business is a lottery is determined by the nature of the appeal which the business makes to secure the patronage of its customers. If the controlling inducement is the lure of an uncertain prize, then the business is a lottery.

Examination of the Holiday Magic Opportunity Meeting scripts, six enrollments, and Opportunity Meeting movies is convincing that the nature of the appeal in Holiday Magic is that money is to be made on the efforts of others in recruitment and/or on product selling which disguises unlimited recruiting as the real medium for extensive profit until oversaturation itself destroys the so-called marketing plan contrary to the usual manner in which a legitimate business usually expands where there is a ratio consistency between the number of distributorships and product market flow to the consumer.

Chain referral schemes which differ from the scheme described in the Quilling case only in that additional participants are recruited by the scheme's sponsors instead of by the participants, have also been held to be lotteries. *Sherwood & Roberts Yakima, Inc. v. Leach*, 409 P.2d 160 (Wash. 1965); *Commonwealth v. Allen*, 404 S.W. 2d 464 (Ky. 1966); also cf. *Blachly v. United States*, 380 F.2d 665 (5th Cir. 1967).

The central point in any endless chain is the mathematical certainty of the exhaustion of new participants. Thus each new participant's success is ' * * * depend[ent] largely upon contingencies beyond his control', i.e., the extent in which the chain has progressed in a given locality. *New v. Tribon Sales Corp.*, 19 F.2d 671 (D.C. Cir. 1927). Furthermore, limitations on the maximum number of participants ' * * * does not cure the evil.' *Florida Discount Centers, Inc. v. Antinori*, 226 So. 2d 693, 695 (Fla. App. 2d 1969), cert. discharged, 232 So. 2d 17 (Fla. 1970).

Holiday Magic's marketing scheme constitutes a lottery not only because it operates as an endless chain scheme but also because success of a participant under this scheme is dependent upon the efforts of parties not under his control. As in the endless chain scheme, the three elements necessary to a lottery are also present here. The elements of consideration and prize therein are identical to those discussed as part of the endless chain scheme. However, the elements of chance differ from those in the endless chain scheme. These elements of chance are as follows:

- (1) The reliance upon the efforts of the participants in opportunity meetings to persuade prospective investors to invest in the program or through the use of the opportunity meeting procedure at which place either corporate team members or special persons with black certificates give the opportunity meetings, and IG's and corporate team people help to 'close' the prospects.
- (2) The 10 percent override received on persons who are replacement Masters, or who were recruited by other persons, and over which the General receives an override, often for little or no contact with such individual and without regard to how far down the chain the Master was recruited. The Continent may separate the two, the General does not sell to the Master, yet he gets his 10 percent monthly.
- (3) The 1 percent overrides on Generals who were either replacement Masters or Masters at one time over which the General got a 10 percent override, but recruited by another. When this Master becomes a General, the 1 percent override is paid not only on the purchases of this new General, but on the purchases of the Masters of their new General as well.

(4) The release fee on a replacement Master going General is paid by someone other than the person directly recruited by the old General. The chain of replacement Masters which we have seen inevitably produces a chain of release fees at more and more unlimited levels.

In *Lippincott Mortgage Investment Co. v. Childress*, 204 So. 2d 919, 920921, 923 (Fla. D.C.A. 1967), the court described the following plan:

Universal Marketing Research, hereinafter referred to as Universal, was engaged in the promotion and sale of central vacuum cleaning systems for use in private homes. In January of 1966 one Prichett, a friend of appellees, approached them and asked if they were interested in making some money. After receiving a positive response from appellees, Prichett stated that he would send somebody out to talk to them about the proposition. Several nights later they were visited in their home by two representatives of Universal who explained the program sponsored by their company designed to sell their product and to earn money for the purchasers. Under the plan appellees would agree to purchase for installation in their home a central vacuum cleaning unit for a total cost of approximately \$750.00 cash, or \$975.00 if bought on time payment plan. To evidence this indebtedness appellees would give their promissory note in return for which they would be employed as representatives of Universal under a commission agreement, the earnings from which would pay for the vacuum cleaning units and in addition yield appellees an indeterminate amount of money. Under these commission agreement appellees would furnish Universal the names of sixteen of their homeowners friends considered to be prime prospects for purchasing the vacuum cleaning unit. For each unit sold by Universal to the prospects furnished by appellees, the latter would be paid the sum of \$50.00. It was represented that sales to such prospective purchasers would yield commissions sufficient in amount to pay in full the promissory note representing the purchase price of the unit sold to appellees. In addition, each prospect submitted by appellees would be offered the same proposal offered appellees, and each would be requested to furnish Universal the names of sixteen of their friends who might be good prospects for purchasing a vacuum cleaning unit. For each person referred by appellees' prospects to whom a unit was sold, appellees would be paid an additional sum of \$50.00. It was from commissions to be earned by the sale of units to the persons referred by appellees' prospects that the big money would be made. The prospective purchasers on this second level of the plan would theoretically number one hundred fiftysix and represent a potential yield of \$7,800.00 in commissions to appellees. Appellees would agree to contact their friends whose names they would submit to Universal and interest them in the idea of participating in a plan to make money, and not to discuss the plan with them in detail until after Universal's representatives had had an opportunity of making a demonstration to them of the plan in its entirety.

As an outgrowth of the foregoing meeting between appellees and the representatives of Universal, appellees agreed to purchase a vacuum cleaning unit and signed a promissory note in the amount of \$972.00 payable to Universal in thirtysix monthly installments. This note represented the purchase price of the unit which was later installed in appellees' home, and the note was subsequently assigned to appellant. At the time of executing the foregoing promissory note, appellees also signed a commission agreement containing in substance the terms and provisions hereinabove related. In the discharge of

their obligation appellees furnished to Universal the names of sixteen of their friends whom they considered would be interested in purchasing the vacuum cleaning unit, and subsequently received from Universal commissions in the total sum of \$200.00. Upon failure or refusal of appellees to make any of the monthly payments called for in their promissory note, this suit was instituted.

[I]t is our conclusion that the plan or scheme devised by Universal and used in the promotion and sale of its vacuum cleaning units * * * constitutes a lottery. The motivating factor which induced appellees to enter into the business arrangement with Universal was not a desire to purchase a vacuum cleaning unit, but to be paid a lot of money in return for a minimum expenditure of time or effort. The purchase of the cleaning unit was incidental to the overriding motive on the part of appellees to earn money by way of commissions on sales to be made by Universal.

And in *People ex rel. Kelly v. Koscot Interplanetary, Inc.*, 195 N.W.2d 43 (1972), a case which very clearly parallels the instant matter (see description of Koscot's marketing plan at pp. 4451), the Michigan Court of Appeals found the plan to be a lottery, citing with approval *Lefkowitz v. ITM*, and stated at p. 54 (citing an earlier Michigan case) that:

A lottery may be defined to be any scheme whereby one, on paying money or other valuable thing to another, becomes entitled to receive from him such a return in value, or nothing, as some formula of chance may determine.

Our statute does not justify a court * * * in deciding a thing is not a lottery simply because there can be no loss, when there may be considerable contingent gain, or because it lacks some element of a lottery according to some particular dictionary definition, when it has all the other elements, with all the pernicious tendencies which the statute is seeking to prevent.

The statute is intended to reach all devices which are in the nature of lotteries, in whatever form presented, and the courts will tolerate no evasions for the continuance of the mischief.

The Court continued at pp. 5455:

In the case before us, the elements of consideration and prize are clearly present. Consideration is present in that a participant in the Koscot plan must pay a sum of money for the privilege of joining the marketing plan. Prize is present in that the participant hopes to receive a return higher than his investment by bringing prospects to a Golden Opportunity meeting whereby the defendant may be able to sign one or more prospects into the organization, thereby allowing the participant to earn commissions on those over whom he exercises no control. When one invites and brings a prospect to a

Golden Opportunity meeting he is relying on the ability and efforts of the operators of that meeting, representing defendant, to persuade the prospect to join. This contingency satisfies the element of chance. For example, if 'A', a distributor, brings 'B', a prospect, to a meeting and 'B' purchases a supervisorship, and 'B' in turn brings 'C' to another meeting, and 'C' purchases a supervisorship; 'A' makes money from both 'B' and 'C', with 'C' being outside of 'A's' knowledge and control. This constitutes chance dominating over skill.

In many instances there is virtually no contact maintained after a person is sold a franchise by defendant. He can move anywhere in the country and yet the person who recruited him will receive profits from whatever he does.

If 'X' in Florida recruited 'Y' in Michigan, 'X' would receive a commission on any sales of recruits brought in by 'Y', regardless of where 'Y' locates. There would be no contact between 'X' in Florida and the new recruits of 'Y'.

Defendant in the case at hand has promulgated a scheme which has all the earmarks of a lottery. The population limitation of one distributor for each 7000 of population is clearly a fiction since saturation of the market will inevitably occur.

The evidence shows that sales to ultimate consumers in Michigan were very small, and most of the sales by defendant in Michigan were sales of inventory to distributors and supervisors. This indicates the main trust in defendant's scheme is not to sell product to the ultimate consumer, but rather to sell franchises through the referral plan.

The combined number of distributorships and supervisorships sold in Michigan to date is over 300. Assuming those presently holding franchises recruit, on an average, one prospect who buys a new franchise, that will total approximately onehalf of the franchises available in Michigan under defendant's plan. If these franchisees also bring in, on an average, one prospect who purchases a franchise, we have reached the saturation point for franchises in Michigan. These last 600 franchisees will be precluded from participating in the referral plan. The defendant is in a position to know this, but that information is not so obvious to the new recruits.

And at p. 58:

And in view of the foregoing cases, we conclude that the plan devised and used by Koscot for the sale of cosmetics products, constitutes referral selling and a lottery, which is prohibited by our statute, supra.

It is evident from defendant's policy statement that its scheme is to generate the income of money to the company through the sale of distributorships and supervisorships through a referral plan. These distributorships and supervisors are general in nature and do not grant an exclusive right to sell in any designated geographical area to the purchaser.

We can see that if a distributor sells another distributorship or supervisorship he receives a rebate called a commission in the form of a percentage of the cost of the new distributorship or supervisorship. The emphasis of this plan is placed by the company on the ability of distributors and supervisors to recruit others into the plan.

While the company supplies a training program for the new franchisees, even at these meetings the major emphasis is placed upon recruiting new distributors and supervisors. Each distributor and supervisor is permitted and recommended to bring prospects to a meeting from anywhere in the state, including his own area, to be sold a franchise by the defendant.

It seems clear that if Koscot's plan was to sell the product to the ultimate consumer the distributors would not be urged to solicit prospects that will necessarily be in direct competition with themselves. Again, the emphasis is placed on recruiting new distributors and inventory loading, not on sale of product to ultimate consumers.

The essential distinctions between the Holiday Magic marketing plan and the pure lottery, referral, or endless chain scheme would appear to be that the distributor, ostensibly, is purchasing an inventory for his money, which reflects an investment in a business enterprise rather than the consideration paid merely for the chance of greater rewards. This argument is usually coupled with the added plea that all businesses have the right to increase their sales and size in this manner.

This is true but only in part. Any unlimited right to recruit other distributors is necessarily limited by the recruiting distributor's ability to sell his products to his recruits, which products must ultimately reach the consuming public, and still make a profit. There are no such limitations in Holiday Magic, for a recruiting distributor can recruit someone whom he need not sell to, and still reap the benefits of overrides, refunds and release fees, ad infinitum.

Public policy decrees the Holiday Magic inherently deceptive marketing plan to be a per se violation of the Federal Trade Commission Act under Section 5 thereof.

In summary, the marketing plan as conceived and operated by the corporate respondent and its officers or agents was conducive to the pyramid recruiting of distributors not only vertically but horizontally to the exclusion of stimulating product market flow to consumers at a ratio consistent with such recruitment within a reasonable time after the distributorships were initially organized. The limitations of the plan as a valid marketing instrumentality is demonstrated conclusively by the failure to maintain an absence of interest in maintaining a complete and consolidated record of consumer sales as the only information upon which consistent distributor recruitment could be effectively formulated. No limitations of recruitment were or could be considered in the absence of a complaint of over saturation by a distributor and there is no evidence of Holiday Magic's disposition under these circumstances or an effort on their part to reconstruct the plan based on such complaints.

II. Count III Charges of Misrepresentation

Count Three of the complaint alleges that Holiday Magic, Inc. has represented, by and through statements and oral representations, directly or by implication, or through its representatives, that it is not difficult for distributors to recruit and retain persons who will invest or participate in the Holiday Magic program either as distributors or sales personnel.

The record is replete with such representations on the part of Holiday Magic, Inc. through its opportunity meeting procedures and through the representations of moneyhungry distributors.

The opportunity meetings describe situations where distributors are said to be able to recruit on the average of five new organizers a month, and that on a part time basis General distributors are supposed to be able to recruit one new General a month or one a week. It is also represented to prospects at the opportunity meetings that anyone who wants to can recruit two Holiday Girls a week to sell the cosmetics, and have 100 Girls at the end of the year, or more if he chooses to duplicate his efforts in several cities.

Count Three alleges that, in truth and in fact, it is difficult, and becomes increasingly more difficult under the geometrically expanding Holiday Magic marketing system, to recruit and retain persons who will invest in the program as distributors and as sales personnel.

In this respect, the record is again replete with instances of distributors not being able to accomplish what is represented to them at the opportunity meeting procedures and otherwise. The testimony of the witnesses who were unable to recruit the distributors and Holiday Girl in the numbers represented, and the statistical evidence of less than one Holiday Girl recruited per distributor establish the misrepresentations. Ft. Pierce, Miami and Eugene reflect that the geometrically increasing number of distributors inhibited recruiting.

Also included in this allegation is the misrepresentation that there is no turn over problem. Holiday Magic, Inc. at its opportunity meeting has failed to divulge to distributors that there is an incredibly high turnover of Holiday Girls, telling them instead that they can make \$108,000 a year by recruiting two Holiday Girls a week and leaving them to believe instead that they can be expected to remain active for at least a year as portrayed in their examples, and thereafter deliberately choosing to represent that the turnover problem is one of Holiday Girls becoming Masters and Generals rather than dropping out of the program!

Count Three of the complaint further alleges that Holiday Magic, Inc. has represented, by and through statements and oral representations, directly or by implication, or through its representatives, that participants in Holiday Magic's marketing program have a reasonable expectancy of receiving large profits or earnings.

This allegation includes the following, of which there is ample evidence in the record:

(a) Actual representations as to earnings potential which are false, misleading and deceptive;

(b) Guarantees of income;

(c) Failure to disclose information concerning reasonably anticipated costs of doing business.

Taking them in turn, the record establishes that Holiday Magic, Inc. has represented through its opportunity meeting procedure that distributors may reasonably expect to earn large sums of money in the program, even on a part time basis. Virtually all distributors receive these representations through the opportunity meeting procedures.

Representations changed over the years in the various opportunity meeting scripts and six enrollment scripts, but never in substantial substance did the representations change. Indeed the opportunity meeting scripts employed throughout continue to represent that Master Distributors can earn \$72,000 a year and Generals \$108,000 a year in the wholesale end of the business. The only difference between the new improved version of the representations and their older counterparts is that Holiday Magic, Inc. states that the examples are hypothetical, and that only the top achievers earn \$108,000. However, anyone who reads the entirety of these scripts will quickly perceive that the imprinted message is the same as it has always been: Make your fortune in Holiday Magic, Make it quickly, and make it by recruiting an unlimited number of participants. Even Al Pangerl, the top producer, came nowhere close to making the \$108,000 as represented. His gross income on wholesale sales, as the number one producer was not \$108,000, but about \$5,000 only. The rest he got by headhunting. And still no Masters earned \$72,000.

One subject that merits discussion is the fact that Count III of the complaint alleges that 'most' participants do not have a reasonable expectancy of receiving large profits. The question, of course, is not whether the word 'most' should have been pleaded, or need have been pleaded, but rather, since it was pleaded, is it a defect in the allegation in question, or is it merely an additional burden which complaint counsel have to overcome. Reasonable construction of the entire complaint which in each count incorporates by reference all allegations of the complaint suggests the word 'most' cannot be interpreted quantitatively.

Nevertheless it is abundantly clear from the record and findings that most General Distributors indeed would not have a reasonable chance of earning one million dollars a year on a pyramiding basis as represented, or \$500,000 a year, or \$108,000 a year, or \$72,000 a year as a Master, or any of the other misrepresented earnings potential, and that most Holiday Girls do not have a reasonable chance of having a gross volume of \$900 a month or even \$300 a month.

Since the total number of Masters, Generals, Organizers and Holiday Girls appears in the record, as of a date certain, simple arithmetic provides ample evidence as found that the Distributors cannot make the kind of money that Holiday Magic represents can and will be made in wholesaling and retailing Holiday Magic product.

It is mathematically impossible for most distributors to have made anywhere near this kind of money from Holiday Magic's sales. Consider the representations of \$108,000 for General Distributors based upon 100 Holiday Girls doing \$300 a month on the average, and \$72,000 for Masters under the same circumstances when the record reflects that of a total of over 9,000 Masters in the program since the inception of Holiday Magic as of early 1969, only 48,000 Holiday Girls had been recruited overall. With a turnover of one Holiday Girl every six weeks or so, and an average sales volume of between \$75 and \$140 when they do work, there is no way a Master or General Distributor, on the average, is even going to break even in the program.

The only way that most can expect to earn a gross income of \$108,000 in their wholesale cosmetics business is for the average of all Generals to be at the very least \$54,000 a year and \$36,000 a year for Masters, who are represented to be able to earn \$72,000 a year. [FN9] Here the Masters and Generals in their average lifetimes with Holiday Magic had purchases on the average of about \$8,000. To sell to a Holiday Girl at 30 percent and to buy at 35 percent or 45 percent means that the gross income, which is what the \$108,000 and \$72,000 figures represent would have to be, on the average, for Masters and Generals, between \$2,000 and \$2,900 on the average, in their lifetimes.

Thus, the figures depicted by Holiday Magic, at best and assuming that all of its products reach the consumer, are for Masters at least 18 times below average for the average requirement for Masters, and 36 times below the Holiday Magic representation of \$72,000.

Respondent Holiday Magic, Inc. through its opportunity meeting procedures portrays to prospective Distributors earnings representations which at the very least are 36 times the average wholesale sales of Masters and 43 times the average wholesale sales of Generals, in their lifetime as Distributors, reflected on a per annum basis, assuming that all of respondents' products sold to its Masters and Generals reaches the consumer.

Although there has been slight moderation in the post investigation approach and representations, they have not been essentially material.

Exemplifying this are the following:

(a) See CX 100B, Opportunity Meeting procedures dated October, 1967.

CX 100E and other exhibits reflect the following representations:

* * * I have seen people earn 5, 10, 15, and even 20,000 per month. This is a tremendous amount of money.

* * * Now as you will recall, we assume that the people [in the film] did \$300 each. Because you have sponsored the, 5 x \$300 would give you a volume of \$1500. That is a total volume they would have

purchased from you your first 30 days * * *. That's what you would have earned your first 30 days in the business.

* * * Let's * * * see just exactly what you would have done to earn this money. You would have invited five people to a meeting just like this one tonight. We would have presented the opportunity to your people for you and after the meeting, we would have thoroughly answered all their questions.

We would have helped you sponsor them into the business. For that, you would have made \$120.

CX 100F:

For that reason, we had Mary do the same thing that you did last month, train and sponsor five new people in the business.

CX 100G:

So, in your third month you would have earned a total of \$900 from your first five people. Again, all the new people in the business this month would be sponsored by someone whom you recruited and trained in a prior month.

CX 100H:

Again, we're talking of an assumed average of five people.

* * * One of our top Distributors sponsored 137 people his first 30 days in the business * * * Granted, these are exceptional people but it illustrates the potential for profit even if you were to cut their results in half.

* * * Obviously, the way to prevent this from happening is not to stop with five people. Recruit as many as you can.

CX 100I:

* * * Let me share this with you. I presently am making more money than I ever have before. If I can do it, what can you do?

* * * Is there anyone in the room that doesn't think that he can sponsor two girls a week working at it full time. No one? Wonderful!

Let's assume that you are now sponsoring two girls a week and at the end of the one year of hard work you have sponsored 104 girls * * *. Assume they do no more than \$300 in volume.

* * * Now, if you did recruit 100 girls, you would automatically be a Master Distributor at 55% * * *. It's a great deal of money, isn't it? That's \$72,000 a year. Now we won't pretend this is what the average distributor earns. But it gives you an idea of what can be done with your abilities.

CX 100J:

* * * That, ladies and gentlemen, is \$108,000 a year, which is quite a salary! And there aren't too many earning it. But it shows you how the marketing plan can work, depending upon your ability, your willingness to work hard and your selling skill.

* * * But if you totally committed yourself to working with your people and giving them everything in the world they need to get the job done give them all the training they need the motivation the supervision give them of yourself, work with them you would then accomplish what our top achievers have indeed obtained and you could earn \$9,000 a month.

(b) See six enrollments, from IG Manual dated Jan. 1970; at CX 90Z6:

When this replacement Master Distributor is brought into the business, an additional \$6,666 in retail product is purchased from Holiday Magic and you, with your 10% commission, would be paid another \$666 in cash. But since the rules require you to pay \$233 in commissions to the new General Distributor who brought in this Master Distributor you net only \$433, on replacement Master Distributors. However, the moment that the replacement Master Distributor is officially recorded by the company, the cash, being held in escrow, is released to you the sponsoring General Distributor. The new General Distributor in effect has just purchased part of your sales organization. Thus, you have earned a total of \$4,099 cash each time you are successful in training and motivating an eligible Master Distributor to become a new General Distributor.

What would happen if you did this once each month for the next year? You would have earned \$49,188 at the end of 12 months and you would still have twelve Master Distributors with which to work. If you did this only once each month and that's all you did, just train successful salesmen you might only be working part time. Under ideal circumstances, this could mean attending only one Opportunity Meeting per month, to which you would bring a qualified prospect one who would have the ability and want to earn that kind of money also. And there are distributors who who are earning this kind of money right now!

Now, when we talk about \$49,188 on a part time basis, we aren't talking of the average distributor. We're talking about a real motivator a person with ambition, drive, skill and selling ability who's able to teach others those same skills. Maybe you're one of them. [Footnotes omitted]

(c) Physical Exhibit B was used throughout Holiday Magic's history, at least through 1969 (Tr. 5600) and nothing in the record shows they were ever stopped.

Holiday Magic has made or has caused to be made false representations as to the amount of earnings that one can achieve, effort involved in recruitment of other Distributors, the extent of its advertising and that employment is offered when in fact an investment in a distributorship is sought.

The evidence in the record shows that these representations were made to numbers of Distributors Holiday Magic sought to upgrade to prospective distributors, in connection with the interstate sale of goods, and that the representations were false, misleading and deceptive. It is not necessary to show actual deception, it is sufficient to show that the misrepresentation has a capacity to mislead, (*Goodman v. F.T.C.* 1957 Trade Cases 68,690, p. 72, 811 812) *VacuMatic Carburetor Co. v. F.T.C. C.C.A.7*, (1946) 4 S & D 576, 580. Moreover, what is represented can be literally true and still be misleading and in violation of Section 5 of the FTC Act. *Rhodes Pharmacal Co. v. F.T.C.* 208 F.2d 382, 387 (1953). See also *Donaldson v. Read Magazine*, 333 U.S. 178. For specific misrepresentation cases on earnings see Federal Trade Commission 1967 Trade Cases 68.690 at pp. 805, 806 and 808809.

Misrepresentations similar to those made by respondents in connection with the placement of ads for employment in the 'help wanted' columns of newspapers is treated in *Cannon v. F.T.C.* (CA D.C. 1961) 1961 Trade Cases 70,133, 295 F.2d 546;

Courts have long held that where the respondent has put the means for consummating a fraud into the hands of another, that the respondent is liable for the consequences thereof.

In *F.T.C. v. Winsted Hosiery* 258 U.S. 483, 42 S. Ct. 384 (1922) at 386 the respondent sold falsely labeled underwear to its dealers. Despite the fact that dealers may have been aware of the falsity and were not deceived, the Court felt that because consumers were not aware of the falsity they would buy respondents' products. The court stated: 'a person is a wrongdoer who so furnishes another (respondents' dealers) with the means of consummating a fraud has long been a part of the law of unfair competition.'

In a case where the respondent sold a chocolate flavored drug preparation in clearly labeled bottles but where the drug was identical to a competing but more expensive drug and thereby causing some druggists to substitute respondent's drug for the more expensive competing drug in sales to consumers, the court found the respondent liable and held that: 'the wrong was in designedly enabling the dealers to palm off the preparation as that of the respondent. One who induces another to commit a fraud and furnishes the means of consummating it is equally guilty and liable for the injury.' *William R. Warner & Co. v. Eli Lilly & Co.* 265 U.S. 526 (1924) at pp. 530531. This language was cited in *C. Howard Hunt Pen Co. v. F.T.C.* 1952 Trade Cases 67,286 at p. 67, 533. The holding in *F.T.C. v. Winsted Hosiery Co.* and *Warner & Co. v. Lilly & Co.* was cited in *Associated Laboratories v. F.T.C.* 1944 Trade Cases 57,258 at p. 57,405. The Court of Appeals held that 'The author of false, misleading and deceptive advertising may not furnish customers with the means of misleading the public and thereby insulate himself against responsibility for its deception.'

Holiday Magic in the case at bar has not only made the false, misleading and deceptive representations directly, through its corporate team activities, but by providing its Distributors with the manuals, movies, Opportunity Meeting scripts, six enrollments scripts, closing techniques and the marketing plan itself. It cannot be heard to maintain its innocence over the activities of independent contractors.

In fact, in the matter at bar, Holiday Magic is legally responsible for the representations of its independent contractor Distributors because they were ordered to assume the role before the public as representatives of Holiday Magic, and Holiday Magic by its other activities ratified and adopted the activities of its Distributors in their recruiting activities.

In *Goodman v. F.T.C.* 1957 Trade Cases 68,690 at pp. 72, 80172, 804, the Court of App. held that an individual engaged in the sale of a home study course in reweaving was responsible for misrepresentations made by his salesmen, even though the individual designated his salesmen as independent contractors.

The court stated that 'when interpreting a statute the aim of which is to regulate interstate commerce and to control and outroot some evil practices in it, the courts are not concerned with the refinements of commonlaw definitions, when they endeavor to ascertain in the power of any agency to which the Congress has entrusted the regulation of a business activity or the enforcement of standard it has established.'

The court indicated that regardless of how the salesmen were described in their contracts, 'as far as the public was concerned, they were his authorized agents and acted not only within the apparent but also within the actual scope of their authority, and the Commission was right in holding him responsible for their acts.'

In *Consumer Sales Corp. v. F.T.C.* 1952 Trade Cases 67,316 at p. 67,745 where the respondents appealed from a Commission order prohibiting them from using deceptive practices to promote sales. The Commission found that by furnishing salesmen with order forms falsely representing that they were making a special offer and by permitting the salesmen to request purchasers to collect box tops, the respondents actively encouraged and participated in making such false representations.

The petitioners had contended that they were not responsible for the misrepresentations by the salesmen as they were independent contractors.

The Court of Appeals stated that since the Commission found that the petitioners 'actively encouraged and participated in making' the false representations is amply supported by the evidence, it is unnecessary to consider whether or not the salesmen's relation to the petitioners was that of independent contractors.

And in *Consumer Home Equipment Co. v. F.T.C.* 19481949 Trade Cases 62,202 at p. 62,208, it had been found that the petitioners had through their salesmen made use of a sales plan employing false

representations and fraudulent schemes. On appeal, the court found that the petitioners had knowledge of the false representations and fraudulent schemes utilized by its salesmen. The numerous letters concerning these transactions (the misrepresentations and fraudulent schemes) received by better business bureaus in Detroit and Toledo, and the petitioners' answers thereto, are evidence that petitioners must have had knowledge of these unfair and deceptive practices.

At bar Holiday Magic clothed its Distributor with the real and apparent authority to represent the company in the recruitment of other Distributors.

Distributors are provided with Holiday Magic contract forms to sign up prospects, they are authorized to accept certified checks made out to Holiday Magic Inc. only. They represent the company nominally in that Holiday Magic is committed to shipping merchandise to anyone brought into the program the moment the check is turned over to the recruiter. Holiday Magic even requires its banners and pictures of Patrick to be present at the opportunity meetings to give the appearance of a 'Holiday Magic Opportunity Meeting.'

The Opportunity Meeting scripts, which the company requires to be given 'on script' make constant and continual references to the distributors as company representatives.

However, there are other equally valid reasons for holding Holiday Magic responsible for the deceptions, misrepresentations and false statements of the distributor in their recruiting activities:

1. The company has a policy of accepting all contracts sent in to it, thereby ratifying all false statements and misrepresentations made in order to get the Distributor into the program. Money will not be refunded regardless of the representations. The company therefore puts itself in a position where it is estopped from denying responsibility for the representations of those persons it sends out to recruit on their mutual behalf. This policy is clearly evident in the cases cited in the findings involving John Woloshyn and Rick Spranzo. Not only did Holiday Magic repeatedly accept distributorships from persons who were misled by these persons, after being put on notice of their activities again and again, but when they were finally terminated, it was for something as innocuous as placing unapproved ads in a Texas newspaper!

2. The company's policy of accepting only certified or cashier's checks coupled with the no refund policy, amplifies the above. It suggests fear of a Distributor's change of heart and stoppayment order on a check which it will not permit with its present policies. This policy alone is evidence of the finality of the recruitment and 'acceptance' by the home office of the moment money changes hands.

3. Holiday Magic's East Coast representative in the person of Bill Dempsey (of Sales Acceleration fame) flatly tells Master and General Distributors at a corporate team gathering in the presence of the company president, Fred Pape and the company national field director, Mark Evans (in Feb. 1968) that when they seek to 'close' a prospect, they are to consider that the prospect 'has money in his wallet, and whatever method that I can use to get my money back out of his wallet, that was perfectly all right.' He

added that 'when the dust cleared, the only thing that counted was who had the money's and he then flashed three of four \$100 bills stating that he had the money.

Holiday Magic, Inc. is unquestionably legally responsible for the deceptions and misrepresentations of its Distributors because it has made Distributors their agents in fact with respect to recruiting activities.

Distributors are agents of Holiday Magic, Inc., with respect to representations involved in the recruitment of distributorships, or in instruction to other Distributors. In connection with the operation of the marketing plan, and for this reason alone Holiday Magic, Inc. is liable for and bound by the statements of these agents with respect to matters with which the agent was either authorized or apparently authorized.

A Distributor who is an independent contractor may be an agent simultaneous with his status as independent contractor.

The Restatement of Agency makes it perfectly clear that an independent contractor and an agent may exist simultaneously. Section 2 (3) reads:

An independent contractor is a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking. He may or may not be an agent. Restatement, Agency 2d s 2 (3).

The comment in the Restatement further clarifies this point:

The word 'servant' is used in contrast with 'independent contractor.' The latter term includes all persons who contract to do something for another but who are not servants in doing the work undertaken. An agent who is not a servant is, therefore, an independent contractor when he contracts to act on account of the principal. Restatement, Agency 2d s 2 (3); comment b.

The comment goes on to point out that a broker is an independent contractor and an agent, and his principal is bound by the broker's unauthorized contracts and representation, but not liable to third persons for tangible harm resulting from unauthorized physical conduct within the scope of the employment, as the principal would be for similar conduct by a servant.

The Restatement of Agency makes it clear again:

One who contracts to act on behalf of another and subject to the other's control except with respect to his physical conduct is an agent and also an independent contractor. Restatement, Agency 2d s 14(n).

The comment in Section 14(n) is further revealing:

'[I]ndependent contractor' is a term which is antithetical to the word 'servant' although not to the word 'agent.' * * * Colloquial use of the term excludes independent contractor from the category of agent as a similar use in the transaction which they undertake they act for the benefit of another and subject to his control. Restatement, Agency 2d s 14(n) comment a.

Some cases which hold the view that a person may be both an independent contractor and an agent are *Hoffman & Morton Co. v. American Inc. Co.*, 35 Ill. App. 2d 97, 181 N.E.2d 821 (1962); *Dempster Bros., Inc. v. United States Fidelity & Guaranty Co.*, 54 Tenn. App. 65, 388 S.W.2d 153 (1965); *Wade v. Traxler Gravel Co.*, 100 So. 2d 103, 232 Miss. 592 (1958); *Ackert v. Ausman*, 29 Misc. 2d 962, 218 N.Y.S.2d 822 (1961), *aff'd*, 20 App. Div. 2d 850, 247 N.Y.S. 2d 999 (1964); *Derrick v. Drolson Co.*, 244 Minn. 144, 69 N.W. 2d 124 (1955); *Hoffman & Morton Co. v. American Ins. Co.*, 35 Ill. App. 2d 97, 181 N.E. 2d 821 (1962); *Commonwealth v. Minds Coal Mining Corp.*, 360 Pa. 7, 60 A.2d 14 (1948); *Witaszek v. Drees*, 280 N.Y.S. 592, 155 Misc. 838 (1935); and *Texas Co. v. Mills*, 171 Miss. 231, 156 So. 866 (1934).

The cases and the restatement are generally of the view that the relationship of a principal to an agent may be of two types employment (servant) or independent contractor. And with respect to the independent contractor, the relationship with the principal may be either for a specific result only, with no control whatever, or in the employment by a principal of an agent to act in a selling capacity, in which case the principal is responsible for misrepresentations but not the physical acts (unless said physical acts were specifically directed).

III. Count IV Charges of Price Fixing

Respondents offered evidence only that showed that after the investigation started they changed their price fixing rule to state that they were fixing prices in fair trade states. Nothing was changed with respect to nonfair trade states, and the practice of fixing prices throughout the country never changed, as the evidence amply demonstrates. (See also Parts XIX and XX of Findings.)

Respondent Holiday Magic, Inc. fixes the prices at which its distributors may resell their products both at wholesale and at retail. Vertical price fixing at both levels has long been held to be unlawful by the courts. *U.S. v. McKesson & Robbins, Inc.*, 351 U.S. 305, 76 S. Ct. 937, 100 L. Ed. 1209 (1956); *U.S. v. Parke Davis & Co.*, 360 U.S. 29, 80 S. Ct. 503, 4 L. Ed. 2d 505 (1960); *U.S. v. A. Schrader's Son, Inc.*, 252 U.S. 85 (1920). Vertical price fixing arrangements are also per se violative of the Federal Trade Commission Act. See *The Roberts Co., et al.*, 56 F.T.C. 1569 (1960), and *Lenox v. F.T.C.* 417 F.2d 126.

The rebates and overrides required by Holiday Magic to be paid by its distributors to other Distributors, requiring such rebates at prescribed amounts is an indirect method setting the wholesale price at which the products may be sold to the Holiday Girls or organizers. Indirect, vertical methods of achieving resale price levels are also condemned by the courts. See *U.S. v. Socony Vacuum Oil Co.*, 310 U.S. 150, 60 S. Ct. 811, 84 L. Ed. 1129.

IV. Count V Charges of Restrictions

A. Customer Restrictions

The Holiday Magic customer restrictions appear in the Findings in Part XXII. They may be summarized as follows:

1. Master and General Distributors may sell at wholesale only to Organizers and Holiday Girls that they sponsored into the business.
2. Distributors may not recruit other Holiday Magic Distributors who have already been sponsored into the business.
3. Distributors are to refrain from selling at the retail level to customers who are being serviced by other Holiday Magic Distributors.

Customer restrictions are unlawful, particularly as here where such restrictions support a plan of resale price maintenance. See *U.S. v. Bausch Lomb Co.*, 321 U.S. 707, 724; 64 S. Ct. 805, 88 L. Ed. 1024 (1944); *U.S. v. Sealy*, 388 U.S. 350, 87 S. Ct. 1847, 18 L. Ed. 1249 (1967); and *U.S. v. Arnold, Schwinn*, 388 U.S. 350, 87 S. Ct. 1856, 18 L. Ed.2d 1239 (1967).

B. Retail Outlet Restrictions

Holiday Magic requires that all Distributors refrain from selling or placing Holiday Magic merchandise in such retail outlets as drug stores, department or variety chain stores, grocery stores or discount stores. Evidence of this restriction appears in Part XXIII of the Findings.

C. Advertising Restrictions

Holiday Magic, Inc. requires that all Distributors must obtain prior company approval for the advertising or promotion of Holiday Magic products. (See Part XXIV of Findings.)

Under the circumstances of the price fixing and retail outlet restrictions of Holiday Magic, Inc., these advertising restrictions must be deemed a phase of the entire control of operations.

D. Purchase Restrictions

Holiday Magic, Inc. imposes restrictions upon its Distributors in respect to their source of Holiday Magic products by requiring that:

1. Holiday Girls and Organizers purchase the Holiday Magic merchandise only from their sponsoring Distributors.
2. All Distributors must refrain from buying back merchandise from those Distributors to whom they may have sold.

3. Distributors must obtain approval from all other Distributors above them in the marketing chain before a transfer into the organization of another Distributor will be allowed.

E. Private Arrangements Restrictions

Holiday Magic requires that all of its Distributors refrain from entering into reasonable business undertaking of their choice by:

1. Requiring that in the event a partnership distributorship dissolves, the departing partner must revert back to his original sponsor.

2. Requiring that in the event a General distributorship in partnership dissolves, the principal or partner who is departing must requalify as a new Master Distributor under his original sponsor, create a replacement Master, and pay the release fee to qualify for the General position again.

3. Requiring that all Master and General Distributors in adding on partners to their distributorships, or in selling a Master or General distributorship, must in those circumstances meet the same retail list price value purchase requirements as do 'workin' Masters.

4. Requiring that Distributors may have a financial interest in one Holiday Magic distributorship at a time, and may not simultaneously be a part of two separate distributorships.

5. Requiring that Distributors must not enter into any agreement with a Distributor in another Holiday Magic organization to make a division of profits, assets or new recruits in violation of the marketing plan.

6. Distributors must not make a consignment of the Holiday Magic merchandise to any person.

These restrictions appear in the Findings of complaint counsel at Part XXV.

According to the 'Rule of Reason' as set forth in *Board of Trade of the City of Chicago v. U.S.*, 246 U.S. 321, 38 S. Ct. 242, 62 L. Ed. 683 (1918), one must examine the effect of the particular restriction on competition and weigh the purpose, nature and probable effect, among other factors, of the restriction in determining whether or not it is unreasonable.

See also *Standard Oil Co. of New Jersey v. U.S.*, 221 U.S. 1, 62, 31 S. Ct. 502, 516, 55 L. Ed. 619, where the Rule of Reason was adopted, and *The White Motor Co. v. U.S.*, 372 U.S. 253, 83 S. Ct. 696, 9 L. Ed. 738, where the Rule of Reason was reaffirmed.

The restrictions herein have only two purposes which are to (1) generate further master inventory purchases from Holiday Magic, Inc. without regard to the needs of the distributor, and (2) to maintain the pricing, override and pyramid structure of the marketing plan.

Under these circumstances, they are anticompetitive.

V. Count VI Charges of Territorial Allocations

Absent either horizontal agreements or price fixing, the Supreme Court has held territorial and customer restrictions imposed by a respondent supplier on its independent Distributors, where the supplier has parted with title and risk in the sale of the products, to be a per se violation of the antitrust laws. *U.S. v. Arnold Schwinn & Co.*, supra. Customer and territorial restrictions by themselves have also been found to be in violation of Section 5 of the Federal Trade Commission Act. In the Matter of [International] Staple & Machine Company, Inc., Docket No. 8083, Sept. 21, 1961 [sic: Nov. 7, 1961, 59 F.T.C. 1080].

At bar we have the situation of the council, which is controlled by Holiday Magic, in the position of at least purportedly establishing routes for Holiday Girls. Territorial restrictions are unlawful where such restrictions support a plan to maintain resale prices. The evidence suggests that in some instances the allocations are very effectively present and in others not. See VI.

VI. Count VII Charges of Price Discrimination

A. Price Differential Between Masters and Generals

Master Distributors purchase Holiday Magic products at a discount of 55 percent of retail value.

General Distributors purchase these same products at a discount of 65 percent.

Although offhand these two different discounts appear to show a difference of only 10 percent, further examination discloses a greater difference.

From the point of view of the disfavored Master, this 10 percent represents 22.2 percent of his cost factor of 45 percent.

Example

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Although the difference between discounts may only be 10 percent, the important factor is how this 10 percent relates to the Master's net cost.

The differential in terms of gross profits is even more significant. The Master pays \$45 for each \$100 of sales and the General pays \$35 for each \$100 of sales to retail customers. Therefore, the Master makes a gross profit of \$55 and the General a gross profit of \$65 on equivalent sales. The percentage increment that the General makes over the Master is $10/55$ or approximately 18 percent greater gross profits.

At the wholesale level, and assuming the average Holiday Girl or Organizer purchases at least \$100 per month, they are at a 35 percent of list discount. The Master, on \$100 worth of retail list price purchases, pays \$45 to Holiday Magic and sells it for \$65 to his Holiday Girl, for a gross profit of \$20. The General, however, who paid \$35 for the same goods, sells it for the same \$65 for a gross profit of \$30. Therefore, the General's gross profits for wholesale sales are 50 percent greater than the Master's gross profits for wholesale sales.

B. Master Distributors and General Distributors are at the Same Functional Level of Distribution

It is established that the classification of customers for discount purposes must not be arbitrary; it cannot be used as a means of discriminating in price between buyers who are actually in competition with one another. Therefore, mere labels or recitations to the contrary should be disregarded where the classification of customers by a seller does not follow real functional differences.

The record in this case is replete with evidence that Masters and Generals performed the same functions. Not only has General Distributor after General Distributor called by both sides stated that they did the same things as General Distributors that they did as Master Distributors, but a comparison of the actual activities and functions engaged in shows no distinctions at all in distributive functions or services. (The differences are in the collection of release fees and overrides.)

Holiday Magic Masters and Generals are wholesalers of Holiday Magic products, and virtually all testified that they sold at retail as well (to a greater or lesser degree). Council membership was necessary for these Distributors to get their Holiday Girls trained, and Masters and Generals paid the same council dues for these purposes. And with the functions performed by the CDC or CRS operations with respect to warehousing, the same can be said. Both Masters and Generals utilized the Distributor warehousing operations, at which they paid the same dues for the same inventory balances. Generals therefore did not even have inventory on hand greater than any Master who was also a member of the CRS or CDC, and Generals, in fact, have no inventory requirement at all, whereas Masters, at least as 'buyins,' must purchase an initial inventory. In this situation the Master probably has greater functions to perform than a General. 95 percent of all active Distributors at the Master and General levels were members of the CRS operation.

A look at the expenses of the various Masters and Generals reflect that they are at the same functional levels. Different functions would necessarily entail different levels of expenses.

Even the schooling of Masters and Generals is the same, and manuals which Holiday Magic sells to its Distributors to tell them how to run their businesses never distinguish between the functions performed by the two artificially and arbitrarily created groups.

To understand the marketing plan is to understand the reason for the creation of the favored class of Generals in the first place. The release fees are paid for the obscure privilege of moving up to General. If Generals bought at the same price as do Masters there would be no 'level' to move up to!

Only to the extent that a buyer actually performs certain functions, assuming all the risks and costs involved, should be qualify for a compensatory discount. The amount of the discount should be reasonably related to the expenses assumed by the buyer, and it should not exceed the cost of that part of the function which he actually performs on that part of the goods for which he performs it. (F.T.C. v. Doubleday, 52 F.T.C. 169 (1955).) The seller must be able to justify the discount to the buyer by reference to the savings to the seller in having the operation assumed by the buyer. The mere possibility of greater cost is not sufficient.

With respect to the merchandise sold to the Generals at a 65 percent discount off list, Generals will in turn sell some of this to Organizers, Holiday Girls or at retail. This merchandise will not flow to the Master Distributor, who will likewise sell merchandise (which he purchases at a discount off list of 55 percent) to Organizers, Holiday Girls or retail customers, perhaps after a period of warehousing as well.

No distributive functions were performed by the General on the goods sold by the General to his retail customers.

C. Like Grade and Quality

In order for a finding of a RobinsonPatman Act violation it is necessary to establish that the goods sold were of 'like grade and quality.' Complaint counsel has shown through witness testimony, product brochures and order forms that Holiday Magic sold only one grade and quality of goods, and only one line of products, and that all goods sold by it were of 'like grade and quality.' Holiday Magic's products consisted of a single 'line' because all of them were listed on the same standard order forms, and all distributors were free to and encouraged to purchase all items listed.

The courts have long held that goods need not be individually identical but need merely be part of the same line in order to be considered of 'like grade and quality.'

The leading case is *Moog Industries, Inc. v. F.T.C.*, 238 F.2d 43 (8th Cir., 1956); *aff'd* on other grounds, 335 U.S. 411 (1958). *Moog* discriminated in price between purchasers of three lines of automobile parts, leaf springs, coil action parts and piston rings. The evidence did not prove that competing favored and nonfavored customers purchased absolutely identical items within these three product lines, i.e., leaf springs, coil action parts, or piston rings designed for automobiles of the same make, model, and year. The court ruled that the Commission need not prove that *Moog* had sold identical or interchangeable parts within each of the three product lines to the two classes of purchasers, but merely to prove sales to the two classes of purchasers of each of the product lines as a whole.

The court ruled in *Moog* that the 'like grade and quality requirement' was designed to isolate those sales 'sufficiently comparable for price regulation by the statute.' *Moog, supra*, 238 F.2d at 50. The court held that because *Moog* sold the items in lines, and because the discriminatory rebate that effectuated the price difference was paid upon all the items in the line, the Commission could find an illegal price discrimination despite the absence of proof that competitors had sold identical items within a line.

The Moog principle was further enunciated by the Commission in *In The Matter of Continental Baking Co.*, 63 F.T.C. 2071 (1963), stating:

The Court in the Moog case said in effect that when Moog made no attempt to govern or determine whether or not certain customers bought certain items of a line, the Commission did not have the burden of becoming immersed in the small details of matching items bought by competing customers to prove a fact, the disproof of which by Moog would have been sheer happenstance. 63 F.T.C. 2109.

D. 'Contemporaneous Sales'

A lessening of competition can be found when sales or purchases by the favored and nonfavored customers occurred within a reasonable period of time up to 3 1/2 months apart. *Fred Meyer, Inc. v. F.T.C.*, 359 F.2d 351, 357 (9th Cir. 1966); Cert. denied, 386 U.S. 908 (1967). Hence, separation of sales or purchases to the two customers in point of time does not exclude the transactions from being held to be anticompetitive especially in instances where the product involved is a standardized item widely and frequently sold in the area during the years involved. In *Hartley & Parker, Inc. v. Florida Beverage Corp.*, 307 F.2d 916, 920, and 921 (5th Cir. 1962) the court allowed a suit for damages arising from alleged discrimination despite the fact that the last sale to the nonfavored customer occurred before the favored customer made any purchases.

There is ample evidence to show the contemporaneous sales in the case at bar. But, since Holiday Magic's policy is one of selling at stipulated discounts and always has been, there should be no real question in this respect.

E. Holiday Girl and Organizer Distributors who do not Purchase Directly from Holiday Magic are Indirect Purchasers within the Meaning of the Robinson-Patman Act.

Both Master and General Distributors purchase their merchandise directly from Holiday Magic, Inc., (See Findings, Part XLV) while Organizers and Holiday Girls purchase through their Sponsor, and are 'indirect purchasers' from Holiday Magic, Inc., within the meaning of the Robinson-Patman Act, as the Commission has defined this concept through the years. (See Findings, Parts XV, and XXVI.)

The two elements of control and contact normally cited as prerequisite to a finding of an indirect purchaser are abundantly present in the instant matter. Indeed, a greater degree of control and contact by a company over its distributors is difficult to imagine.

From the very inception of the relationship at the company controlled opportunity meetings, to the training programs, rigid rules and regulations restraining the freedom of the distributors in pricing and customers limitations, the termination of those who violate the rules, the entering into contracts between distributor and company, etc., the company maintains strict controls and numerous contacts with the distributors.

The sale by Masters or Generals to Organizers and Holiday Girls is quite literally controlled by Holiday Magic. Organizers and Holiday Girls can only buy from the Master or General sponsoring them, and then only at the prices stipulated by Holiday Magic according to the

In Purolator Products, Inc. v.

In Purolator Products, Inc., v. F.T.C., 352 F.2d 874, (1965), cert. denied, 389 U.S. 1045, 88 S. Ct. 758 where the respondent sold at discriminatory prices to wholesalers with whom jobbers (the alleged indirect purchasers) completed with in sales to dealers, the Court held that where 'a seller can control the terms upon which a buyer once removed may purchase the seller's product from the seller's immediate buyer, the buyer once removed is for all practical, economic purposes dealing directly with the seller.' The Court further stated that 'if the seller controls the sale, he is responsible for the discrimination in the sale price * * *.'

In the Purolator case, the Commission found sufficient control to apply the indirect purchaser doctrine where the facts showed that (1) Purolator had at one time reserved to itself the legal right to control sales and (2) Purolator wrote and supplied the wholesaler/jobber agreements and (3) utilized suggested resale prices lists. See also In the Matter of Champion Spark Plug Co., 50 F.T.C. 30, (1953) at pp. 4345 where the Commission applied the indirect purchaser doctrine upon finding elements of control similar to those above. In its opinion, the Commission stated 'The terms and conditions of sales to such Franchise accounts were fixed by Champion. The degree of control exercised by respondent over sales to such Franchise accounts was such that such sales were in all essential respects sales by respondent, these indirect accounts are considered by the Commission to be purchasers within the meaning of the Clayton Act, as amended.'

F. Discrimination by Holiday Magic, Inc. With Respect to Sales to Holiday Girls

Holiday Girls purchase from Masters and Generals in the same manner as do the Organizers, but resell only at the consumer level. Organizers resell to Holiday Girls as well as to consumers.

In selling at retail to the ultimate consumers, Holiday Girls, depending upon their volume for the month, buy at either a 30 or 35 percent discount, compared to 55 percent discount for Masters and 65 percent discount for Generals, who certainly perform no additional function with respect to their own retail sales.

It is well established that when a buyer performs both wholesale and retail functions, as in the case of Masters and Generals at bar, the seller must be careful to distinguish between the two in his pricing policies if he chooses to engage in price differentiation between competing customers. Holiday Magic has not done so. This is perhaps one reason why turnover is so great at the Holiday Girl level.

G. Discrimination by Holiday Magic, Inc. with Respect to Sales to Organizers

Except to the extent that Organizers do not purchase their products directly from the company, they are in the same position that a Master would be in attempting to compete with a favored General. Only the Organizer is in a position even lower than the Master in terms of discount.

Compared with the Master, who purchases at 55 percent off list price, the Organizer will purchase at anywhere from 30 percent to 55 percent off list price according to Holiday Magic's refund bonus schedule. Thus, the Organizer's maximum disfavored buying percentage visavis the General is 35/70 or a 50 percent discount. For every \$70 the Organizer spends on his products, the General spends only \$35. Similarly, the Organizer may purchase up to as much as a 100 percent markup in price.

There are of course, some functional distinctions between the Generals and Masters and their Organizers, but only to the extent that the Master or General sells his products to the organizer rather than directly at retail himself. However, the volume discount arrangement, which is cumulative on a monthly basis, indicates the frailty of the argument that the difference in price to Organizers is functionally justifiable. The more an Organizer buys, the less disfavored he becomes, and the more disfavored the Master becomes with respect to the General since with very substantial sales by a Master to an Organizer, the Organizer's volume discount will approach 55 percent, which will create a situation where the Master is not being reimbursed for his functions at all. Therefore, all discriminations along the way show that the price differential is not based upon functional distinctions. The more the Master performs in the way of function, the lower is his profit on those sales. The CRS usage fee alone will absorb most of his gross profit, since the Master must pay 5 percent of retail value to CRS on Organizer purchases. When the Organizer reaches the discount of 46 percent, the Master loses money. This is not a recognition of function, but a total disregard thereof.

H. Competitive Injury

It is well established that substantial difference in prices charged to competing customers are sufficient to base a finding that such difference in prices, in and of themselves, may tend to substantially lessen competition at the secondary level. *E. Edelman & Co. v. F.T.C.*, 239 F.2d 152, 154 and 155 (7th Cir. 1956); *Cert. denied*, 355 U.S. 941 (1956); *rehearing denied*, 356 U.S. 905 (1957). Especially so as this is true in situations such as we have here where profit margins are so extremely low.

The difference in price charged by Holiday Magic to Generals and Masters is of such magnitude as to warrant a finding that it is 'reasonably possible,' as well as 'reasonably probable,' that such price difference may tend to substantially lessen competition between the favored and nonfavored customers. (See *F.T.C. v. Morton Salt*, 334 U.S. 37 (1948); *E. Edelman & Co.*, *supra*, at 154.)

The Supreme Court's decision in *Federal Trade Commission v. Morton Salt Co.*, 334 U.S. 37 (1948) should be ample precedent for the complaint alleging unlawful price discrimination in the instant matter.

The importance of the Morton Salt decision is that the Commission's finding that the effect of the quantity discount on the salt carloads may be substantially to lessen competition was proven sufficiently

by the showing that said discounts resulted in price differentials between competing purchasers sufficient in amount to influence the resale price of salt. Furthermore, the Court added that the showing of 'substantial' differentials in price to competitors is in itself, sufficient to justify a conclusion (of the Commission) that injury to competition was adequately supported.

When the facts of Morton Salt are compared with those of Holiday Magic, the substantial discounts of salt pale in comparison to the discounts in Holiday Magic.

The Morton salt prices per case were as follows:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

These figures reveal that the minimum discount is $.10/1.60$ or 6.2 percent. The other two discounts are $.20/1.60$ and $.25/1.60$, or 12.5 percent and 15.6 percent, respectively. These figures, it must be remembered, are further affected by the realization that salt is a small item in most wholesale and retail businesses, and that less than 1/10 th of 1 percent of Morton's total salt business failed to get the benefit of the carload lot discount.

Holiday Magic's discounts are not only substantially greater than the substantial discounts in the Morton salt plan, but also account for the major or entire business of its retailers and wholesalers, and all sales by the company produce the discount via the rebate system.

In *Muller Co. v. F.T.C.*, 323 F.2d 44, (7th Cir. (1963); cert. denied, 377 U.S. 923 (1964), the court sustained the Commission's finding of the requisite competitive injury based solely on the substantiality of a price difference of precisely 10 percent between the favored and nonfavored customers. [FN10]

The Courts have repeatedly held that evidence of specific or actual adverse effects on competing purchasers need not be shown. The best exposition of this is found in *Moog Industries, Inc. v. F.T.C.*, *supra*, wherein the court held:

The Commission was not required to show that petitioner's rebate system has, in fact, adversely affected competition. The language in the 'effect' clause of the statute is 'may be substantially to lessen competition * * *' (Italics supplied.)

The Supreme Court has repeatedly held that Section 2(a) of the Act does not require a finding that the discriminations in price have in fact had an adverse effect on competition. *Corn Products Refining Co. v. F.T.C.*, 324 U.S. 726, 738, 742; *Federal Trade Commission v. Morton Salt Co.*, 324 U.S. 37, 46; *Standard Fashion Co. v. Magrane-Houston Co.*, 258 U.S. 346, 356, 357. It has also held that 'The statute is designed to reach such discriminations 'in their incipience' before the harm to competition is effected. It is enough that they 'may have the prescribed effect.'" *Corn Products case*, 324, U.S. at 738.

For more recent expressions of this proposition, see *Monroe Auto Equipment Co. v. F.T.C.*, 347 F.2d 401, 404 (7th Cir. 1965); cert. denied 382 U.S. 1009 (1966). There, the court upheld the Commission's finding

of the requisite anticompetitive effects based solely on the fact that the price discriminations were 'far in excess of the average net profit usually earned by automotive parts jobbers.'

The courts have further held that the lack of price competition between favored and nonfavored customers is no barrier to a finding of a lessening of competition through secondary line discrimination. *Foremost Dairies, Inc. v. F.T.C.*, 348 F.2d 674 (1965), cert. denied 382 U.S. 759; *Standard Motor Products, Inc. v. F.T.C.*, 265 F.2d 674, 676 (2d Cir. 1959), cert. denied 361 U.S. 826 (1959). Indeed the courts found a lessening of competition even in instances in which resale prices were rigidly adhered to by both favored and nonfavored customers. See *National Dairy Products v. F.T.C.*, 395 F.2d 517, cert. denied, 393 U.S. 977 (1968); *Edelmann*, supra.

And courts have upheld a finding of a lessening of competition despite testimony to the contrary from nonfavored customers. See *Foremost Dairies, Inc.*, supra; *Moog Industries*, supra, 238 F.2d at 50 and 51; *Whitaker Cable Corp.*, supra, 239 F.2d at 255; *E. Edelmann & Co.*, supra, 239 F.2d at 155. The requisite finding of anticompetitive injury has been upheld even in the extreme case where some nonfavored customers prospered more than some favored customers. *Standard Motor Products*, supra, 265 F.2d at 676.

Because of the substantiality of the discounts, and the nature and amount of the expenses which both Master Distributors and General Distributors must endure in order to remain in business, the likelihood is great that the General with his favored status is far more likely to remain a viable competitor longer—even in situations where he is suffering losses such as we have seen exist at bar, if he can plow his added income back into the business in order to get it off the ground and achieve a sounder operation in the long run without the release fees and overrides to distract him.

I. Low Profit Margins

The expenses of Masters and Generals are many, and varied. For example, advertising, office space, warehouse room, samples, sales aids, auto, telephone, shipping, training, recruiting, council and distribution center, and other expenses all eat away at a distributor's gross profits. Their expenses, of course, highlight the injury to various Distributors.

The record also amply demonstrates the low and often negative profit margins in this business. The tabulation of the various profit levels have been shown on the three charts covering Milwaukee, Miami and Chicago, for Distributors from whom profit and loss statements were obtainable.

In order to make a profit, sales must be higher than cost of sales. However, in many cases the gross profit margin is so low that a reasonable profit could not be anticipated because of the other operating expenses, at the volume of business that was available to each individual.

As an example, Sharon Fisher traded in the Milwaukee area, showed gross receipts of \$2,427 as a Master Distributor, which yielded a gross profit of \$1,890. However, the other operating expenses

heretofore mentioned amounted to \$1,990, which resulted in a net operating loss of \$100. If Sharon Fisher had been a General (which she finally did become) her gross profit margin would have been substantial enough for her to have absorbed the heavy operating expenses and still show a profit rather than a loss. Sharon Fisher's gross receipts do not reflect additional income that would be available to a General only such as the overrides and release fees.

Of those few distributors such as Belton, Toepfer, and Benson who do show large profits as a percentage of gross sales, the record reflects that in every case this was a result of the release fees and overrides which preoccupied their time. No Master Distributors have overrides and release fees available to them, and so no Masters are in the position of having substantial gross profits as a percentage of gross sales.

J. 'Availability' of Lower Prices

Holiday Magic could of course defend the sales plan as being 'available' to all distributors, and therefore a defense to a Section 2(a) proceeding.

Although the availability concept does not specifically appear in Section 2(a), the availability requirements for promotional payments on proportionally equal terms under Section 2(d) of the RobinsonPatman Act, has enabled the availability concept to work its way into Section 2(a). (See 'The Status of 'Availability' under Section 2(a) of the RobinsonPatman Act' by Ira M. Millstein, Vol. 42 Number 3, New York University Law Review, May 1967.)

As applied to Holiday Magic, the argument fails both with regard to the quantity discounts offered Holiday Girls and Organizers, and the discrimination between the purchases of the Masters and the Generals who buy without regard to quantity discounts.

Dealing first with the MasterGeneral differential, it is clear that the concept of availability cannot apply. The Master distributor does not purchase his products under a discriminatory price, the argument goes, because he may some day qualify for the General Distributor position.

This position lacks support both in law and in reason. It is unreasonable because it is so obviously contrary to the very purpose of the RobinsonPatman Act which is 'to curb and prohibit all devices by which large buyers gained discriminatory preferences over smaller ones by virtue of their greater purchasing power.' F.T.C. v. Henry Broch & Co., 363 U.S. 166, 168 (1960). To simply argue that some day the small can become big and thereby be in a position to share in the discrimination and competitive advantage would be folly.

In the Dayco Corp. case, Trade Reg. Rep. (Transfer Binder 19631965) P17039, at 22140 (1964), the Commission was faced with the argument that because lower prices would be available to individuals who could form buying groups of their own, 'lower prices were available.' The Commission stated that

'lower prices are not 'available' where a purchaser must alter his purchasing status before he can receive them.' Id. at 22140.

The 'availability' argument with respect to a volume discount arrangement, is more sophisticated. The argument is that, in a schedule of quantity discounts offered to all customers even if not cost justified, a price is not discriminatory where the highest bracket is within the purchasing range of the average small purchaser. The availability concept thereby assumes the disruption of the nexus between the price discrimination and any potential injury. [FN11]

As indicated above, the Dayco case suggests that the Commission indicated it might reject an availability defense if the customer is required to take any action whatsoever beyond his ordinary purchasing routine. The Commission's declaration in its entirety is to the point, at p. 22140.

Lower prices are not 'available' where a purchaser must alter his purchasing status before he can receive them. Patently, a lower price is not 'available' to a merchant who must, in order to qualify, purchase more goods within a given time period.

If the disfavored customer had to undergo a change in his status or incur a substantial expenditure to receive the favored discount, the discount is not 'available' to all and therefore there is competitive injury. In the Matter of Alhambra Motor Parts, 57 F.T.C. (1007 (1960)) the Commission found that members of a buying group induced discriminatory discounts since such discounts weren't available to other jobbers. Subsequent to the entering of an order forbidding such discrimination, the Commission accepted a compliance report which provided for the continuation of the buying group and its receipt of discounts provided essentially that anyone could join the group without paying any charge. [FN12]

The Commission also examined the question of an availability defense in United Fruit Company, et al., Dkt. No. 8795, Jan. 12, 1973 [82 F.T.C. 53]. It held that mere theoretical availability was insufficient to constitute a defense to a price discrimination charge. It characterized as a 'meaningless gesture' an offer to sell at the favored terms that would require the unfavored customers to construct new distribution facilities.

An examination of the factual background of this case shows that the extra discount granted General Distributors clearly was not 'available' to Master Distributors. Masters could not simply avail themselves of the added discount by changing their purchasing habits, as would be true in the case of an extra discount given on a monthly order. Instead these Masters would have had to more than double their initial investment plus recruit a competitor!

It therefore becomes clear that the discount at which General Distributors buy their Holiday Magic products are not 'available' at all to Master Distributors, to Organizers or to Holiday Girls. With respect to sales at the retail level, for which the Holiday Girls and Organizers compete, these lower level Distributors would have to pay approximately \$9,000 today, plus recruit a Master Distributor in order to have the 65 percent discount available to them.

K. No Cost Justification

If no function is performed by the General which is compensated by the seller in the form of an additional discount, it can only be justified if such differentials make only due allowance for differences in the cost of manufacture, sale or delivery, and if such cost differences are those resulting from the differing methods or quantities in which the goods are sold or delivered to the Master and General Distributors.

No differences in the cost of manufacture, sale or delivery on the part of Holiday Magic were even raised by respondents in their defense case that would seek to justify such price discrimination. If anything, the record indicates that it may be cheaper for Holiday Magic to sell to Masters than to Generals for the simple reason that the bulk of Master orders appear to be the initial inventories, whereas the General never has to order products in the quantities of the initial Master inventory.

The one argument which has been made is that Generals perform services for Holiday Magic in training and motivating Masters, which Holiday Magic would have performed but for its performance by the Generals and the price structures reflect 'compensation' for their services rendered.

Not only are such 'services' fictitious, but there is no way that a discount to a General Distributor on his purchases for resale to the General's customers in any way is connected to the alleged training and motivation of a Master Distributor, to whom he does not sell.

Certainly a General with gross sales of \$10,000 per month performing a given amount of work in training a Master for Holiday Magic should not be compensated 10 times less than another General (or the same General in another month) having gross sales of \$100. There is simply no connection between the Generals' own purchases and the 'services' to a Master. If anything, it is an inverse proposition. The more the General purchases, the more likely he is to dwell on his own business activities, yet he will receive far more by way of discounts from Holiday Magic.

It is conceptually impossible to base a payment for services rendered on proportion to the success of the person performing the service in unrelated business activities (his own).

But most importantly, the record establishes that it is Holiday Magic, Inc., through its Instructor General and Trainer General programs that does all the training for the Masters, and for which the Masters have to pay. The record is replete with instances in which no services were performed by a General, and nothing was ever done, except that Holiday Magic would tell the Master Distributor that he's in business for himself and that he should be able to handle all of his own problems; or perhaps join a council in his area.

No cost justification study of any kind was evidenced. The burden is on respondents to present one. They haven't shown that it is less costly to sell to General Distributors than to Master distributors.

In *F.T.C. v. Morton Salt Co.*, 334 U.S. 37, at pp. 43, 45, 48, the Supreme Court held that in supporting a cost justification defense it must be shown that the difference in price must be based upon actual cost differences, to the seller with the burden of showing a cost justification upon the one shown to have discriminated in prices.

L. The 10 Percent Override

The 10 percent override should not be confused with the differential in price between Masters and Generals since the General will receive an additional 10 percent of the list price purchase value of Master Distributors in his organization. This means that after the basic discriminations are taken care of, the General receives a compounded 10 percent payment, which makes the discrimination, in net effect, much greater.

The 10 percent override is directly related to the purchase of products by the Master the nonfavored customer. Every time he purchases products from Holiday Magic, Inc., the extent of his nonfavored status is given to the General. It is, in effect, a compound discrimination in 'net' price.

Discriminatory rebates are as much a discrimination in 'net' price as are discriminations *ab initio*. In a 'net' basis there is no difference, and that is all there is to the statutory requirement.

There is absolutely no relation between the amount received by way of overrides to a General and the time, effort or money spent on an alleged training program. It is conceptually impossible to pay an override of 10 percent for supposed services rendered, on the purchases of a Master Distributor allegedly receiving aid since such payment must be based upon savings to Holiday Magic, and the company would run up a greater expense in training a less successful Master than a more successful Master, yet the General who 'trains' the unsuccessful Master gets little or nothing for his efforts. In reality, training is performed by the so-called Instructor Generals and Trainer Generals, who are paid for their services by the individuals who actually receive the training.

Such training as there is is provided by councils and the IG and IG program, both of which are supported by dues or payments from Masters and Generals.

M. Customer Restrictions and Price Discriminations

If anything, Holiday Magic's customer restrictions upon its Distributors highlight the inherent competition existing between and among them. If there were no competition, there would be no need to make it appear restrictions were being imposed on selling to one another's customers. At any rate, customer restrictions do not inhibit potential competition.

Even the assignment of territorial routes without consistent enforcement does not insulate Distributors from competition as an inducement to participation. In order to obtain a route and keep a route, a minimum of \$300 a month in volume had to be obtained and maintained. Since this was often (and

usually) not the case, the routes were changing hands often. The product competition and competition in obtaining product routes is undeniable in the presence of fluctuating territorial overlapping adjustments to keep pace with Holiday Girl turnover.

All this, of course, indicates that with or without customer limitations or exclusive routes for Holiday Girls (which is all the complaint alleges with respect to routes) Distributors are in potential competition. There is no need to show that Distributors are in competition by selling to the same customer. The absurdity of this approach would lead to the illogical conclusion that Distributors selling high priced items, or once in a lifetime items, are not in competition because the same customer does not buy from both Distributors.

N. Adherence to Holiday Magic SoCalled Marketing Plan Is Inherently Price Discriminatory

If the mandatory plan is adhered to as evidenced, the discounts allowed at different levels of distributorships must not only be conducive to price discrimination but actually price discriminatory as reflected by the foregoing Findings and Conclusions in the absence of respondent affirmative proof to the contrary.

VII. Summary of Conclusions

1. The Federal Trade Commission has jurisdiction over respondents and over this proceeding.
2. Respondent Holiday Magic, Inc. is engaged 'in commerce' within the intent and meaning of Section 5 of the Federal Trade Commission Act, and is engaged in the interstate sale of its Holiday Magic products within the intent and meaning of Section 2 of the Clayton Act, as amended.

Respondent William Penn Patrick is the founder of Holiday Magic, Inc. has been and is responsible for establishing, supervising, directing and controlling the business activities and practices of Holiday Magic, Inc.

The entire unconscionable scheme which respondents have engaged in was the sole creation of respondent Patrick, and the corporate respondent was simply the means he created to carry out this scheme.

It is respondent Patrick whose future conduct must be the concern of the Commission and it is Patrick's conduct which the relief must be designed to effectively restrain if future law violations are to be prevented.

Respondent Fred Pape was responsible, along with others, for establishing, supervising, directing, controlling and participating in the businessactivities of respondent Holiday Magic, Inc.

There is public interest in issuing a cease and desist order against Mr. Pape in his individual capacity in order to prohibit future business activities of a similar nature on Pape's part.

Respondent Janet Gillespie was responsible, along with others, for establishing, supervising, directing, controlling and participating in the business activities of respondent Holiday Magic, Inc.

There is public interest in issuing a cease and desist order against Gillespie in her individual capacity in order to prohibit future business activities of a similar nature on Gillespie's part.

Except to the extent that actual and potential competition has been lessened, hampered, restricted and restrained by reason of the practices alleged in the complaint, respondents' Distributors and dealers, in the course and conduct of their business in distributing, offering for sale, and selling of cosmetic and home care products are in substantial competition in commerce with one another, and corporate respondents' distributors are in substantial competition in commerce with other firms or persons engaged in the manufacture or distribution of similar products.

Corporate respondent is in substantial competition with other firms or persons engaged in the manufacture or distribution of cosmetic and home care products.

Respondents have adopted, placed in effect and carried out, by various methods and means, the marketing plan to hinder, frustrate, restrain, suppress and eliminate competition in the offering for sale, distribution and sale of cosmetics, toiletries and home care products.

Respondents have entered into contracts, agreements, combinations or understandings with each of its Distributors whereby said Distributors agree and are required to maintain the resale prices at wholesale and retail levels, as established and set forth by the company, notwithstanding that some of such Distributors are located in states which do not have fair trade laws.

Respondents have entered into contracts, agreements, combinations or understandings with each of its Distributors whereby said Distributors agree and are required to maintain the discounts, overrides, rebates, bonus schedules, and finder's fees, as established and set forth by the company, notwithstanding that some of such distributors are located in states which do not have fair trade laws.

Respondents have entered into contracts, agreements, combinations or understandings with each of its Distributors whereby said Distributors are restricted as to whom they may purchase their cosmetics and home care products from, and to whom they may resell them, by:

(a) requiring Holiday Girls and Organizers to purchase only from their sponsoring distributors:

(b) prohibiting its Distributors from buying back merchandise already sold to other distributors in the distribution line;

(c) restricting the Distributors from transferring into the organization of any other Distributor of their choice, from whom they may choose to deal with and purchase product.

The practice of restricting the Distributors to purchasing Holiday Magic products only from the specified source constitutes an unreasonable restraint of trade and an unfair method of competition.

Respondents have engaged in the practice of restricting their Distributors as to the customers to whom they may resell their Holiday Magic products by:

(a) Requiring that Masters, Generals and Organizers sell at wholesale only to Organizers and Holiday Girls whom they have sponsored into the Holiday Magic program;

(b) Prohibiting Distributors from recruiting or sponsoring other Distributors who have already been sponsored into the Holiday Magic program;

(c) Prohibiting Distributors from selling at retail to consumers or retail customers who are currently being serviced by other Holiday Magic Distributors.

The practice of restricting the Distributors from selling their Holiday Magic products to specified persons or classes constitutes an unreasonable restraint of trade and an unfair method of competition.

Respondents have engaged in the practice of restricting the retail outlets in which Holiday Magic products Distributors may sell or offer for sale Holiday Magic products by prohibiting Holiday Magic Distributors from placing Holiday Magic products in drug stores, department or variety chain stores, grocery stores or discount stores. The practice of restricting the retail outlets in which or from which Holiday Magic Distributors may offer their Holiday Magic products for sale constitutes an unreasonable restraint of trade and an unfair method of competition.

Respondents have engaged in the practice of requiring its Distributors to obtain the prior approval of Holiday Magic, Inc. prior to the advertising or promotion of Holiday Magic products by the Distributors.

The practice of requiring the Holiday Magic Distributors to submit all forms of advertising for the Holiday Magic product to the respondent for approval prior to the advertisement of same constitutes an unreasonable restraint of trade and an unfair method of competition.

Respondents enter into agreements with their Distributors and restrict and delimit their Holiday Magic Distributors from engaging in their business activities free of arbitrary and undue interference by corporate respondent in that Holiday Magic, Inc. requires:

(a) that in the event a partnership distributorship dissolves, the departing partner is required to revert back to his original sponsor;

(b) that in the event a General distributorship partnership dissolves, the departing partner must requalify as a new Master Distributor under his original sponsor, create a replacement Master and pay a release fee to qualify for the General position again;

(c) that the addition of partners to an existing Master or General distributorship or the sale of a General or Master distributorship must meet the same retail list price value purchase requirement as do Master Distributors;

(d) that distributors may only have a financial interest in one Holiday Magic distributorship at a time;

(e) that Distributors must not enter into any agreement with any other Distributor to make a division of profits, assets or new recruits in violation of the marketing plan;

(f) that Distributors must not make a consignment of the Holiday Magic merchandise to any person.

The restrictions and limitations that Holiday Magic places upon its distributors constitute unreasonable restraints of trade and unfair methods of competition.

Respondents and their representatives have engaged in the practice of allocating exclusive sales territories to Holiday Girls in connection with the sales of Holiday Magic products to retail customers in certain areas.

The allocation of territories to Holiday Girls, and the manner in which such territories were allocated, constitute unreasonable restraints of trade and unfair methods of competition.

Master Distributors and General Distributors are at the same functional level of distribution in connection with wholesale sales.

Master Distributors, General Distributors and Holiday Girls are at the same functional level of distribution in connection with direct retail sales to the consuming public.

Master Distributors and General Distributors in the same geographic market area including the city and suburban area in which they reside and do business are in actual and potential competition with one another in connection with the wholesale sale and distribution of Holiday Magic products. Master Distributors, General Distributors and Holiday Girls engaging in retail sales activities in the same geographic area are in actual and potential competition with one another in connection with retail sales of Holiday Magic products.

Respondent Holiday Magic, Inc., is discriminating in price by selling to Master Distributors at a substantially lower price than it sells to General Distributors.

Holiday Girl Distributors and Organizer Distributors are indirect purchasers of Holiday Magic, Inc.

Holiday Magic, Inc. is discriminating in price indirectly by selling to Organizers and Holiday Girls indirectly at substantially lower prices than it sells to other Organizers, Masters and Generals.

The effects of such price discrimination may be to substantially lessen competition or tend to create a monopoly.

The operation of respondents' merchandising program contemplates geometrical increases in the number of distributors to insure participants the earnings represented and implicitly realizable from the program.

Respondents' marketing program holds out to prospective Distributors the lure of making large sums of money through a virtually endless chain of recruiting additional participants to whom products need not be sold, or who are at the same functional level as the recruiter.

Participants may be, and in substantial numbers of cases were and will continue to be, unable to find additional investors or participants in a given community or geographical area by the time that they enter the merchandising program.

As to each of the individual participants in respondents' merchandising program, respondents' recruitment program must of necessity ultimately collapse when the number of potentially available Distributors which can be recruited to serve a particular area is exhausted and/or the number of distributors theretofore recruited has so saturated the area with Distributors as to render it virtually impossible to recruit any more.

Although some participants in respondents' merchandising program may realize a profit through recruitment, all participants do not have the potentiality of receiving equivalent sums of money through the recruitment process, and the greater the number of Distributors previously recruited, the lower the actual chances for such success.

Respondents' merchandising program is operated in such a manner that the realization of financial gains is often predicated upon the exploitation of others who have been induced to participate therein, and who have virtually no chance of receiving the kind of return on their investment implicitly realizable and represented as realizable in the said merchandising program.

Participants in respondents' merchandising program are induced to invest substantial sums of money on the possibility that the activities and efforts of others, over whom they need exercise little or no control, they will receive substantial financial gains.

The realization of substantial financial gains in respondents' merchandising program need not depend upon the skill and effort of the individual participants, but instead may result from predominant elements of chance, such as the number of prior participants in the program, the ability of their own recruits to recruit other Distributors, and the ability of their own recruits to either sell merchandise or recruit other persons who may be successful in selling merchandise.

Respondents' merchandising program is in the nature of a lottery because it is a gaming device, gift enterprise or lottery scheme.

The marketing plan is not primarily designed as an offer to knowledgeable businessmen, competent to weigh and evaluate commercial risks. It is designed rather to appeal to uninformed members of the general public, unaware of and unadvised of, the true nature of the risks run by persons with limited capital who are led to part with that capital by promise and hopes which are seldom, if ever, fulfilled.

Implicit in the arrangement of the Holiday Magic marketing plan is the promise, rarely if ever kept, that the recruiting Distributor can, without himself working, profit greatly from the work of others.

Respondents have represented to prospective participants, directly and indirectly, that it is not difficult to recruit and retain persons who will invest or participate in the Holiday Magic merchandising program.

It is difficult, and becomes increasingly more difficult under respondents' geometrically increasing program to recruit and retain persons who will invest in respondents' program.

Respondents have represented to prospective participants that Holiday Magic products will be or are advertised widely and substantially in the community or geographic area in which such representations are made.

Respondents do not advertise their products to the extent that they or their representatives represent.

Respondents have represented to prospective Distributors, directly or indirectly, that employment is being offered.

Respondents, their representatives and Distributors do not offer employment in connection with the Holiday Magic marketing program, but instead use advertisements indicating employment is offered to obtain leads to prospective investors in their marketing program.

Respondents have represented to prospective participants, directly and indirectly, that participants in the Holiday Magic marketing program have the reasonable expectancy of receiving large profits or earnings.

Most participants in respondents' marketing program do not in fact have a reasonable expectancy of receiving the large profits or financial gains represented, and most participants in respondents' marketing program do not and have not received the earnings and income represented as reasonably attainable.

Respondents have perpetuated a scheme fraught with misrepresentations from which they try to insulate themselves by using devious contractual language and so-called 'hypothetical' examples of earnings potential not clearly understood or understandable by persons exposed to this scheme.

Respondents have calculated the program to enrich only themselves at the expense of innocent would-be small businessmen, lured into it by 'getrich quick' promises. Respondents even require that these new Distributors pay for their own training programs and sales manuals, which are of dubious value.

Because of the nature of the Master Distributors' inventory loading and the incredibly large numbers of such Master and General Distributors who bought inventories of cosmetics in order to participate in respondents' merchandising program or marketing scheme, the inventories in many situations are largely worthless to persons who are unable to sell the same at wholesale or at retail.

VIII. Nature of the Order as Related to Restitutive Relief

An order which merely prohibited respondents from engaging in similar frauds in the future would have no real effect on preventing respondents from devising another illegal business venture.

The Commission in its most recent expression of its powers to order restitution in *Universal Credit Acceptance Corporation, et al.*, Docket No. 8821, issued Feb. 16, 1973 [82 F.T.C. 570], stated the broad powers it has in this respect as follows:

The Courts have made it abundantly clear that the Commission is duty bound to devise an appropriate and reasonable remedy to cure violations found to exist and to prevent their recurrence. The central purpose of relief is 'to prevent violations of the Act, the threat of which is indicated by past conduct of the petitioners.' *Feitler v. F.T.C.*, 201 F.2d 790, 794 (9th Cir.), cert. denied, 346 U.S. 814 (1953).

Moreover, the Commission through its order 'cannot be required to confine its road block to the narrow lane the transgressor has traveled; it must be allowed effectively to close all roads to the prohibited goal, that its order may not be bypassed with impunity.' *F.T.C. v. Ruberoid*, 343 U.S. 470, 473 (1952); *F.T.C. v. National Lead Co.*, 352 U.S. 419, 431 (1957). Once a violation is found the Commission must 'frame its order broadly enough to prevent respondents from engaging in similarly illegal practices in [the] future * * *.' *F.T.C. v. Colgate Palmolive Co.*, 380 U.S. 374, 395 (1965); *Atlantic Rfg. co. v. F.T.C.*, 381 U.S. 357, 367 (1965); *F.T.C. v. Henry Brock & Co.*, 368 U.S. 360, 364 (1962). Through these orders the Commission is required 'to develop that enforcement policy best calculated to achieve the ends contemplated by Congress. * * *' *Moog Industries, Inc. v. F.T.C.*, 355 U.S. 411, 413 (1958). We conclude, therefore, that restitutionary relief is essential in this case in order to redress the competitive balance disrupted by respondents' fraudulent program and prevent repetition of these practices in the future.

And as to the liability of individual respondents for restitutionary relief:

Respondents argue that respondent Heater should not be subject to the refund provisions in the order because he received no income from the marketing and operation of the program, and alternatively, that he should be excused from the refund provisions on humanitarian grounds. Neither contention has any merit. The Law Judge found that respondent Heater was the essential author and promoter of the illegal credit card program. He created the corporations through which the program was implemented.

He was the sole stockholder of the corporations which were active during the relevant period, served as president of both International and Universal for most of the relevant period and was found by the Law Judge to have had primary responsibility for establishing, supervising, directing and controlling all of the acts and practices of these corporate respondents. He was in fact the alter ego of these corporate respondents which had no real existence separate from him.

The Law Judge's finding that Heater dominated every aspect of the program is fully supported by the record. All member and franchisee complaints were ultimately brought to his attention and were answered in accordance with his directions. He took an active role in the preparation of the program's promotional material and prepared material was submitted for his approval. Additionally, he often acted as an instructor for the franchisees. His influence in the origination and implementation of this fraudulent scheme was all pervasive. [Footnotes and citations omitted]

Restitutive relief under the Commission's concept aforesaid is justified in the case at bar:

(a) The obtaining by respondents of the illegally obtained money from investors is a violation of Section 5 of the Federal Trade Commission Act, and therefore the retention and failure to refund same is a continuing violation of Section 5.

(b) There is no need to plead in the complaint that the retention and failure to refund that which has been illegally obtained is a violation of Section 5 since the complaint alleges the taking of the money as a violation. If the taking is unlawful, then the retention is automatically unlawful.

(c) Respondents were formally put on notice of complaint counsel's intentions to seek restitutive relief the first day of trial on November 1, 1971 (See Tr. 6870) although not provided for in the proposed order attached to the complaint which in any event is not binding on the Commission or administrative law judge unless misleading. Adequate and timely notice by complaint counsel on the record with regard to seeking restitutive relief clearly meets all requirements of due process necessitating the elimination of surprise.

(d) Adequate relief on the false, misleading and deceptive practice allegations require restitutive relief.

(e) Adequate relief in the anticompetitive aspects of this matter including the anticompetitive nature of the false, misleading and deceptive matters, requires restitutive relief.

(f) Restitutive relief is proper not only with respect to Mr. Patrick and Holiday Magic in connection with Holiday Magic activities, but also against Mr. Patrick in connection with with all aspects of the order since he is legally responsible in his individual capacity.

Because he is legally responsible in his individual capacity, by continuing to refuse to refund money from other operators of the same ilk as Holiday Magic (if any) he engages in a continuing violation of the provisions of the order.

Restitution is therefore appropriate with respect to all activities of Mr. Patrick which violate the order.

The record reflects a recent change in the control of Holiday Magic, Inc. in that Holiday Magic is now a subsidiary of Marketing Associates, Inc. which in turn is a subsidiary of U. S. Universal, Inc. Thus, corporate control and responsibility over the acts and practices of Holiday Magic would extend to these two corporations as well as any other agents, successors or assigns within the organization of the corporate structure.

Since these corporations have not been made parties to the complaint an order specifically directed to them would be improper. However this cannot effect the impact of the order which is directed to the agents, representatives, successors and assigns of Holiday Magic, Inc. regardless of who they are now or eventually may turn out to be (i.e., Marketing Associates Inc., U. S. Universal Inc. or any other entity). All parties have been placed on notice to this effect pursuant to the proposed order annexed to the complaint.

In concluding it might be well to point out that unfortunately in this particular and exceptionally protracted case it has been impossible to render findings and conclusions with more brevity in the presence of the volume of evidence involved reflective of Holiday Magic's entire plan and details of the operation thereof as related to seven different charges or counts, each of which is premised upon a different legal theory involving deception, lottery, price fixing, price discrimination, Holiday Magic control over independent contractors indicative of agency relationship under certain circumstances and condonation of certain independent contractor malpractices from which adoption may be reasonably imputed. In fairness to the parties it has also been necessary to discuss in detail a major part of all the evidence indicative of Holiday Magic's complete modus operandi with extensive precise quotation of the corporate respondents' publications including manuals and directives as well as other media.

The issues involving an evaluation of whether or not the entire plan per se violates public policy as related to fair trade practice under Section 5 of the Federal Trade Commission Act and whether or not the plan is conducive to and in fact involves RobinsonPatman violations under Section 2(a) of the Clayton Act, also requires extensive recitation of the evidentiary facts and discussion in order to avoid inept consideration. In the foregoing connection to assure credibility and accuracy of the findings, documentary excerpts have been quoted rather extensively to avoid any possible out of context misinterpretation of the findings themselves. To have otherwise abbreviated summarily would have only enhanced unwarranted and time consuming interpretive argument hereafter over what the relevant and material evidence accurately is in resolving the enumerable issues. Therefore careful and exhaustive consideration of every facet of the evidentiary findings, conclusions and order has been given to the thorough and able although unabbreviated proposals and argument of complaint counsel and respondent counsel. The excellent charts prepared by complaint counsel's staff reflecting profit margins, sales summaries as well as areas of competition, also vividly substantiate the findings and conclusions justifying the entry of the order hereinafter set forth.

ORDER

I.

It is ordered, That respondent Holiday Magic, Inc., a corporation, its officers, agents, representatives, employees, successors and assigns, and respondent William Penn Patrick, individually and as chairman of the board of directors of Holiday Magic, Inc., respondent Fred Pape, individually, and respondent Janet Gillespie, individually, their agents, representatives and employees, directly or indirectly, or through any corporate or other device, in connection with the offering for sale, 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, rebates, overrides, commissions, fees, or other terms or conditions of sale relating to pricing upon which goods or commodities may be resold.

(b) Require, coerce or suggest that any person 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 of commodities may be resold.

(c) Requiring or coercin any person to refrain from selling his merchandise in any quantity to or through any specified person, class of persons, business, class of business or retail outlet of his choosing.

(d) Require, coerce or suggest that any person enter into a contract, agreement, understanding, marketing system, or course of conduct or requiring, inducing, coercing or entering into any agreement with any distributor to refrain from selling any merchandise in any quantity to or through nay specified person, class of persons, business, class of business, or retail outlet of his choosing.

(e) Require, coerce or suggest that any person 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 geographic area; Provided, however, That nothing contained herein shall prevent respondent corporation, acting alone and not in conjunction with other distributors, from assigning routes to individual distributors as areas of primary responsibility.

(f) Require, coerce or suggest that any person 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.

(g) Require, coerce or suggest that any person enter into a contract, agreement, understanding, marketing system, or course of conduct which prevents the distributor from selling his merchandise to another under terms and conditions which they may mutually agree to.

(h) Require, coerce or suggest that any person enter into a contract, agreement, understanding, marketing system, or course of conduct which prevents the distributor from entering into business or financial arrangements with persons of their own choosing, and under terms and conditions mutually acceptable to the distributors and said third persons.

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

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

5. Classifying distributors who are in competition or potential competition with one another into different categories, where such to continue to do business amount of inventory initially purchased, the amount of inventory purchased during any specified period of time, or any monies invested.

6. Preventing distributors from operating their business in any lawful manner they choose to, including but not limited to:

(a) individual owning or having a financial interest in more than one distributorship;

(b) an individual incorporating his distributorship or taking on additional partners without the necessity of each individual separately purchasing additional inventories or qualifying as a separate distributor;

(c) a distributorship selling the business to another individual or potential distributor;

(d) distributors entering into consignment arrangements;

(e) requiring departing partners of a partnership distributorship to requalify in any manner to continue to do business with respondents.

7. Adopting, encouraging, participating in, coercing or otherwise promoting any plan or common course of conduct whereby distributors in competition with one another allocate or are allocated sales territories.

8. Engaging, either as part of any contract, agreements, understandings, or courses 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 for a period of three (3) years. Thereafter, no such list or material shall be employed 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 discount, rebate, commission, override, or other bonus to be paid by one distributor or class of distributors to any other distributors or class of distributors, suggested or otherwise.

(c) Entering into, maintaining, enforcing, or threatening to enforce any contracts, agreements, rights, or privileges pursuant to or claimed by virtue of the MillerTydings Act, as amended, the McGuire Act, or any other similar legislation, for a period of three (3) years from the effective date of this order.

9. Paying or granting anything of value to any dealer, distributor, or participant in respondents' merchandising program, directly or indirectly, except for services actually rendered to respondents in connection with the sale or purchase of goods, wares, or merchandise; Provided, That the solicitation, sponsorship, training or upgrading of other participants shall not fall within the meaning of services rendered in connection with the sale or purchase of goods, wares, or merchandise described herein.

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

It is further ordered, That the aforesaid

It is further ordered, That the aforesaid respondents and their officers, agents, representatives, employees, successors and assigns, in connection with the advertising, offering for sale or sale of products, franchisees or distributorships, or with the seeking to induce or inducing the participation of persons, firms or corporations therefor, in connection with any marketing program or any other kind of merchandising, marketing or sales promotion program, in commerce, as 'commerce' is defined in the Federal Trade Commission Act, do forthwith cease and desist, directly or indirectly, from:

1. Operating or participating in the operation or suggested operation of any program or plan wherein participants may join in a process of geometrical expansion of other participants at the same functional or horizontal levels or other 'endless chain' scheme.

2. Operating or participating in the operation or suggested operation of any program or plan wherein participants engage in a program or plan involving referral selling.

3. Operating or participating in the operation or suggested operation of any program or plan wherein the financial gains to the participants are or may be dependent in any manner and to any degree upon the recruitment of other participants.

4. Offering to pay or paying, or authorizing, suggesting or requiring the payment of any commissions, fees, release fee, bonus, override, commission, crosscommission, discount, rebate, dividend or other consideration or thing of value to any participant in respondents' marketing program or other kind of merchandising, marketing or sales promotion program, for the solicitation, recruitment, referral, upgrading or training of other participants or potential participants therein.

5. Operating or participating in the operation or suggested operation of any program or plan which is in the nature of a lottery, gift enterprise or gaming device.

6. Requiring, suggesting, using or participating in any multilevel marketing program or pyramid marketing program or any other kind of merchandising, marketing or sales promotion program, directly, or indirectly:

(a) Wherein any compensation, profits or other thing of value inuring to participants therein are or may be dependent, in whole or in part, upon the element of chance dominating over the skill and judgment of the participants.

(b) Wherein no amount of judgment or skill exercised by the participant has any appreciable effect upon any or all compensation, profits or other things of value which the participant may receive or be entitled to receive.

(c) Wherein the participant is without that degree of control over the operation of such plan as to enable him to substantially affect the amount of any or all compensation, profits or other things of value which the participant may receive or be entitled to receive.

(d) Wherein a participant pays a valuable consideration for the chance or right to receive compensation for introducing or recruiting one or more additional persons into participation or for the chance to receive compensation when person introduced by the participant introduces a new participant.

(e) Whereby a participant gives or agrees to give a valuable consideration for the chance to receive something of value for inducing one or more additional persons to give a valuable consideration in order to participate in the plan or operation, or for the chance to receive something of value when a person induced by the participant induces a new participant to give such valuable consideration including such plans known as chain referrals, pyramid sales, or multilevel sales distributorships.

7. Requiring or suggesting that prospective participants or participants in any merchandise, marketing or sales promotion programs purchase product or pay any other consideration, either to respondents or to any other person, other than payment for the actual cost of reasonably necessary sales materials, as determined by the purchaser, in order to participate in any manner therein.

III.

It is further ordered, That the aforesaid respondents and their officers, agents, representatives, employees, successors and assigns, in connection with the advertising, offering for sale or sale of products, franchisees or distributorships, or with the seeking to induce or inducing the participation of persons, firms or corporations therefor, in connection with any marketing program or any other kind of merchandising, marketing or sales promotion program, in commerce, as 'commerce' is defined in the Federal Trade Commission Act, do forthwith cease and desist, directly or indirectly, from:

1. Representing, directly or by implication, or by use of hypothetical examples that participants in any marketing program, or any other kind of 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, accurately reflect the average earnings of all active and inactive participants under circumstances similar to those of the participant or prospective participant to whom the representation is made, and actually resulted from predominant elements of skill and judgment rather than chance.
2. Representing, directly or by implication, or by use of hypothetical examples, that a gross income is a net income, salary, earning or profit figure.
3. Misrepresenting the facility of recruiting or retaining participants in any merchandising, marketing or sales promotion programs, as distributors or sales personnel.
4. Representing, directly or by implication, that any participant in any merchandising, marketing or sales promotion programs can attain financial success.
5. Misrepresenting the supply or availability of potential participants or customers in any merchandising, marketing or sales promotion programs in any given community or geographical area.
6. Failing to clearly disclose to each prospective participant in any merchandising, marketing or sales promotion programs, the total number of participants at the various levels or positions, whether active or not, in the county, state, and geographical market area in which prospective participants reside.
7. Representing that persons can expect to remain active in business for any length of time; or representing, in any manner, the longevity or tenure of past or existing persons unless in fact the

periods of time represented are those for which the average and mean number of all persons who pursued their business operation at all.

8. Selling, or offering distributorship, in any manner, without disclosing clearly and conspicuously in writing at or before the time of the first oral sales presentation, or in the event no oral sales presentation is made, at least seven (7) days prior to the execution of a franchise application, agreement or contract:

(i) the median and mean gross earnings of all active and inactive franchisees or distributors in any program by all persons in the most recent calendar year preceding the year in which such sale or offer is made;

(ii) the total number active and inactive franchisees or distributorships nationwide;

(iii) the total number of active and inactive franchisees or distributors recruited in the state and county in which the prospect resides, since the company has been in existence;

(iv) the total number of franchisees or distributors in subparagraph (ii) above who had profits during the most recent calendar year in the following dollar amounts:

a. \$1,000 or less

b. over \$1,000 but not over \$5,000

c. over \$5,000 but not over \$10,000

d. over \$10,000 but not over \$20,000

e. over \$20,000

(v) the turnover rate of sales personnel of products or of the personnel of franchisees or distributors of respondents' products.

(vi) the average dollar volume of monthly sales generated by sales personnel of products or the sales personnel of franchisees or distributors of respondents' products.

(vii) the nature and total amount of the expenses which a distributor, businessman or franchisee can reasonably anticipate in his business activities.

(viii) the names and current address of each of the distributors or franchisees recruited in the county in the most recent calendar year preceding the year in which such sale or offer is made;

(ix) a financial statement reflecting respondents' assets and liabilities (stating separately fixed assets and liquid assets) for the most recent calendar year;

Provided, however, That in the event respondents operated or used any corporate or trade name for a period of less than five years, the disclosures called for in this paragraph shall reflect the operations of the last preceding business entity used by respondents to sell and administer distributorships, or franchises.

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

10. Misrepresenting that once a man understands the business, he will not or cannot fail.

11. Misrepresenting that any business operation, merchandising or sales promotion plan can be the key to a person's financial future and security, or the answer to a person's financial dreams.

12. That a business operation, merchandising or sales promotion plan is an once in a lifetime opportunity.

13. Misrepresenting the amount or degree of the consuming public's acceptance of any products or representing that the public receives any products with great enthusiasm or that repeat business is high without making available at the same time market studies which in fact substantiate the representations.

14. Misrepresenting that it is not difficult to obtain a lifelong income in connection with any merchandising, marketing or sales promotion programs.

15. Misrepresenting that any merchandising, marketing or sales promotion program are sound, profitable and distinguished.

16. Representing that a person who knows respondents' merchandising, marketing or sales promotion programs cannot fail.

17. Representing that persons who fail in respondents' merchandising, marketing or sales promotion programs are either lazy, stupid or greedy.

18. Misrepresenting the relationship between profits and income at one functional level of business to any other functional level of that or any other business.

19. Misrepresenting that the wholesale sales actually reflect retail sales or consumer demand for products.

20. Using or encouraging the use of advertisements which offer or suggest employment when the purpose of such advertisement is to obtain nonemployee participants in any merchandising, marketing or sales promotion program; or misrepresenting, in any manner, the kind of character of the position or job opportunity offered to prospective applicants.

21. Representing, directly or by implication, that it is not difficult for participants to recruit or retain persons who will invest or participate in any marketing program or any other kind of merchandising marketing or sales promotion program, either as distributors, franchisees, wholesalers or sales personnel, or that there is a very large number of prospective distributors or sales persons from which to choose.

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

23. Selling, or offering franchises of distributorships, in any manner, without furnishing to each prospective purchaser at least seven (7) days reasonably prior to the execution of a franchise application or agreement, a copy of the Federal Trade Commission Consumer Bulletin No. 4, 'ADVICE FOR PERSONS WHO ARE CONSIDERING AN INVESTMENT IN A FRANCHISE BUSINESS.'

24. Representing that respondents have applications pending for a particular area; or that any person must act immediately to be considered for a franchise or distributorship, or that he must act immediately to take advantage of a special deal, sale or event or misrepresenting, in any manner, the nature and extent of interest of others in any particular franchise or distributorship.

25. Representing that persons risk losing little or nothing in investing in a franchise or distributorship.

26. Misrepresenting that franchises or distributorships increase in value over the years.

27. Using any payment check or other materials which purport to represent the satisfaction or success of franchises or distributorships.

28. Misrepresenting the earnings potential of franchises or distributors, prospective franchisees or prospective distributors.

IV.

It is further ordered, That respondents, their successors and assigns, incident to selling their franchises or distributorships:

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

2. Refund immediately all monies to all persons who have requested cancellation of the application or contract within seven (7) days from the execution thereof.

V.

It is further ordered, That corporate respondent and William Penn Patrick, their successors and assigns:

1. Within thirty (30) days from the effective date of this order, compile a list which shall name each distributor from whom monies were obtained directly or indirectly, or in trust, during the period from and including Oct. 1, 1964, to the effective date of this order, state the last known address of each such distributor and specify all fees and payments for products paid by each such distributor to Holiday Magic, Inc. or to William Penn Patrick, or to their successors and assigns, directly or indirectly, or to or through any parent or subsidiary corporation, in connection with any activities engaged in which violate the Commission's order in the instant matter.

VI.

It is further ordered, That corporate respondent and William Penn Patrick, their successors and assigns, within thirty (30) days after this order becomes final, shall make an offer to any participant of a refund of all sums of money to which the participant is entitled under this order, and within sixty (60) days after the aforesaid respondents, their successors and assigns, receive notification of the acceptance of such offer of refund from such participant shall pay all sums of money to which the participant is entitled under this order.

1. For the purposes of this order, the term 'participant' shall mean any person who invested money to participate, in any manner, in marketing programs of respondents, their successors and assigns.

2. For the purposes of this order, the term 'refund' means all sums of money paid by a participant to respondents, or their successors and assigns, directly to or through a trust, parent or subsidiary corporation, less:

(a) any amount of money paid by respondents or their successors and assigns to participants, including any refund either made voluntarily or pursuant to court order, and

(b) the price paid for any products purchased by participant that participant does not return (a participant requesting refund pursuant to this order who has product either credited to him in an account, or in his actual possession, shall be entitled to refund for such products on the basis of the price paid by participant for the products; Provided, however, That any of said products in participant's actual possession for which he requests refund under this order must be delivered to one of the warehouses of respondents or their successors and assigns before refund is payable to participant), plus

(c) interest at the rate of 6 percent per annum on the amount to be refunded to participant from the date participant entered into respondents' program to the date notification of the right to refund is received by participant.

3. For the purposes of this order, the term 'offer' means a notification by certified mail, return receipt requested, to each participant with the following information and none other:

(a) On the front of the envelope, together with the name and address of the participant and the name and address of the sender, the following legend in 16 point, boldface type: 'IMPORTANT: REFUND NOTICE'.

(b) On the letter, in 12point, boldface type, the following language:

IMPORTANT NOTICE

By order of the Federal Trade Commission, all persons who invested money to participate, in any manner, in [name of company] are hereby offered a refund of all sums of money so paid, less (1) any amount of money paid by [name of company] to you, including any refund either made voluntarily or pursuant to court order, and (2) the price paid for any products purchased by you that you do not return to [name of company] (a participant requesting refund pursuant to this order who has [name of company] product either credited to him in an account, or in his actual possession, shall be entitled to refund for such products on the basis of the price paid by participant for the products; provided, however, that any of said products in participant's actual possession for which he requests refund under this order must be delivered to one of [name of company] warehouses before refund is payable to participant), plus interest at the rate of 6 percent per annum on the amount to be refunded to you, from the date you entered into [name of company] program to the date this notification of the right to refund is received by you.

If you accept this offer, then (1) send a letter to [name and address of company] within 60 days of receipt of this notification stating the amount and basis of your claim and (2) send any product in your possession to a [name of company] warehouse or, (3) in the event product is credited in an account with [name of company], a statement that upon receiving a refund, you relinquish any rights to such account.

Within 60 days after the receipt of the said information, you will receive all sums of money to which you are entitled under the formula set forth above.

Provided, however,

(c) If respondents or their successors and assigns claim they do not have adequate funds to comply with this order provision, they may within sixty (60) days of the effective date of this order petition the Commission to reopen the proceedings to consider the claim. The petition shall set forth the list of distributors or franchisees to whom refunds are due under this order and the sum of money each such

distributor or franchisee is to receive in accordance with this order, a notarized statement of all assets and liabilities together with the assets and liabilities of all corporations in which the individual is an officer or stockholder.

Upon receipt of this petition and any response thereto which complaint counsel wishes to make, the Commission will assign an administrative law judge for the purpose of making findings and recommendations with respect to the claim. The administrative law judge shall furnish petitioner with the Commission's Statement of Financial Status (F.T.C. Operating Manual, Chapter 6, Illustration 20, Paragraph 6.19), shall require its prompt execution and may conduct such interrogations of the petitioner or require the production of such documents as he deems necessary in order to make findings and recommendations as to any modification of this order which may be warranted on the issues raised by petitioner's claim. The findings and recommendations will be reported to the Commission for a final determination.

(d) If any dispute arises as to the compliance with the refund provision of this order which cannot be satisfactorily resolved by the parties, notice shall be given to respondents or to their successors and assigns of the extent to which they are regarded not to be in compliance and the facts respecting such alleged noncompliance. Within thirty (30) days after the receipt of such notice of noncompliance, they may petition the Commission for a hearing on such noncompliance or for a modification of the order provision giving rise to the disputed compliance or for such other relief as he believes is warranted and the Commission may set the matter down for hearing before itself or before an administrative law judge or shall either grant or deny such petition by order formally entered in the same manner and form as if it were an original order of this Commission.

VII.

It is further ordered, That respondents and their successors and assigns shall maintain adequate records, to be furnished upon request by the Federal Trade Commission, which disclose the manner and dates members and franchisees or distributorships entitled to refunds under this order have received refunds or the reasons such members or franchisees have not received refunds.

VIII.

It is further ordered, That the respondents and their successors and assigns shall forthwith deliver a copy of this order to cease and desist to all past, present and future salesmen and franchisees, distributors or other persons engaged in the sale of franchises, distributorships, products, or services, and secure from each such salesman, franchisee or person a signed statement acknowledging receipt of said order.

IX.

It is further ordered, That respondent corporation and its successors and assigns shall forthwith distribute a copy of this order to each of its operating divisions and respondent William Penn Patrick furnish a copy of this order to each corporation or business entity in which he has any interest directly or indirectly.

X.

It is further ordered, That the respondents and their successors and assigns 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 corporation which may affect compliance obligations arising out of the order.

XI.

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 all of the provisions of this order. The report which corporate respondent, William Penn Patrick and their successors and assigns shall file within sixty (60) days after service upon them of this order shall include the lists they are to compile in accordance with subsection (a) of the provision of this order requiring them to refund certain monies.

Thereafter, within two hundred ten (210) days after service upon them of this order, they shall again file with the Commission a second report in writing, setting forth in detail the manner and form in which they have complied with this refund order.

OPINION OF THE COMMISSION

BY DIXON, Commissioner:

The complaint in this matter was issued on Jan. 18, 1971, charging respondents with numerous violations of Section 5 of the Federal Trade Commission Act (15 U.S.C. s 45) and Section 2(a) of the Clayton Act (15 U.S.C. s 13(a)).

Among the unfair and deceptive acts and practices alleged were (1) operation of a multilevel opened (pyramid) type distributional scheme which had the capacity to deceive and was also in the nature of a lottery; (2) making of various specific misrepresentations to participants in the program, including use of misleading 'want ads' purporting to offer employment, misrepresentation of the ease with which participants could recruit other participants, misrepresentation of the extent to which respondents' products would be advertised by the parent organization, and misrepresentation of profit expectations.

Among the unfair methods of competition charged were (1) price fixing; (2) division of territories; (3) imposition of assorted restrictions on resale rights of distributors; and (4) price discrimination.

After protracted hearings, the administrative law judge rendered a lengthy initial decision on May 31, 1973, finding respondents in violation on all counts of the complaint. The administrative law judge recommended a detailed cease and desist order, including provisions requiring restitution on the part of the corporate respondent and individual respondent Patrick.

On June 9, 1973, respondent Patrick perished in the crash of his private airplane.

Surviving respondents have appealed from a large portion of the initial decision.

On appeal, respondents challenge in general the validity of the initial decision, arguing that the administrative law judge borrowed heavily and verbatim from findings proposed by complaint counsel. In raising this point, respondents mistake the significance of the Coors and Grand Caillou cases which they cite in attacking the judge's findings. [FN1] These cases do not hold that it is impermissible per se for the administrative law judge to use findings proposed by either side, or that it is necessarily inconsistent with the required exercise of independent judgment and evaluation of the record for the judge to do so. To the contrary, while in both Coors and Grand Caillou the judge did adopt most of the proposals of one side, the other side on appeal subsequently pointed out the precise respects in which the initial decision was therefore incorrect, or in which it overlooked evidence germane to the charges in the complaint, and the Commission's own review of the record bore out those specific attacks on the initial decision.

With the exception of those findings of fact pertaining to the Clayton Act charge, respondents' brief is noticeably lacking in specific examples of findings of fact in the initial decision which are alleged to be incorrect, and similarly lacking in specific examples of excluded evidence which might compel legal conclusions contrary to those reached by Judge Buttle. Under such circumstances, we cannot take seriously an attack on the initial decision to the extent it is based on the barebones contention that the findings of one side are adopted verbatim. Moreover, our own review indicates that, while occasionally repetitive, and by no means a paragon of succinctness, the law judge's findings of fact are supported by the record, and, with the exceptions noted, inter alia, we adopt them as our own, and have relied upon them in our disposition of the appeal. We have taken greater issue with parts of the law judge's legal analysis, as have respondents, though again we have concluded it is correct with respect to most counts of the complaint. Finally, we have made substantial revisions in the order proposed by the administrative law judge, for reasons noted in the text.

I. BACKGROUND THE HOLIDAY MAGIC MARKETING SYSTEM

Holiday Magic, Inc., was founded in 1964 by William Penn Patrick. Individual respondent Fred Pape was president of Holiday Magic and the company's first Master Distributor, and respondent Janet Gillespie was vicepresident, a member of the board of directors, and the first Organizer Distributor.

Holiday Magic, through its multilevel marketing program, purports to enlist the services of men and women throughout the country to sell its products (primarily cosmetics, and some toiletries and home care products) at wholesale and retail. In order to enter the program, participants must purchase inventories of varying sizes, and having entered they may earn money by reselling the product they have purchased, and by recruiting others to participate in the program, as set forth below.

An individual may enter the marketing program at one of three levels, [FN2] Holiday Girl, Organizer, and Master Distributor, and persons at each of these levels may attain the fourth and 'highest' level of General Distributor. Entry at each of the three levels requires a different monetary investment. Purchase requirements have varied with time, but the figures cited in the initial decision are \$11.99 for Holiday Girls, [FN3] \$130.41 for Organizers, [FN4] and \$2,500 to \$4,500 for Masters. (I.D. 80) The Master's investment pays for an inventory of cosmetics and sales aids. Individuals may also work up to the Master level by achieving the requisite volume of retail sales, either by themselves or through the efforts of themselves and others recruited by them. Entry into General status requires payment of a 'release fee,' described at greater length hereinafter, which has ranged in amount from \$2,500 to \$4,500, payable by certified check to Holiday Magic. (I.D. 84)

Profits are earned in the marketing system by (1) retailing, (2) wholesaling, or (3) recruiting others into the system. Persons at all four levels may sell at retail. Masters and Generals buy directly from Holiday Magic at 55 percent and 65 percent off list price respectively. Organizers and Holiday Girls buy from their sponsors at discounts ranging from 30 percent to 55 percent depending on monthly sales volume. Those at all levels but Holiday Girl may also wholesale. (I.D. 328, 6264, 7073, 81, 83, 86)

Profits from recruiting others are earned in a variety of ways which are detailed in the initial decision (I.D. 118142, 104107), and the various Holiday Magic Manuals (e.g., CX 76115). Compliant counsel in their reply brief identify the two most important recruiting possibilities as the 'Organizer to Master' level and the 'Master to General' level (CB 5) and for convenience we shall adopt this terminology.

In the 'Organizer to Master' level, Organizers, Masters, or Generals may sponsor other Organizers and Masters, with the right to recruit passed on ad infinitum.

Promotional material prepared by Holiday Magic states or implies that Organizers will each, on the average, recruit five other Organizers each month, for at least three months. (I.D. 74; CX 79231) It is thus represented as possible for Masters and Generals to recoup their large investments merely by recruiting other Masters (or Organizers who become Masters). For each Master (or Organizer who becomes a Master), the recruiting General receives 10 percent of the retail list price value of the Master's inventory purchase (which ranged from \$5,000 to \$7,000). A Master who recruits another Master (or Organizer who becomes a Master) receives 2 percent of the Master's inventory purchase. [FN5]

It is at the so-called 'Master to General' level that the greatest abuse appears to have occurred. A General obtains his position by paying the release fee and recruiting a 'Replacement Master.' Respondents have pretended from time to time that certain qualifications beyond the tender of a

certified check and a replacement Master were required for elevation to General, but the evidence shows otherwise. (I.D. 85) While an individual could not enter the program directly as a General, one could become a General almost immediately after entering as a Master. [I.D. 85(b)] Once a General, an individual could make large sums of money merely by recruiting other Generals. The 'release fee' of each new General recruited would be paid to the recruiting General. Two release fees would normally be sufficient to compensate the recruiting General for his or her own investment (the release fee plus the initial inventory purchase required to become a Master). Thereafter, every release fee of \$2,500 to \$4,500 obtained by the General would be pure profit. Moreover, each time a General persuaded a Master to ascend, the Master would be required to replace himself or herself with a 'Replacement Master,' whose own ascension would mean another release fee for the General (and, of course, another sale of \$2,500 in inventory by Holiday Magic to the new replacement Master). [FN6]

The release fee described earlier is rationalized by the company as a 'contract settlement fee,' an amount paid to the General for the loss of income which would otherwise be made from the 10 percent override on sales of the Master who has left, and the Master's organization. There is little evidence in the record to suggest that this release fee bore any reasonable relationship to the real loss which any General collecting it would suffer. Rather, the major inducement for many individuals to become Generals was clearly the prospect of recruiting other Generals and receiving the release or contract settlement fee from them, rather than the opportunity to earn equivalent amounts by building a sales organization which would generate the requisite retail volume.

None of these various overrides, it would appear, constituted compensation for continuous wholesaling services being performed by those to whom they were paid. (I.D. 125, 13637, 142)

II. MISREPRESENTATIONS (COUNTS I AND III)

The Holiday Magic marketing plan was presented to individuals in a variety of ways, of which chief was the 'Opportunity Meeting.' There, representatives of the company, in some cases its employees and in others various distributors acting pursuant to instructions contained in company manuals, described Holiday Magic and the marketing plan to potential distributors. (I.D. 287317) The administrative law judge found, and respondents do not contest, that in the course of advertising the Holiday Magic program to potential distributors, numerous misrepresentations were made, and high pressure sales tactics employed, as described in great detail over more than 60 pages of the initial decision. (I.D. 392-432, 483; pp. 164216, 278291 [pp. 875906, 949955 herein])

Among the specific deceptions alleged in the complaint and found by the administrative law judge were:

(1) False representations of the earnings potential of distributors, and of the ease with which retail selling distributors could be recruited; (I.D. 392 423)

(2) False representations concerning the ease with which one could succeed in Holiday Magic, including representations that through the application of hard work and diligence anyone could succeed in the program; (I.D. 392423)

(3) False representations of the amount, degree, and type of advertising which Holiday Magic engaged in for the purpose of creating retail demand for its product; (I.D. 424427)

(4) Misleading use of 'employment offered' advertisements for the purpose of attracting distributors with the promise that a job, with guaranteed income, was being offered. (I.D. 428432)

Of greatest importance were the numerous misrepresentations of earnings potential and ease of sales and recruitment for participants in the program. Some of these took the form of misleading illustrations of the manner in which an individual, as a result of recruiting others, could build a large sales organization, with substantial wholesale and retail volume producing hefty profits. Similarly misleading were various representations concerning the ease with which those who had paid several thousands of dollars to become 'Generals' could recoup their investments by recruiting other Generals.

Some of the misrepresentations emanated directly from the corporate respondent and its officers, in the form of manuals, films, directives, and the like. Other misrepresentations were the creation of distributors of the company who added their own deceptive gloss to the marketing plan in order to garner more recruits. The administrative law judge found that, in various instances, Holiday Magic became aware of the misrepresentations being made by its representatives but did not repudiate them, and refused to refund money paid to Holiday Magic by those induced to become distributors by these misrepresentations. (I.D. 411419, pp. 336340 [pp. 898902 herein])

Holiday Magic furnished its representatives with detailed instructions for the operation of opportunity meetings, covering specific promotional representations to be made, decor and format, and even particular 'closing techniques' designed to hasten that magic moment when a prospect signed an application and parted with a certified check. One highly recommended technique was the 'Impending Event;'

* * * This is a PowerHouse method of enrolling your prospect through presenting him a situation which he can take advantage of only today and which will not be available tomorrow. (I.D. 318)

Holiday Magic assisted by creating numerous 'Impending Events,' repeatedly announcing increases in the cost of General Distributorships to take effect imminently, but then withholding the increase when the threatened time came. The same imminent increase could then be threatened again, to create the requisite sense of urgency on the part of a new batch of prospects. (I.D. 320)

Among closing techniques recommended, as described by the administrative law judge (I.D. 325; CX 184222029) were:

(j) Final Objection Enrollment Make guest explain his objection until he feels 'stupid'.

(1) Ben Franklin Balance Sheet Enrollment Used for indecisive prospects. Put down reasons pro and con for joining. Help prospect with pro reasons. Subconscious mind won't be able to switch to the con so fast.

(s) Name Enrollment Ask prospect to write down names of five people who would like to make an extra \$25,000 a year. Then explain how much money these five people will make for your prospect if he sponsors them into the business. But in order to sponsor you have to enroll. If he doesn't enroll, threaten him that you will sponsor the people. The moment you enroll one of his contacts you will have leverage to enroll him again.

(u) Cash Money Enrollment Used when you have a prospect who is a non believer. Pull roll of \$100 bills out of your pocket and say 'Now, I am not trying to impress you with the money I'm making, but would earning this kind of money each week interest you? Wonderful.'

When all that remained was for the prospect to sign, Holiday representatives were well prepared with 'Pen Handling Techniques' recommended by the company:

(1) Pen Circling Always circle pen into your prospect's hand beneath his eye level (between the first finger and thumb).

(2) Pen Snapping Make a mark on the application where you want him to write, then snap the pen down upon the top (indicating you want him to use it). 'Please put your name and mailing address right here.'

(3) Pen Reaching When you have a wide distance to cover in placing your pen in prospect's hand. Place pen in prospect's hand while keeping your eyes at his level.

(4) Pen Dropping Should only be used after several unsuccessful attempts have been made to place your pen in your prospect's hand. You must become extremely nervous and accidentally on purpose drop your pen, saying 'Whoops.' When prospect picks up pen, don't thank him, but tell him to put his name on the application.

(5) Pen Tapping Is used to bring about fast signature. 'Let's go.'

(6) Pen Borrowing Used when prospect has his own pen close at hand. Borrow his pen to make a mark on application, then give it back to prospect, telling him to finish filling out application.

(7) Pen Priming Techniques Used to get prospect to start writing after pen successfully placed in his hand.

(i) Quick Prime Pick up second pen and quickly point to place you want him to sign 'Just like a small bird sitting on your prospect's shoulder and softly whispering into his ear 'You forgot to sign your name.'"

(ii) Hot and Cold SwitchPut pen that has started writing into prospect's hand. Clear the negative deception from his conscious mind first. (I.D. 325)

As a result of the representations and misrepresentations made by Holiday Magic and its agents, thousands of individuals were induced to invest millions of dollars in inventories of cosmetics and release fees to become Holiday Magic distributors. These investments in more than a few instances turned out to be worthless or of little value. Holiday Magic's great concern for moving non returnable product into the hands of its distributors often proved in marked contrast to its rather more casual attitude toward movement of product from the hands of its distributors into the homes of consumers. The administrative law judge found that Holiday Magic does not know and keeps no records of the retail sales of its products at the consumer level (I.D. 482); that it claims not to know what the turnover ratio is of its Holiday Girls (I.D. 469), although assumptions about the retail sales of Holiday Girls figured prominently in the Opportunity Meetings (I.D. 392, 394, 396, 398), and that it does not know the effect of the retail advertising it does. (I.D. 477) While some attention was certainly paid by the organization to the retail sales of its products, it is clear from the record that the major emphasis in promoting the program, and the major attraction for many participants, was the prospect of the profits to be made through recruitment of others. (I.D. 327352)

Hoving acknowledged responsibility for the orgy of deception described by the administrative law judge, respondents do not object to entry of order provisions specifically prohibiting those misrepresentations challenged in Count III of the complaint (with a few exceptions noted hereinafter). Respondents do, however, balk at the administrative law judge's finding pursuant to Count I of the complaint, that the Holiday Magic marketing plan is, by its very nature, deceptive, and they object to order language recommended by the administrative law judge which would prohibit use of any sort of open ended, pyramidal form of distribution in the future. We believe, nonetheless, that such a prohibition is warranted by the evidence introduced in support of both Counts I and III.

Count I of the complaint alleged in part that:

* * * respondents' multilevel merchandising program is operated in such a manner that the realization of financial gains is often predicated upon the exploitation of others who have been induced to participate therein, and who have virtually no chance of receiving the kind of return on their investment implicit in said merchandising program. Therefore, the use by respondents of the abovedescribed multilevel merchandising program in connection with the sale of their merchandise * * * was false, misleading and deceptive, and was and is an unfair act and practice. * * *

In essence, the Holiday Magic marketing plan is little more than an elaborate, modernday version of the chain letter, with the capacity to part a slightly more sophisticated, and more ambitious victim from his or her money. The plan holds out the promise of profit for all based upon recruitment of other distributors, at both horizontal and vertical levels, with the passing on of such right to recruit to those recruits, as an inducement for them to join, and so on ad infinitum.

That such a plan must lend itself to massive deception is amply demonstrated by the initial decision and the record in this case. Holiday Magic encouraged its distributors to illustrate the operation of the marketing system by means of diagrams which portrayed an individual entering the program and recruiting five distributors, who in turn each recruited five others, who in turn each recruited five more. While Holiday Magic argues that its promotional materials did not extend these calculations beyond three months, the marketing plan did, of course, allow and encourage distributors to promise those whom they recruited that those recruits could generate the same chain of subdistributors; hence in the hypothetical illustration those who were induced into the program at any given period of time would presumably have been so induced by the promise that they could generate their own chain, as illustrated, for at least three months, and so on without end. [FN6a] Clearly such a system must fall of its own weight, and well before every citizen of the United States is recruited to work for the company.

The mere, unqualified, holding out of an openended, pyramidal distributional system allowing for uninterrupted recruitment as a reasonable business opportunity for all inevitably creates the potential for massive deception, and the fact that this potential was realized on an enormous scale in this case only underlines the patent illegality of the scheme. Implicit in the holding out of the system as a reasonable business opportunity is the promise that the party to whom the system is represented can earn profits in it by means of recruiting others. This representation may be true with respect to those to whom the representation is initially made; those at the beginning of the chain or the top of the pyramid. But, since a fundamental aspect of the system is that those at the beginning will be able to succeed by promising others the same ostensibly lucrative right to recruit, and so on, it is a virtual certainty that at some point the representation that profits are to be earned will be made to individuals to whom it will still appear plausible but for whom it is blatantly untrue, by virtue of the fact that the universe of potential recruits has been effectively exhausted. The party who utters the words which deceive and injure may well not be the perpetrator of the scheme, just as the originator of a chain letter may never correspond with those who become its eventual victims. But the deception and unfairness are not, thereby, any less the responsibility of the one who initiates the process. [See *GerRoMar, Inc., et al.*, Docket No. 8872, Slip Op. pp. 812 (July 23, 1974) [84 F.T.C. 95]; Cf. *Twentieth Century Company v. Quilling*, 139 Wisc. 318, 110 N.W. 173, 176 (1906)]

In this case, as illustrated by the initial decision, there is striking evidence that saturation of the market for distributors actually occurred, i.e., that recruitment in certain areas was carried to such extremes that the mere offering of a Holiday Magic distributorship as a reasonable business opportunity amounted to the grossest deception. (I.D. 372380) In these instances, quite apart from any specific misrepresentations that may have been made, the simple solicitation of money from individuals, with the implicit understanding that money could be made in return by means of recruiting (or, indeed, by one's own retail sales), was patently false and misleading.

But even if such saturation were not painstakingly shown to have occurred, the overwhelming potential for fraud and oppression would have remained, and the system as a whole would still require proscription. Counsel for respondents quarrel with the administrative law judge's purported holding that the Holiday Magic marketing plan is 'inherently' deceptive, without regard to specific

misrepresentations made by its exponents. Put somewhat differently, we believe the holding is essentially correct. 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, quite apart from whatever particular representations may be made in promoting the plan. A plan involving such unlimited recruitment which extracts a valuable consideration from individuals in return for the opportunity to participate in it, threatens severe injury since at some point the likelihood must arise that participants will be unable to recoup their investment of money and time in the manner held out as reasonable. The Holiday Magic marketing plan meets these criteria entirely. To say that it is 'inherently' deceptive is to say no more than that it contains this intolerable potential to deceive, and on those grounds as well the plan requires condemnation. [See *GerRoMar, Inc.*, supra, pp. 812 I.D., pp. 292310 [pp. 956967 herein]; *Goodman v. Federal Trade Commission*, 244 F.2d 584, 604 (9th Cir. 1975); *FTC v. Algoma Lumber Company*, 291 U.S. 67, 81 (1934); *VacuMatic Carburetor Company v. FTC*, 157 F. 2d 711 (7th Cir. 1946), cert. denied, 331 U.S. 806 (1947)] Indeed, a tragic aspect of this case is that the challenged marketing plan was not obliterated in its infancy, before the seed of deception ripened into the poisonous fruit of fraud and oppression. The Commission will consider carefully in the future whether marketing plans of the sort involved here are a suitable target for its newlygained authority to obtain injunctive relief.

Aside from the actual and potential deceptiveness of the marketing plan (Count I of the complaint), its proscription is also warranted by virtue of the multitude of particular misrepresentations which were found to permeate it (Court III). We do not believe that an order which merely forbade respondents to make specific misrepresentations would succeed in eliminating such misrepresentations, at least on the part of those independent distributors in whose hands respondents were allowed to continue placing the instrumentality of deceptionthe Holiday Magic Marketing Plan.

One of the saddest aspects of this case is the picture it presents of 'consumers' being schooled in fraud, and in some cases learning their lessons all too well. Some of the worst deceptions on the record were perpetrated by Holiday Magic's socalled 'independent' distributors, albeit with the aid and ultimately profitable and knowing acquiescence of respondents. The Holiday Magic marketing plan lends itself to exaggeration and misrepresentation of the sort which occurred, particularly on the part of those who, having made a large investment, feel the urgent need to get it back. Holiday Magic encouraged such deception on the part of its distributorrepresentatives, both directly and through its emphasis on the use of emotionally exploitive selling techniques. Such deception is its responsibility, and an order designed to serve the public interest must be designed both to eliminate misrepresentations on the part of named respondents, and those made by respondents' distributors with respondents' aid. We doubt at this late date that such a result can be achieved by a mere prohibition in terms of specific misrepresentations. Only a future prohibition on use of the marketing plan which nourishes such deception will ensure the elimination of Section 5 violations. For this reason, additionally, we must enter order provisions forbidding Holiday Magic to utilize a marketing system which partakes of the pernicious elements of the plan in effect at the time of this case. [FN7]

III. ORDER PROVISIONS (COUNTS I AND III)

The Commission has given careful attention to the question of appropriate relief in this matter, and has obtained the views of both sides via supplemental submissions filed subsequent to oral argument. Counsel for Holiday Magic notes that by virtue of the company's settlement of litigation brought by the Securities and Exchange Commission and various private litigants [Civil Action No. 73 1095 (DCNDCA, Apr. 1, 1974)] the company has agreed to modify its mode of operation in certain respects, and counsel moves that further hearings be held before an administrative law judge to determine what additional order provisions should be imposed by the Commission, and to avoid inconsistencies in the orders of the Commissions and the District Court.

We do not believe that further hearings are necessary as part of this already muchdelayed adjudication, and the motion therefor will be denied. The order to which corporate respondent has agreed enjoins it from various violations of laws other than the Federal Trade Commission Act. The company had further agreed to devote a portion of any future earnings to the payment of restitution to distributors. A Special Counsel has been appointed to oversee corporate operations.

While we are not qualified to evaluate the adequacy of the consent order in redressing alleged violations of the laws pursuant to which the SEC and various litigants brought suit, it is clear to us that the consent order is in no way adequate to remedy and ensure the nonrecurrence of violations of Section 5 of the Federal Trade Commission Act found in the record, nor, of course, was it intended to be. In particular, we note that while the consent order contains certain broad prohibitions on the use of fraud and the use of Master and General distributorships, these prohibitions may be avoided by respondents if the products of the company are 'rendered in substantial degree to consumers' (Pars. I, II). There is still room for a great deal of fraud and injury to distributors in a program in which product is rendered in substantial degree to consumers, fraud and injury of the sort respondents have shown themselves past masters in administering. By selling inventory to distributors only on consignment, or by offering to buy it back (perhaps at reduced price), a company can guarantee that its product is rendered in substantial degree to consumers (to the extent it is rendered at all). This situation, however, is hardly inconsistent with the use of pervasive deception to induce distributors to pay franchise fees, training and instruction fees, sample kit fees, or to make other investments all of which may turn out to be worthless. To remedy violations of Section 5, therefore, an order must prohibit deceptive practices whether or not the company renders such product as it does produce in substantial degree to consumers.

We do not believe that any inconsistencies should result from the orders of the Commission and the District Court. Certainly we do not believe that the intention of the SEC in bringing suit under its Act, and entering into a settlement of it, or the intention of the District Court in approving the settlement, was to permit Holiday Magic to insulate itself from the effects of an order fully warranted on the basis of lengthy administrative proceedings demonstrating numerous violations of the Federal Trade Commission Act (and, in one small respect, the Clayton Act). The order that we shall enter is intended to ensure that violations of the statutes we are required to enforce will not recur in the same or related form. To the extent that the order prohibits conduct that is not prohibited by the order of the District

Court, it may require modifications of the corporation's latest marketing plan. We believe that the District Court contemplated such a result when it modified its own order on June 7, 1974. [FN8]

We agree with respondents that it is highly desirable that Holiday Magic continue as a viable business entity, offering individuals throughout the country a legitimate business opportunity selling cosmetics to consumers, and devoting a portion of any profits realized therefrom to repayment of victims of past illegalities, as contemplated by the order of the District Court. At the same time, it would be folly for us to ignore the record of this case and enter an order which would permit respondents to engage in future deceptions so that they might thereby be better able to repay victims of past ones.

Respondents do not object to the majority of the administrative law judge's proposed order provisions prohibiting specific misrepresentations (Part III of proposed and final orders). With the exception of rewording for the sake of greater clarity and precision, we have generally retained those portions of the administrative law judge's proposed order.

Respondents do object to Paragraphs 6, 8 and 23 of Part III of the proposed order. Paragraphs 6 and 8 require disclosure of certain information to prospective participants in any marketing program operated by respondents prior to entry. Respondents argue that, since they have modified their program so that an initial investment of only \$25 in sales materials is required for participation, there is little need for the disclosures required by Paragraphs 6 and 8, and the cost and difficulty of furnishing them would be excessive.

We agree with respondents that provision of aggregated operating results for numerous small distributors might constitute an onerous burden which we shall not impose. Strict adherence by respondents to those portions of the order forbidding misrepresentation of earnings potential should be sufficient to remedy the abuses in this regard. [FN9]

We have difficulty, however, accepting respondents' arguments with respect to those portions of the order requiring disclosure of the number of competing distributors in a given market area. This is information which respondents should have in their possession. The record in this case reveals that respondents encouraged the recruitment of thousands of distributors into their program without regard for whether or not the market for their products would sustain those recruits. When an individual pays a valuable consideration to participate in a marketing program, his or her assumption is that there is a reasonable possibility of earning back the investment by selling the product. It is of crucial importance to the individual to know that scores of others in the same marketing area may be attempting to earn back investments by selling the very same brand product, and at the heart of the fraud in this case was Holiday Magic's failure to disclose that fact.

We agree that by reducing the amount of money which is extracted from a participant to enter the program the injury which may be done is thereby also diminished. [FN10] But the potential for some injury remains, and we are loath to abandon a disclosure requirement so germane to the decision to become a distributor, so long as respondents require any investment whatsoever on the part of their

distributors in order to participate in their program. As modified, our order will require respondents to disclose the number of other participants in a given market area, prior to the time an individual is required to pay any consideration to respondents in order to enter their program, including payment for sales aids. Respondents may avoid the bite of this paragraph by furnishing sales aids to their distributors on a consignment or delayed payment basis, so that an individual may determine for himself or herself the extent of the intrabrand competition before being obliged to make any monetary investment.

Respondents object to Section III(23) of the administrative law judge's order, and Section VIII of the order. The former would require delivery to all prospective participants of the Commission's Consumer Bulletin No. 4, 'Advice for Persons Who Are Considering an Investment in a Franchise Business,' and the latter would require delivery of a copy of the order in this matter to prospective distributors. Respondents argue that the cost of such requirements is unwarranted in view of the substantially reduced nature of their business.

There is no question that the Commission may properly require delivery of a copy of its order to distributors of a franchisor found to be in violation of Section 5. Delivery of the order places the distributor on notice of past violations and future prohibitions, and assists in enforcement of the order by alerting potential victims of conduct which would violate it. While the rationale for delivery of the order is abundantly applicable to the case before us, we also recognize the unusual length of the order in this matter, and the cost its distribution to thousands of distributors might entail. We believe it is most important that participants be furnished with the provisions of Section III of the administrative law judge's order forbidding specific misrepresentations. Other provisions of the order are likely to be less readily comprehensible to the full range of participants, and compliance therewith is more readily determinable by review of the company's printed materials. We have modified our order accordingly to require provision to distributors only of Section III of the order.

Also, we do not believe that furnishing Consumer Bulletin No. 4 to prospective participants in the program should prove unduly burdensome to respondents, particularly in view of the large number of publications they have been able to distribute to participants in the past. The purpose of this short consumer bulletin is to alert individuals to the questions they should ask in order to evaluate, and before investing in, a business opportunity. The need for such vigilance on the part of participants in respondents' program is abundantly clear from the record and will help to ensure that past deceptions are not repeated.

With respect to Section II of the administrative law judge's order, we have omitted some of the more nebulous prohibitions, and those pertaining solely to the vacated lottery count, but retained, we believe, the essence of his proposed relief. Paragraph II(1) prohibits respondents from operating a marketing program in which an individual pays a valuable consideration in return for the right to earn compensation for the mere act of recruiting other participants, irrespective of such recruits' sales to consumers. This paragraph is designed to ensure that any compensation received by a participant for recruiting activities will be based strictly on product sales of recruits, and not on the inventory purchases (or other payments) of recruits. Without such an absolute prohibition, individuals may be induced to

purchase inventory from, or pay other consideration to, respondents on the understanding that they may recoup their investment (at least in part) by inducing others to purchase inventory and pay a consideration, and by offering them the prospect of making back their investment in the same way. This is a chain letter scheme, pure and simple. We must unequivocally reject respondents' contention that they be allowed to apy some 'nominal' sum to distributors for the mere act of recruiting other distributors, whether such distributors sell at retail or not. The amounts taken from individual Holiday Magic victims ran into the thousands of dollars, but they might as easily and no less unfairly have been in the hundreds. 'Buy a sales kit, sell cosmetics, and earn the right to \$25 for each person you induce to buy the sales kit and enter our program.' This is an illegal chain letter scheme just as much as 'Buy \$5000 worth of cosmetics, sell cosmetics, and earn the right to \$500 for each person you induce to do the same thing.' At some point many people will be unable to recoup their investment from referral fees, and to induce them to make such investment with the promise that they can so recoup it is fraud- whether or not such product as is involved in the program happens to be rendered in substantial degree to consumers. Paragraph II(1) will not prohibit payment of compensation to distributors for recruiting other distributors based on actually consummated sales of such recruits to consumers. We recognize that some incentive is necessary in a direct selling system in which a company lacks resources to hire distributional personnel, to induce distributors to recruit other distributors. Overrides based on actually consummated retail sales of recruits appear to us to be the least potentially pernicious of such incentives, and not subject to the same abuse in which respondents engaged with respect to flat payments or overrides related to inventory purchases. The order would not forbid such payments to compensate distributors for recruiting efforts, but such an incentive structure should help impress upon all participants that their concern must be with retailing or building a retail organization, and not merely with recruiting.

Order Paragraph II(2) is addressed to the related problem of unlimited recruitment. Even if socalled 'headhunting' is eliminated by Paragraph 1, and participant profits from recruiting in the system are related solely to the retail sales of successive generations of recruits, the possibility of deception remains, because an individual may be induced to participate in the program on the mistaken premise that he or she can delegate the retailing function to later generations of recruits, who in turn may enlist for similar mistaken reasons. The misrepresentations made by respondents concerned both the possibility of huge profits based on inventory purchases and payment of release fees by recruits, and the possibility of such profits based on retail sales of successive generations of recruits. Our order will allow respondents to establish a participantrecruited threetiered system of distribution, provided that those at the lowest level may not perform recruiting functions for a period of at least one year following their entry into any merchandising program. This should permit respondents reasonable flexibility in building a distribution network, while helping guarantee that the plan must be presented to potential participants in a way which makes clear that their profits will depend directly on their own efforts in retailing to consumers or in directly building a retail organization. We recognize that upgrading of participants at the lowest level of a legitimate business organization is an important feature; for that reason the third level of recruits is allowed to engage in recruiting functions after one year. At the same time, it is crucial to create a pronounced interruption in any chain of recruitment, even one limited by

Paragraph II(1), to avoid the inherently deceptive lure of the pyramid mechanism as exploited by respondents.

Paragraph II(3) is adapted from Paragraph II(7) proposed by the administrative law judge. It prohibits respondents from suggesting or requiring that an individual make any inventory purchase as a condition of participating in any marketing program. We believe this provision is fully warranted in light of the gross abuses of inventory purchases wrought by respondents. There is no evidence in the record to suggest that respondents cannot operate a legitimate direct selling business without requiring inventory purchases on the part of participants.

Restitution

The administrative law judge concluded that restitution is necessary to remedy the continuing violation of Section V resulting from retention by the corporate respondent and respondent Patrick of monies unlawfully obtained from participants in the Holiday Magic program. The administrative law judge found that by virtue of respondents' massive misrepresentations and inventory loading schemes, the large inventories of cosmetics purchased by participants 'in many situations are largely worthless to persons who are unable to sell the same at wholesale or at retail.' (I.D. pp. 37172 [pp. 10111012 herein])

The order proposed by the judge provides in essence that restitution shall be made based upon the amount of money paid by distributors to respondents, less any monies returned to distributors by respondents, and less the cost to distributors of inventory which distributors do not tender back to respondents.

In view of respondent Patrick's postinitial decision demise, complaint counsel moved to substitute his executor, Sam Olivo, as party respondent in this matter for the purpose of effecting such restitutionary relief as might be appropriate. Olivo opposed this motion. By order of Aug. 29, 1974 [p. 347 herein], the Commission granted the motion to substitute the executor, and granted him 30 days within which to file an appeal brief from the initial decision. The executor has filed no appeal brief, however the arguments raised in opposition to restitution by corporate respondent Holiday Magic apply generally to the executor as well and will be considered with respect to both parties. Holiday Magic challenges the Commission's authority to order restitution generally, and in this particular case, and the propriety of ordering restitution in view of the previously noted settlements between respondents and the SEC and class action litigants in California.

We have discussed at length in other recent opinions our general authority to order restitution of unlawfully obtained and retained monies and will not repeat those arguments here. See *Curtis Publishing Co.*, 78 F.T.C. 1472 (1971); *Universal Credit Acceptance Corporation*, 82 F.T.C. 570 (1973). Respondents' challenge to the Commission's authority to order restitution is thus rejected. [FN11]

Holiday Magic further alleges that it was not adequately apprised that the Commission would consider restitution in this case, and that certain comments of the administrative law judge led respondents to

think that restitution would not be considered. (Tr. 6970.) These contentions are similarly rejected. Complaint counsel stated their intention to seek restitution on the first day of trial (Tr. 6870), at least 15 months before closing of the record. Respondents were left with adequate time in which to prepare to cross-examine and call witnesses with relation to the matter of restitution.

At the start of the trial, the administrative law judge stated as follows:

I will be guided by the complaint insofar as the order is concerned * * * my ruling will be they [complaint counsel] are not going to get any relief that they haven't asked for, that cannot be supported by the complaint. (Tr. 6970.)

These comments expressed nothing more than an intention to limit any eventual order to the scope of the complaint. The complaint set forth clearly the basis for a restitutionary order, alleging that as a result of various unlawful practices individuals were induced to make investments on which they subsequently received little or no return. Respondents' counsel had full opportunity to argue the relevant issues at trial and on appeal, and indeed was not so misled by the administrative law judge's remarks that he did not seek to justify the presentation of a mammoth defense record on grounds of its relevance to restitution. (Tr. 7570.) We do not believe that respondents were deprived of due process by postnotice order introduction of restitution, nor have they indicated with particularity any respect in which they were injured by noninclusion of restitution in the notice order.

With regard to the propriety of restitution in this particular case, we believe it is clear beyond peradventure. Illegality permeated every facet of the promotion of the Holiday Magic marketing program. All agree that respondent Patrick was its architect and prime mover. Tens of thousands of individuals invested tens of millions of dollars in huge inventories of cosmetics and release fees, often as the result of misconceptions fostered by respondents, and often with the end result of financial disaster. There is every indication in the record that respondent Patrick regarded institution of the Commission's suit not as a sign to go slow, but as a spur to intensify the heist. [FN12] Retention of deceptively and illegally obtained property is as much a violation of Section 5 as continuation of the deception. Our duty is to enjoin both.

The administrative law judge's proposed formula for measuring the amount of unlawfully obtained funds appears reasonable, though exactitude is obviously impossible under the circumstances. Unlike common law restitution, restitution under Section 5 is designed to remedy the continued violation of the statute resulting from retention of unlawfully obtained funds. To some extent, therefore, respondents are let off the hook by the requirement that refunds on inventory purchases be made only to the extent that inventory is returned, because in certain instances distributors may have destroyed or given away such inventory, and even in instances in which inventory has been sold, this would not alter the fact that respondents had made their sale as a result of deception. A countervailing consideration is that, despite the pervasive, all encompassing nature of deception in the Holiday Magic scheme, some inventory sales to distributors may have been consummated without deception, even though distributors still retain such inventory. On the whole, we believe the administrative law judge's formula

is a reasonable and equitable one for measuring the amount of funds obtained unlawfully by respondents, and we shall not disturb it.

Holiday Magic argues that no order is required, because by virtue of a settlement reached with the Securities and Exchange Commission and certain class action litigants, respondent Holiday Magic has agreed to devote a large part of current assets and a portion of future earnings towards repaying monies taken from General and Master distributors. Our concern under Section 5 is to ensure that monies unlawfully obtained and retained are disgorged. With respect to the corporate respondent, the settlement, if executed, appears likely to achieve the result. While Holiday Magic will retain certain assets fraudulently procured, these will be used to continue its operations, some profits from which will be returned to distributors. Under these circumstances, it appears that the settlement does contemplate effective disgorgement by the corporate respondent of all unlawfully retained monies.

At the same time, the violations of Section 5 have been massive, and in view of the record herein and the length of these proceedings, we are reluctant to omit entirely any provision for restitution, thereby necessitating reopening of the proceedings in the event a material modification or violation of the California settlement should occur. For this reason, we shall enter an order of restitution against the corporate respondent, but stay its effective date so that it will not (ever) become operative unless a violation of the California settlement pertaining to restitution should occur. In that event, the order permits the corporation to request proceedings to consider the practicability of further restitution, but the question of its legal justification will not be subject to retrial.

The situation is somewhat different with respect to the assets unlawfully retained by decedent Patrick. The record before us indicates that tens of thousands of individuals became Masters or Generals in Holiday Magic, each investing sums of \$2000 to \$9000 or more. Not all this money was retained by Holiday Magic (some release fees went back to recruiting Generals, for instance) and some of the inventory purchased by defrauded individuals has undoubtedly been resold (and so would not come within the scope of our restitution order). Nonetheless, it would appear that the amount of money illegally obtained by Holiday Magic and deceased respondent Patrick amounts to scores of millions of dollars.

The papers now before us indicate only that, after liquidation of certain assets, a sum somewhat in excess of \$2 million will be available for the class victims. Since this amount is far less than the amounts unlawfully obtained by respondents, since the assets of the corporation appear to be effectively depleted by the settlement, and since decedent Patrick exercised substantial control over the corporation and was in a position to withdraw substantial amounts of money from it, it seems to us that the Patrick estate may well be retaining substantial sums of illegally obtained funds, unless such funds have been spent. [FN13]

If it is an unfair practice for an individual to retain monies obtained as a result of fraud and overreaching, it would seem no less unfair for the estate of that individual to retain such monies and dispose of them in accord with the wishes of the defrauder. It is clear to us that Section 5 does not permit an individual

or a corporation to become rich and powerful by use of monies secured as a result of flagrantly illegal behavior. This case may present the question of whether the law allows an individual to pass on to his heirs a massive financial legacy crafted from the callous deception of his fellow citizens. We think Section 5 clearly does not, and we think it our clear duty to inquire further to determine whether or not that is what is transpiring here. We shall thus order that restitution be made by substituted respondent Olivo to the extent he administers funds obtained from Holiday Magic, which are not already subject to restitution. The order provides that at such time as it becomes effective, the individual respondent, as to whom its effect would not be stayed, may petition the Commission to hold supplemental hearings in the event he cannot make the restitution required. It may be that the estate is not in possession or entitled to possession of funds obtained as a result of illegality, in which case respondent Olivo will be effectively in compliance and may so demonstrate. We would be remiss in our duty, however, were we not to provide for the possibility that the situation is otherwise.

IV. RESTRAINT OF TRADE COUNTS

A. PriceFixing

Holiday Magic rule 3, contained in company manuals and incorporated by reference into the contract signed by the company's distributors, provided that:

Distributor agrees to purchase merchandise only from the company or his Sponsor in accordance with the Holiday Magic marketing plan and to sell merchandise only at those prices established by the company. (I.D. 179)

An agreement to fix prices, whether horizontal or vertical, is illegal per se, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 228 (1940); *Dr. Miles Medical Co. v. John D. Parke & Sons Co.*, 220 U.S. 373, 408 (1911); *Albrecht v. Herald Co.*, 390 U.S. 145, 15253 (1968). The distributor's contracts incorporating the abovequoted language were clearly agreements to fix prices, and hence illegal. Even assuming, as respondents argue (contrary to the findings of the administrative law judge) that the above provision was not enforced, its inclusion in the distributor's contract would still constitute a violation of the law, for it is the agreement to fix prices that is illegal, regardless of whether it comes to fruition or not. See *United States v. Socony Vacuum Oil Co.*, *supra*, p. 275 n. 59. The danger of illegal pricefixing agreements in an organization like Holiday Magic is particularly great, because it is likely that many distributors signing the contract will lack the legal expertise or recourse to legal counsel necessary to inform them that their agreement is unenforceable in court. Whether or not the company takes steps to enforce the pricefixing contract, there is always a danger that the other party to it will feel obliged to adhere. Moreover, as noted, there is evidence in the record to indicate that at various times and places efforts were made to enforce the resale price maintenance provisions of the Holiday Magic contract. (I.D. 184, 186)

Sometime in the fall of 1967, the abovesited rule appeared with the added phrase 'in accordance with Fair Trade Statutes in those states having Fair Trade Laws.' (I.D. 179) Respondents argue that by addition

of this phrase they effectively abandoned their earlier policy of illegal pricefixing, limiting retail price maintenance to so-called 'fairtrade' states. [FN14] The administrative law judge concluded otherwise, citing certain other language in the Holiday Magic manuals (I.D. 179), continued reference by the company to resale prices without indication they were suggestions only (I.D. 18083), and occasional efforts to enforce adherence to stated prices (I.D. 186). It is clear from the initial decision that prior to the fall of 1967, respondents did enter into illegal agreements to fix prices, and they did not entirely discontinue such pricefixing by virtue of the change in their manual as of October. Moreover, even were the abovementioned change to be construed as discontinuance, we find no basis in the record of this case for concluding that respondent corporation may be relied upon to abstain permanently from the discontinued activities except under compulsion of law. Our duty is thus to enter an order prohibiting any recurrence of pricefixing found to have existed in the past. [See *Carter Products, Inc. v. Federal Trade Commission*, 323 F.2d 523, 531 (5th Cir. 1963); *Guziak v. Federal Trade Commission*, 361 F.2d 700, 704 n. 6 (8th Cir. 1966).]

With respect to pricefixing at the wholesale level, it appears that this practice has continued unabated to the present time. If a company chooses, as did Holiday Magic, to pass title to its distributors and receive payment from them without regard to their ability to resell, it has no right whatsoever to establish the price terms under which those distributors may resell the product they have purchased. [FN15]

For these various reasons, an order prohibiting resale pricefixing will be entered. We shall, however, modify the order of the administrative law judge in certain respects. As urged both by respondents and complaint counsel, we shall alter the order to take account of Fair Trade laws. In addition, our order will not require the company to desist from the use of all suggested price lists for a period of three years, as recommended by the administrative law judge.

Under normal circumstances, of course, the use of suggested resale prices is not illegal, and, indeed, where the distributors to whom the suggestion is made are, as here, generally in need of business guidance, provision of information as to what price might constitute a competitive resale price may serve a useful and procompetitive function, provided it is very clear that the suggested price is merely that.

Those cases in which a temporary prohibition on use of resale price lists has been imposed have generally involved distributors who were also fulltime business people, and not likely to be in need of pricing information. [FN16] There were also involved longstanding coercive relationships between supplier and distributor, such that simply prohibiting the overt coercion, while permitting uninterrupted use of the price lists which had been at the heart of such coercion, was deemed unlikely to eliminate the impetus to fix prices. In this case, the constant turnover in distributors militates against the sort of relationship found in *Coors* or *Lenox*, *supra*. Moreover, while not effectively abandoned, it is clear that respondents' pricefixing activities have moderated in some respects since the early stages of the Commission's investigation. For all the above reasons, we believe that the corporate respondent should be allowed to continue use of 'suggested retail prices.' Our order provides, however, that such

suggested prices must be clearly denominated as 'suggested' in states in which the suggestions may not legally be enforced. This proviso should satisfy the legitimate business needs of Holiday Magic to inform its distributors of suggested resale prices and permit them to advertise suggested retail prices like other cosmetics salespersons, while making clear to those distributors that they remain free to charge the prices they choose.

B. Marketing Restrictions

Count V of the complaint charged that various restrictions imposed upon Holiday Magic participants via the distributor's contract were unfair methods of competition in violation of Section 5. Respondents do not generally contest that the challenged restrictive agreements were in fact entered into, but they dispute the administrative law judge's conclusions of illegality and recommendation that appropriate order provisions issue.

1. Wholesale Sale Restrictions

Respondents required that Masters, Generals, and Organizers sell at wholesale only to the Organizers and Holiday Girls they sponsored, and that Holiday Girls and Organizers purchase only from their sponsoring distributors. Distributors were prohibited from buying back merchandise already sold to other distributors. (I.D. 187, 189, 191, 192)

The administrative law judge concluded that the above restrictions were anticompetitive and unreasonable because their only 'Purposes' were to (1) generate further master inventory purchases from Holiday Magic, Inc., without regard to the needs of the distributor, and (2) maintain the pricing, override and pyramid structure of the marketing plan. (I.D. p. 344, [p. 991 herein]) Respondents argue summarily that the restrictions were necessary to facilitate the entry of Holiday Magic into an oligopolistic market and that in any event these restrictions were not enforced. (RB 10102)

We do not find these contentions convincing. The restrictions described above are in essence customer restrictions, limitations of the right of one who has purchased goods outright to resell those goods to customers of the owner's choosing. The Supreme Court has declared customer restrictions to be illegal per se, *United States v. Arnold, Schwinn & Company*, 388 U.S. 365, 382 (1967). There is some suggestion in the Schwinn opinion that exceptions to this rule might be recognized in the case of failing firms or small and aspiring entrants, whose use of such restrictions would be evaluated on a 'rule of reason basis.' While not deciding whether Holiday Magic would fall within this possible narrow exception to the Schwinn rule, the administrative law judge did determine that the challenged customer restrictions were not reasonable and on balance served anticompetitive ends. We find no reason to upset this conclusion. The record in this case indicates that individuals acquired large inventories of Holiday Magic cosmetics which they were in some cases subsequently unable to resell. Prohibitions on the right of such individuals to resell acquired merchandise to particular distributors or, conversely, limitations on the right of particular distributors to purchase inventory) could only serve to increase inventory purchases from Holiday Magic itself, without at the same time necessarily increasing the flow of product to the

ultimate consumer. It is possible, of course, that from the standpoint of the potential distributor, a guarantee that his or her recruits would be bound to purchase from the distributor might serve to operate as a needed incentive for undertaking the risk of becoming a Holiday Magic distributor. (Tr. 9314) At the same time, however, the restrictions could only serve to increase the risk of loss if it turned out that the distributor could not liquidate inventory via his or her own efforts or those of recruits, since the likeliest resale outlets for the remaining inventory would be foreclosed.

In addition, these restrictions would clearly have the possible effect of supporting the company's illegal policy of wholesale and retail price maintenance. See *United States v. Bausch & Lomb Co.*, 321 U.S. 707, 724 (1944). On the whole, we believe that the administrative law judge's evaluation of the 'purpose, nature, and probable effect' of these restrictions was accurate and we find no reason to disturb his conclusion that they were anticompetitive.

Respondents' alternative argument that the restrictions were not enforced (RB 102) is not well taken. For one thing, there is evidence that these contract provisions were enforced [CX 686B; I.D. 191(c)]. [FN17] The point was often made by Holiday Magic officials that adherence to the marketing plan was critical, and violators would be terminated. As in the case of pricefixing, the existence of an illegal agreement itself creates the danger that parties unaware of its illegality will feel constrained to adhere.

2. Retail Outlet Restrictions

Respondents, at least until 1970, entered into agreements with their distributors prohibiting them from reselling to a wide variety of commercial retail outlets, including drug stores, grocery stores, variety stores, and chain stores. Evidence that these agreements were enforced was adduced at trial. (I.D. 194) In 1970, well after institution of the Commission's investigation, this policy was changed to the extent that the formerly 'unauthorized' outlets became merely 'nonrecommended' outlets. (RB 103; RX 133D) Also prohibited under the marketing plan were sales of products on consignment (I.D. 202), a practice which would be necessary in some cases in order to supply retail outlets.

Respondents contend that these restrictions were intended for protection of the Holiday Magic trademark, which might suffer if Holiday cosmetics were displayed alongside the products of better-established competitors (a fate which might, of course, befall them in the boutiques, wig shops, beauty schools, barber shops, and health food stores which were 'authorized outlets'). The administrative law judge found this justification unconvincing, whatever its legal relevance, and concluded that this customer restriction, like others, was designed to prevent pricecutting on Holiday Magic products. (I.D. pp. 342, 344 [pp. 989, 991]) There can be no doubt that prohibition of resale to the kinds of retail outlets noted above does serve to limit the likelihood that pricecutting on the retail level will occur by eliminating the most likely pricecutters from access to the product.

It is not illegal for Holiday Magic merely to 'recommend that its products be withheld from certain classes of stores, but it is unlawful for it to enter into agreements with its distributors which prohibit resale to certain classes of customers. Even assuming, *arguendo*, as did the administrative law judge,

that a justification for these restrictions initially should be considered in view of Holiday's fledgling status at the time they were instituted (though not, of course, by the time they were nominally eliminated) we still do not find the justification presented adequate to excuse the likely anticompetitive potential of the practice. We find that the retail outlet restrictions of Holiday Magic are unfair methods of competition in violation of Section 5 of the Federal Trade Commission Act, and an order provision prohibiting their recurrence is required.

3. Advertising Restrictions

The administrative law judge found that Holiday Magic had entered into agreements with its distributors providing that prior company approval must be obtained for advertising or promotion of Holiday Magic products. (I.D. 195) The law judge concluded that the prescreening of advertising was a:

device which enables Holiday Magic, Inc., to control and supervise by prior restraint the price fixing and retail outlet restriction requirements of Holiday Magic, Inc. * * * (I.D. 196)

There is no doubt that prescreening of all product advertising may be a powerful means of coercing adherence to unlawful pricefixing and customer agreements. The distributor who wants to cut prices will likely want to advertise that fact, and it is not hard to surmise the chilling effect created by the necessity to clear such advertisements in advance with the company which disapproves of such price-cutting. In the circumstances of this case we agree with the administrative law judge that unqualified prescreening of advertising material is a violation of Section 5.

Holiday Magic argues that it is obliged to review the advertising of its distributors by virtue of various orders of the Food and Drug Administration and the Attorney General of the State of California. (RB 103-04) The order proposed by the administrative law judge speaks fully to this objection by forbidding only the prescreening of advertising from which price terms and the names of retail outlets have not been deleted. Under the proposed order, which we shall adopt as our final order, Holiday Magic may in the future concern itself fully with those aspects of distributor advertising which are its legitimate business, and with which other agencies have required it to be concerned i.e., claims about the product itself, and claims about the marketing system which have been the subject of so much abuse. Deletion from prescreened advertising of price terms and retail outlet identifications will ensure that the company does not exercise control over matters which the law requires be left to the ultimate control of its independent distributors.

4. 'Private Arrangements'

Certain other restrictions on distributors, deemed 'private arrangements' by the administrative law judge, were challenged by the complaint. These related to the fact that a 'Distributor' (Master or General) under the Holiday Magic system might be not only one individual person, but a husband and wife, a partnership, a corporation, or some other business entity. Among challenged contractual restrictions, whose existence was not contested, were:

(1) Upon the dissolution of a distributor partnership, the departing partner is required to revert back to his or her original sponsor (i.e., he or she may not remain in the role of Master or General occupied by the partnership). (I.D. 197)

(2) In the event a General Distributorship dissolves, the principal or partner who is departing, if desirous of staying in the organization, must requalify as a new Master Distributor under the original sponsor, create a replacement Master, and pay a \$2500 release fee to qualify as a General again. (I.D. 198)

The administrative law judge found these restrictions to be unreasonable restraints of trade, in violation of Section 5. This portion of the administrative law judge's opinion is not, however, adequately supported by record evidence or legal precedent, nor, after our own review of counsel's arguments and the sparse record on this point, can we find these restrictions to be in violation of Section 5. The record evidence concerning the meaning and operation of these restrictions is not overwhelmingly clear. Apparently the thrust of the restrictions is that once an individual leaves a distributorship, the individual may not continue to purchase from Holiday Magic on the same terms as did the distributorship, but must revert to purchasing from the original sponsor, and requalify if so desired as Master or General in order to purchase on the terms granted a Master or General.

These restrictions are not, in the same sense as those discussed previously, limitations on the right of alienation by the distributor of goods already owned. [FN18] It is not challenged that Holiday Magic may establish certain conditions under which it will accord an individual the rights of a distributor. It chose to require a certain initial inventory purchase for the buyin Master, whether the Master was an individual or a group. Imposition of the subject restrictions on departing partners amounts to no more than insistence on the same qualifying conditions for all distributorships, whether the distributor be a de novo entrant or a prior partner. While this restriction was obviously designed to encourage large inventory purchases and no doubt might have such an effect, the same can be said of the very requirement that one purchase \$5000 of merchandise in retail value to become a Master instead of any lesser amount. Assuming that Holiday Magic had the right to impose such a requirement on an individual entering initially, [FN19] we do not see why it did not have a right to impose the same requirement on one who might initially have qualified for the Master's discount by virtue of making only half the required investment (by entering with a partner), so long as these rules were clearly spelled out and no deception was involved. Certainly these restrictions are not per se illegal, and it is not apparent to us from the sparse record that they operated, or were likely to operate, to achieve an impermissible anticompetitive end.

Other restrictions on private arrangements of distributors were that

(3) An individual could not be part of more than one distributorship;

(4) Distributors could not enter into agreements with other distributors to make a division of profits, assets, or new recruits in violation of the marketing plan; and

(5) Addition of new partners to an existing distributorship, or sale of the distributorship must meet the same requirements as a new Master or General (whichever the distributorship was).

Here, again, the record is insufficient to permit an evaluation of the competitive effects of these restrictions, and we shall, therefore, dismiss the complaint with respect to them. [FN20]

C. Exclusive Territories

The administrative law judge found that respondents had conspired to allocate territories among their Holiday Girls. (I.D. 38591) The record shows that various Holiday Magic manuals advised and instructed so-called 'Distributor's Council' organizations of Holiday Magic distributors to assign routes to Holiday Girls. (I.D. 385388) While it appears that in many areas routes were not assigned, evidence exists to show that they were assigned in areas of Florida at the instigation of Holiday Magic, via its 'suggestions' in the manuals and at the express recommendation of respondent Pape, corporate president. (I.D. 386)

There is some question initially as to whether or not the territories imposed by respondents were exclusive, or more akin to the 'areas of primary responsibility' permitted by the order of the administrative law judge. While the Holiday Magic manuals speak of allocations in order to insure market coverage, at least one case in which respondents conspired to allocate routes arose where the market had become saturated, and the purpose of imposing territories was to avoid competition between Holiday Girls and their distributors. (I.D. 386) This consideration is dispositive of the issue of exclusivity. Clearly the conspirators did not contemplate, in trying to undo the effects of market saturation, that distributors given scarce territories would be able to go outside them, since the entire point was to allocate scarce territory, not stretch limited resources over large areas. (See also I.D. 391, CX 76D.)

We believe that a determination of the legality of these exclusive territories is governed by our decision in *Adolph Coors*, supra (slip op. pp. 1430). Here, as in *Coors*, imposition of exclusive territories was accompanied by price fixing, and that combination renders the use of exclusive territories illegal per se.

Respondents argue that the only instances in which allocation of territories was actually proven to have occurred were in Florida, a state which sanctions resale price fixing contracts under certain conditions. We do not believe that this situation constitutes an exception to the rule in *Coors*, nor have respondents shown any reason why it should. Fair trade laws are in essence a compromise of the public interest in competition, and the exemption from the antitrust laws they confer must be construed narrowly, *United States v. McKesson & Robbins*, 351 U.S. 305, 316 (1956).

The order of the administrative law judge on this point is entirely proper, forbidding the imposition of exclusive territories, but expressly permitting the assignment of areas of primary responsibility to Holiday Girls, which will enable the company to insure coverage of a particular market area.

D. Price Discrimination

The administrative law judge concluded that respondents had engaged in price discrimination violative of Section 2(a) of the Clayton Act (15 U.S.C. 13) in two major respects:

(1) Wholesale General Distributors, the favored customers, received goods at 35 percent of list price, while the disfavored Master Distributors received them at 45 percent of list (and disfavored Organizers at somewhat more). All sold at wholesale.

(2) Retail The disfavored customers, Holiday Girls and Organizers, purchased product at 70 percent of list price (or less, depending on volume) which they sold at retail, as did the favored General and Master Distributors who bought at 35 percent and 45 percent of list, as noted above. (Masters were also disfavored at retail with respect to Generals.) (I.D., pp. 345363 [pp. 991 1006 herein])

The only issue with respect to both facets of the challenged discriminations is whether or not their effect, in statutory terms, 'may be substantially to lessen competition.'

Complaint counsel did not demonstrate any actual injury to competition from the discriminations, but both sides recognize that such a demonstration is not necessary for a violation to be made out. All that need be shown is that the challenged discrimination may have the prescribed anticompetitive effect, see *FTC v. Morton Salt Co.*, 334 U.S. 37, 46 (1947); *Corn Products Refining Co. v. FTC*, 324 U.S. 726, 738 (1945), and this showing may rest on inferences drawn from the state of competition and the nature of the discrimination.

With respect to the discriminations at the wholesale level, respondents attempt to nip the inferential process in the bud by arguing that Masters and Generals did not actually compete at wholesale because of company-imposed customer restrictions which required that a Holiday Girl (or other retail outlets buying at a similar discount) continue to purchase from her or his recruiter. (RB 39) This argument is wholly unpersuasive. Even assuming the complete effectiveness of this customer restriction, it would not have eliminated vital competition between Masters and Generals for new accounts, i.e., individual Holiday Girls, boutiques, beauty parlors, and the like, selling at retail. Such competition assumed a particularly important role in the Holiday Magic scheme in view of the demonstrably large turnover of Holiday Girls, necessitating continuous recruitment on the part of any Master or General who desired to make a living by wholesaling to retailers. (I.D. 6566) The fact that Masters or Generals did not compete for sales to already recruited girls and retail outlets simply does not have any bearing on the existence of substantial competition to sign up new girls and outlets. The evidence clearly shows that Masters and Generals operated in the same limited geographic areas in seeking to enlist Holiday Girls and retail outlets to the cause. (I.D. 442445; 447) There were no divisions of territories or populations between Masters or Generals seeking individuals and businesses to sell at retail. They were free to, and did, advertise to and solicit within the same population group in any geographic area. No more than this need be shown to demonstrate that favored and disfavored customers were in competition. Hand-to-hand combat on the doorsteps of prospective Holiday Girls is not a necessary element of proof. (But see I.d., pp. 289290 [pp. 954955 herein])

It is clear, moreover, that the substantiality of the price discrimination (the favored customer bought at 22.2 percent less than the disfavored customer), and other findings of the administrative law judge compel a finding of substantial potential prejudice to competition. Such a margin obviously leaves great leeway for the favored customer to offer a discount from the suggested resale price when it is not enforced, or to subsidize various services which would assist the favored customer in competing for accounts. (Cf. I.D. 452) The record contains many instances of wholesale distributors operating at low or nonexistent profit margins (I.D. 453), and in such circumstances product price advantages are obviously crucial. The evidence compels us to conclude, therefore, that the discrimination in favor of General Distributors at wholesale runs afoul of Section 2(a). [FN21]

With respect to discriminations at the retail level, we do not find the evidence of violation to be as convincing. Once again, we are not impressed by respondents' argument that customer restrictions prevented favored and disfavored customers from competing for repeat sales to Holiday customers, because this does not account for competition for initial purchasers. Nevertheless, respondents' assertions regarding the relative insignificance of competition between favored and disfavored customers ring somewhat truer in the context of Holiday Magic retail sales than they do at the wholesale level. Of the purchases made by favored Generals, cited by the administrative law judge, only a relatively small portion appear to have been devoted to retail sales, and in some cases so-called favored retailing generals do not appear to have engaged in more than sporadic retail sales to friends and relatives. Certainly the fact that products were retailed doortodoor does not in itself necessitate evidence of competitive 'encounters' to sustain the complaint, as respondents suggest. The situation of casual salespeople endeavoring to dispose of product by going doortodoor and in a pinch prevailing on sympathetic relatives is, however, somewhat different from that in which the same volume of goods is offered to all comers by competing retailers at stationary outlets accessible to the public at large. On the record before us we are unable to find a degree of retail competition between favored and disfavored customers sufficient to warrant an inference that the challenged discriminations may have had the statutorily proscribed effect. See *UniversalRundle Corporation v. Federal Trade Commission*, 382 F.2d 285, 287 (7th Cir. 1967).

The proposed order language of the administrative law judge will be retained insofar as it relates to the illegal discrimination at the wholesale level.

V. INDIVIDUAL RESPONDENTS

Respondents object to application of any order to individuals Pape and Gillespie. They argue that deceased respondent Patrick was the creator and guiding light of Holiday Magic, and that to select two of his employees for imposition of liability is unwarranted.

With respect to respondent Pape, the record clearly compels a finding of individual liability. The record relates that Pape 'took the reins' and 'raised Holiday Magic to even greater heights' while his patron Patrick ran for the California gubernatorial nomination. (CX 1840L; I.D. 30) Later Pape became president and as chief executive officer he was responsible for directing the daytoday activities of the corporation.

While Pape may not have originated various of the plans and policies attacked in the complaint, he played an instrumental role in directing their execution, with full knowledge of what they were. This is emphatically not a case in which the subordinates of a corporate president perform illegal acts without his knowledge. Holiday Magic was a small organization and direction of all facets of business operation came directly from the top, from William Penn Patrick and respondent Pape. That Mr. Pape left Holiday Magic in 1968 is wholly immaterial to his liability. Some of the worst practices evidenced in the record occurred while Mr. Pape directed the operations of corporate respondent. In order to prevent recurrence of illegal practices, it is necessary that any order run against those shown to have engaged in or directed such practices. We conclude that the administrative law judge properly applied his order to respondent Pape. (I.D. 2732; *Federal Trade Commission v. Standard Education Society, et al.*, 302 U.S. 112, 119120 (1937); *Benrus Watch Co. v. Federal Trade Commission*, 352 F.2d 313, 324325 (8th Cir. 1965), cert. denied, 384 U.S. 939 (1966))

Respondent Gillespie was the first Holiday Magic Organizer, and later served as administrative vice president, and a member of the Board of Directors. Gillespie's own testimony reflects considerable familiarity with the daytoday operations and policies of Holiday Magic, which is understandable inasmuch as she was responsible at various times for directing headquarters' operations and wrote revised editions of various Holiday Magic distributor's manuals. The testimony of witness Gay indicated that Gillespie, together with Pape, directed the activities of Holiday Magic during Patrick's absence. (Tr. 992632) Though not president, it is clear that Gillespie was centrally involved in directing the operations of Holiday Magic, and at a time when respondent Patrick had withdrawn to the political arena. Once again, hers is not a case in which a respondent is charged with actions of subordinates for which the respondent is nominally responsible, but of which the respondent is unaware. Gillespie, with full knowledge of the operations of the company, played a key role in directing them. To eliminate practices found, an order must name those found to have engaged in or knowingly directed the practices, particularly, as here, where the wrongdoing was so pervasive, and is readily subject to transfer to a different business operation. For these reasons, we believe that respondent Gillespie was properly included. While it may be that the complaint did not exhaust the universe of individuals who should be held accountable for the wrongdoing which occurred, the naming, in addition to founding father and guiding light Patrick, of the two individuals who shared primary responsibility for directing the company in the patriarch's absence, was in no sense arbitrary.

VI. MISCELLANEOUS OBJECTIONS

Respondents have raised other miscellaneous objections which are without merit.

A. Alleged Prejudgment

Respondents claim that the Commission has prejudged certain issues in their case, because shortly after these proceedings began the Commission initiated a Trade Regulation Rule Proceeding in which it indicated its belief that certain practices in the area of franchising might constitute violations of Section 5. Respondents allege that the practices covered by the proposed rule are so similar to theirs that the

Commission's consideration of the rule amounts to a consideration of the illegality of their own practices, a consideration in which respondents (like all others), have been denied leave to cross-examine witnesses, and in which ex parte communications have been made by the staff to the Commission.

As we have noted before,

Prejudgment occurs when there is evidence that a decision maker in an adjudicatory proceeding has irrevocably closed his mind on the specific facts of a case yet to be heard by him. [Emphasis added. Hearst Publishing Co., Docket No. 8832, Interlocutory Opinion; 79 F.T.C. 1007, 1011 (1971)]

There is no suggestion here that the Commission or the administrative law judge has prejudged in any respect whether or not respondents engaged in the acts and practices challenged in the complaint. The determination of the facts in this case has been entirely on the voluminous record compiled in accord with standard adjudicatory procedures.

Respondents appear to argue that prejudgment still exists because, by instituting the rulemaking proceedings, the Commission had made a determination that certain actions of respondents, allegedly subject to coverage by the rule, were violations of Section 5. Initially, it should be noted that the rule in question has not been finally promulgated, and, in promulgating a rule for public comment, the Commission expresses no more than a determination that it has reason to believe that the practices subject to the rule are violative of the laws it administers. Thus, even if respondents' acts and practices are in some respects subject to the rule, the Commission has as yet made no determination in the rulemaking proceeding as to their legality. Assuming, however, that the Commission were to make such a determination in the rulemaking proceeding, it is not clear in what respect respondents would have been injured, since rulemaking is a proper function of the Commission, and, if undertaken according to appropriate rulemaking procedures, parties engaging in covered activities are subject to the rule made, even though the rulemaking process does not confer all the rights of an adjudication. *Federal Trade Commission v. National Petroleum Refiners Association*, 482 F.2d 672 (D.C. Cir. 1973), cert. denied, 415 U.S. 951 (1974) Of course, any party cited for violating a rule is entitled to an adjudication to determine whether or not it has engaged in the acts and practices which the rule condemns.

More to the point, perhaps, respondents' arguments amount to the contention that the Commission must enter every judicial proceeding with a totally open mind concerning the legal principles applicable to the conduct challenged in the particular adjudication. This is folly. The Commission's statutory mandate requires that it be constantly considering, in both adjudicative and non adjudicative contexts, the applicability of statutes it is charged to administer to a variety of acts and practices. No citizen or corporation accused of violating the law has the right, under the Constitution or any law, to a judge with an open (or empty) mind as to what the meaning of the law is under which the citizen or corporation is be tried. [FN22] Virtually all the cases cited by respondents in support of their position deal with prejudgment of facts. (RB 145157) Respondents conclude by citing the APA which grants a party adjudicatory rights to obtain a 'full and true disclosure of the facts.' [5 U.S.C. s 556(d) (1967)] There has

been no prejudgment in this case whatsoever with respect to the factual issues of whether or not respondents have engaged in challenged acts and practices. Moreover, the Commission has considered carefully the arguments of respondents on all legal issues. Whether or not the Commission has considered these same or related legal issues in other proceedings, in which respondents had no right to cross-examine or even participate at all, is, however, totally immaterial to whether respondents have been accorded a fair hearing.

B. Denial of Right to Amend Answer

Petitioners also object to the decision because the administrative law judge denied them leave to amend their answer to the complaint to include the meritless defense which we have just considered. If the judge erred in this regard his error was harmless, since the Commission has now fully considered respondents' argument on the issue of prejudgment as it relates to the Trade Regulation Rule Proceedings. Respondents apparently still object, on the grounds that if the administrative law judge had permitted them to amend their answer they could then have undertaken discovery of Commission files to determine the extent of what they mistakenly view as illegal Commission prejudgment of the issues. The administrative law judge correctly perceived that respondents' argument on prejudgment raised no issues that would warrant further factfinding. There is simply no hint here of prejudgment or ex parte communications concerning the facts of this case, and hence no grounds for discovery. In denying respondents' motion to amend their answer, the administrative law judge in effect dealt as fully with the prejudgment defense as if he had allowed an amendment of the answer but then denied motions for discovery on the grounds the answer raised no basis for them. Whether the administrative law judge should technically have allowed an amendment of the answer is unnecessary to decide. Respondents' legal argument has been fully considered here. It is misconceived and raises no issues that could possibly warrant additional factfinding below.

C. Interference of SEC

Respondents allege a denial of the right to present witnesses in their defense because an SEC process server caught one defense witness in the hearing room after her testimony (and after departure of the ALJ) and served her with a subpoena in that agency's investigation of respondents. Thereafter, contend respondents, only a few of the 84 witnesses they had planned to call in the New York area were willing to appear for fear of similar treatment.

While the incident is regrettable, it did not deprive respondents of the right to present their defense. Both complaint counsel and the administrative law judge deplored the occurrence, and assurances were given by an SEC official that the agency would F.T.C.'s New York proceedings. witnesses during the pendency of the F.T.C.'s New York proceedings. (Tr. 744749) Respondents thereafter had the opportunity to subpoena any witnesses who might still have been apprehensive about testifying. They did subpoena some, but six refused to testify on Fifth Amendment grounds, arguably still for fear of the SEC. When respondents made no proffer of proof, the administrative law judge ruled that, in the absence of a proffer, the testimony of nonappearing and appearing non testifying witnesses would be

held cumulative. Respondents then filed a limited proffer of proof, though not covering the witnesses who had taken the Fifth Amendment. No indication is given in their brief by respondents of how the proffered evidence might undermine the conclusions of the administrative law judge, and that being so we cannot accept the argument that respondents were in any way prejudiced by the SEC's intervention.

D. Rulings on Respondents' Witnesses

Respondents argue that they were also denied an opportunity to present their defense because of rulings by the administrative law judge to the effect that testimony of witnesses respondents sought to produce would be cumulative, and because of various comments made by the administrative law judge regarding the approach he would take in evaluating the testimony of those distributors who did appear.

It had not occurred to us, upon first glance at a record comprising over 10,000 pages of testimony, and 17 binders of physical exhibits, compiled in hearings spanning more than a year, to commend the presiding official for his expedition. Respondents' arguments (and our review of the record) convince us, however, that such commendation is warranted. A balance must be struck in all adjudications between the respondents' right to defend and the public's right to have violations of law adjudicated and halted in a reasonable amount of time. The administrative law judge struck this balance more than equitably with respect to respondents, who have given no concrete indication of how any limitations on witnesses would have altered the findings [Cf. *Basic Books, Inc. v. Federal Trade Commission*, 276 F.2d 718, 72021 (7th Cir. 1960)] and who might even still be calling witnesses at hearings throughout the land had their original grandiose of what justice and the public 6786) not yielded to a more realistic notion of what justice and the public interest require. Enough is enough.

An appropriate order is appended.

FINAL ORDER*

This matter having been heard by the Commission upon the appeal of 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 denied, in larger part, and granted in lesser part, the appeal:

It is ordered, That the following Findings of Fact and Conclusions of Law of the administrative law judge (as hereinafter modified by the appended listing of 'Errata') are adopted as Findings of Fact and Conclusions of Law of the Commission: Pp. 16 [pp. 763766 herein]; Findings 1483; pp. 292311 (through 1st paragraph) [pp. 956967 herein]; pp. 326 (penultimate paragraph) 342 [pp. 978989 herein]; Paragraphs D(1)(2) and E(6) on pp. 343344 [pp. 989991 herein]; pp. 345361 [pp. 9911005 herein]; pp. 364367 (through 3rd paragraph) [pp. 10061008 herein]; p. 368 (last 6 paragraphs, except for second sentence of penultimate paragraph and substituting 'higher' for 'lower' in last paragraph) [pp. 1009 herein]; p. 369 (except for 2nd paragraph) [pp. 1010 herein]; page 370 (except for 3rd and 4th full paragraphs) [pp. 10101011 herein]; pp. 371376 [pp. 10121015 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 be, and it hereby is, entered:

ORDER

I.

It is ordered, That respondent Holiday Magic, Inc., a corporation, Its officers, agents, representatives, employees, successors and assigns, respondent Fred Pape, individually, and respondent Janet Gillespie, individually, their agents, representatives and employees, directly or indirectly through any corporate or other device, in connection with the offering for sale, 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, 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 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 refrain from selling his or her merchandise in any quantity to or through any specified person, class of persons, business, class of business, or retail outlet of his or her choosing.

(d) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct or require, induce, coerce, or enter into any agreement with any distributor to refrain from selling any merchandise in any quantity to or through any specified person, class of persons, business, class of business, or retail outlet of his or her choosing.

(e) 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 geographic area; Provided, however, That nothing contained herein shall prevent respondents from assigning routes to individual distributors as areas of primary responsibility.

(f) 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 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 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 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.

II.

It is further ordered, That the aforesaid respondents and their officers, agents, representatives, employees, successors and assigns, 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 therefor, in connection with any marketing program or any other kind of merchandising, marketing or sales promotion program, in commerce, as 'commerce' is defined in the Federal Trade Commission Act, to forthwith cease and desist, directly or indirectly, from:

1. 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 for (1) the opportunity to receive compensation in return for inducing other persons to become participants in the plan or program, or for (2) 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.
2. Offering, operating, or participating in, directly or indirectly, any marketing or sales plan or program wherein the financial gains to participants 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 participating the recruitment of participants.
3. Requiring or suggesting that prospective participants or participants in any merchandising, marketing or sales promotion program purchase product 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 of reasonably necessary sales materials, as determined by the purchaser, in order to participate in any manner therein.

III.

It is further ordered, That the aforesaid respondents (Holiday Magic, Inc., Fred Pape, and Janet Gillespie) and their officers, agents, representatives, employees, successors and assigns, 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 marketing program or other kind of merchandising, marketing or sales promotion program, in commerce, as 'commerce' is defined in the Federal Trade Commission Act, do forthwith cease and desist, directly or indirectly, from:

1. Representing, directly or by implication, or by use of hypothetical examples that participants in any marketing program, or any other kind of 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 said past participants to achieve the earnings represented, and failing to maintain adequate records which disclose the facts upon which any claims of the type discussed in this paragraph of the order [III(1)] are based; and from which the validity of any claim of the type in this subparagraph of the order can be determined.

2. Representing, directly or by implication, or by use of hypothetical examples, that a gross income figure is a net income, salary, earnings, or profit figure.

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

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

5. 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.

6. Requiring that an individual pay a valuable consideration of any kind in return for the right to participate in any marketing or sales program without first disclosing to such prospective participant in writing the number of other participants already active in the market area in which such prospect plans to operate.

7. 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 implies 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.

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

9. Representing that once a man or woman understands any business, or marketing plan or program, he or she will not or cannot or should not fail to achieve success in it.

10. Misrepresenting that any business operation, merchandising or sales promotion plan can be the key to a person's financial future and security, or the answer to a person's financial dreams.

11. Representing that a business operation, merchandising or sales promotion plan is a onceinalifetime opportunity.

12. Misrepresenting the amount or degree of the consuming public's acceptance of any products or representing that the public receives any products with great enthusiasm or that repeat business is high without making available at the same time market studies which in fact substantiate the representations.
13. Representing that it is not difficult to obtain a lifelong income in connection with any merchandising, marketing or sales promotion program.
14. Misrepresenting that any merchandising, marketing or sales promotion program is sound, profitable, or distinguished.
15. Representing that persons who fail in any merchandising, marketing or sales promotion program are lazy, stupid or greedy, or any combination thereof.
16. Misrepresenting the relationship between profits and income at one functional level of a business to those at any other functional level of that or any other business.
17. Misrepresenting that wholesale sales actually reflect retail sales or consumer demand for products.
18. Using or encouraging the use of advertisements which offer or suggest employment when the purpose of such advertisement is to obtain nonemployee participants in any merchandising, marketing or sales promotion program; or misrepresenting, in any manner, the kind or character of any position or job opportunity offered to prospective participants.
19. Representing, directly or by implication, that it is not difficult for participants to recruit or retain persons who will invest or participate in any marketing program or any other kind of merchandising, marketing or sales promotion program, either as distributors, franchisees, wholesalers or sales personnel, or that there is a very large number of prospective distributors or sales persons from whom to choose.
20. Representing, directly or by implication, that products will be or are 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.
21. Selling, or offering franchises or distributorships, to obtain which a participant is required to make monetary investment without furnishing to such participant at least seven (7) days prior to the time at which such investment must be made, a copy of the Federal Trade Commission Consumer Bulletin No. 4, 'ADVICE FOR PERSONS WHO ARE CONSIDERING AN INVESTMENT IN A FRANCHISE BUSINESS.'
22. Misrepresenting that respondents have applications pending for distributorships in a particular area; or that any person must act immediately to be considered for a franchise or distributorship, or that any person must act immediately to take advantage of a special deal, sale or event, or misrepresenting in any manner the nature and extent of interest of others in any particular franchise or distributorship.

23. Misrepresenting that persons risk losing little or nothing by investing in a franchise or distributorship.

24. Misrepresenting that franchises or distributorships increase in value over the years.

25. Using any payment check which purports to portray the satisfaction or success of franchisees or distributors, or any other document which misrepresents the satisfaction or success of franchisees or distributors.

26. Misrepresenting the earnings potential of franchises or distributorships, prospective franchisees or prospective distributors.

IV.

It is further ordered, That the aforesaid respondents, their successors and assigns, 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 tenpoint gold** type, that the application or contract may be cancelled for any reason by notification to respondents in writing within at least seven (7) days from the date of execution.

2. Refund immediately all monies paid pursuant to any contract or application by all persons who request cancellation of the application or contract within at least seven (7) days from the execution thereof.

V.

It is further ordered, That corporate respondent and respondent Sam Olivo, as executor for William Penn Patrick, their successors and assigns, within thirty (30) days after this order becomes final, shall make an offer to any participant of a refund of all sums of money to which the participant is entitled under this order, and within sixty (60) days after the aforesaid respondents, their successors and assigns, receive notification of the acceptance of such offer of refund from such participant, shall pay all sums of money to which the participant is entitled under this order.

1. For the purposes of this order, the term 'participant' shall mean any person who invested money to participate, in any manner, in marketing programs of respondents, their successors and assigns.

2. For the purposes of this order, the term 'refund' means all sums of money paid by a participant to respondents or their successors and assigns, directly to or through a trust, parent or subsidiary corporation:

- (a) less any amount of money paid by respondents or their successors or assigns to participants, including any refund either made voluntarily or pursuant to court order, and
- (b) less the price paid for any products purchased by participant that participant does not return, and
- (c) plus interest at the rate of 6 percent per annum on the amount to be refunded to participant from the date participant entered into respondents' program to the date notification of the right to refund is received by participant.

3. For the purposes of this order, the term 'offer' means a notification by certified mail, return receipt requested, to each participant with the following information and none other:

(a) On the front of the envelope, together with the name and address of the participant and the name and address of the sender, the following legend in 16 point, boldface type: 'IMPORTANT: REFUND NOTICE.'

(b) On the letter, in 12point, boldface type, the following language:

IMPORTANT NOTICE

By order of the Federal Trade Commission, all persons who invested money to participate, in any manner, in [name of company] are hereby offered a refund of all sums of money so paid, less (1) any amount of money paid by [company or individual] to you, including any refund either made voluntarily or pursuant to court order, and (2) the price paid for any products purchased by you that you do not return to [company or individual], plus interest at the rate of 6 percent per annum on the amount to be refunded to you, from the date you entered into [name of company]'s program to the date this notification of the right to refund is received by you. A participant requesting refund pursuant to this order who has [name of company] product either credited to him in an account, or in his actual possession, shall be entitled to refund for such products on the basis of the price paid by participant for the products; Provided, however, that any of said products in participant's possession for which participant requests refund under this order must be delivered to one of [company's or individual's] warehouses before refund is payable.

If you accept this offer, then (1) send a letter to [name and address of company or individual] within 60 days of receipt of this notification stating the amount and basis of your claim, and (2) send any product in your possession to a [name of company or individual] warehouse, or (3) in the event product is credited in an account with [name of company], a statement that upon receiving a refund you relinquish any rights to such account.

Within 60 days after the receipt of the said information, you will receive all sums of money to which you are entitled under the formula set forth above.

Provided, however,

(c) A participant requesting refund pursuant to this order who has product either credited in an account or in his or her actual possession, shall be entitled to refund for such products on the basis of the price paid by participant for the product; Provided, That any of said products in participant's possession for which participant requests refund under this order must be delivered to one of the company's or individual's warehouses before payment is made, if the company or individual so elects.

(d) The obligations of this section (V) of the order shall be stayed indefinitely with respect to corporate respondent for so long as it remains in compliance with the order entered In the Matter of Securities and Exchange Commission v. Holiday Magic, Inc., et al., Civil Action No. C 73 1095 LHB (N.D. Cal. Apr. 1, 1974) insofar as that order requires the payment by corporate respondent of monies to its Master and General Distributors.

(e) If respondents or their successors and assigns claim they do not have adequate funds to comply with this order provision, each may within sixty (60) days of the effective date as to him or it of the refund obligations of this order petition the Commission to reopen the proceedings to consider the claim. The petition shall set forth the list of distributors or franchisees to whom refunds are due under this order and the sum of money each such distributor or franchisee is to receive in accordance with this order, plus a notarized statement of all assets and liabilities.

Upon receipt of this petition, and any response thereto which complaint counsel shall make, the Commission will assign an administrative law judge for the purpose of making findings and recommendations with respect to the claim. The administrative law judge shall furnish petitioner with the Commission's Statement of Financial Status, shall require its prompt execution, and may conduct such interrogations of the petitioner or require the production of such documents as he deems necessary in order to make findings and recommendations as to any modification of this order which may be warranted on the issues raised by petitioner's claim. The findings and recommendations will be reported to the Commission for a final determination.

(f) If any dispute arises as to compliance with the refund provisions of this order which cannot be satisfactorily resolved by the parties, notice shall be given to respondents or to their successors and assigns of the extent to which they are regarded not to be in compliance and the facts respecting such alleged noncompliance. Within thirty (30) days after the receipt of such notice of noncompliance, they may petition the Commission for a hearing on such noncompliance, or for a modification of the order provision giving rise to the compliance dispute or for such other relief as is believed warranted, and the Commission may set the matter down for hearing before itself or before an administrative law judge, or shall either grant or deny such petition by order formally entered in the same manner and form as if it were an original order of this Commission.

VI.

It is further ordered, That respondents Holiday Magic, Fred Pape, and Janet Gillespie, their successors and assigns shall forthwith deliver a copy of Section III of this order to cease and desist to all present and

future salespeople, franchisees, distributors 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 of said Section III of this order.

VII.

It is further ordered, That respondent corporation and its successors and assigns shall forthwith distribute a copy of this order to each of its operating divisions.

VIII.

It is further ordered, That the corporate respondent and its successors and assigns notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondent, 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 corporation which may affect compliance obligations arising out of this order.

IX.

It is further ordered, That Fred Pape and Janet Gillespie promptly notify the Commission of the discontinuance of their present business or employment, and of their affiliation with any new business or employment. Such notice shall include the individual's current business address and a statement as to the nature of the business or employment in which he or she is engaged, as well as a description of his or her duties and responsibilities.

X.

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, corporate respondent, and respondent Sam Olivo as executor for William Penn Patrick, shall file with the Commission a second report, in writing, setting forth in detail the manner and form in which they have complied with Section V of the order.

Commissioner Nye not participating.

ERRATA

(The initial decision is adopted by the Commission subject to the exclusions noted in the order, and subject to the following changes. Lines are numbered by including chapter headings, captions and all other lines of print in the count.)

1. Finding 86, line 3, substitute '65%' for '54%'
2. Finding 115, line 3, substitute 'continues' for 'contines'
3. Finding 131, delete subparagraph 'a'
4. Finding 132, subparagraph 'a,' substitute 'Finding 130' for 'XIII 3'
5. Finding 133, subparagraph 'a,' substitute 'Finding 130' for 'XIII 3'
6. Finding 140, substitute 'Finding 131' for 'XIII 4'
7. Finding 141, lines 2 and 3, substitute 'who obtain a 10% override on their sales' for 'over whom a 10% override is obtained'; substitute 'Findings 132, 133' for 'XIII 5, 6'
8. Finding 159, subparagraph 'a,' substitute 'Findings 152158' for 'XVII 174'
9. Finding 175, p. 64, line 9 [p. 810, line 12 herein], substitute '\$200' for '\$300'
10. Finding 186, p. 71, lines 13 and 38, substitute 'lose' for 'lost'
11. Finding 187, line 9, substitute 'marketing' for 'merketing'
12. Finding 196, delete 'See Part XVII 6'
13. Finding 198, line 5, substitute 'is' for 'in'
14. Finding 287, line 8; Finding 288, line 6, substitute 'Enrollments' for 'Enrollements'
15. Finding 333, p. 128, line 17 [p. 851, line 20 herein], substitute '\$39,600' for '\$39,009'
16. Finding 360, line 23, substitute 'Pangerl' for 'Pangrel'
17. Finding 369, subparagraph 'c,' substitute 'Finding 320' for 'Part XXXII 4'
18. Finding 381, line 12, substitute 'Marget' for 'Margert'
19. Finding 381, p. 159, line 22 [p. 871, line 44 herein], delete second 'to'
20. Finding 382, line 9, substitute 'procedures' for 'producers'
21. Finding 387, p. 164, line 7 [p. 874, line 30 herein], insert 'in' before 'approximately'
22. Finding 393, p. 170, line 14 [p. 878, line 16 herein], substitute 'undivided' for 'individed'

23. Finding 393, p. 170, line 40 [p. 878, line 30 herein], substitute 'their' for 'their'
24. Finding 402, line 14, substitute 'accomplish' for 'accompolish'
25. Finding 403, p. 202, line 36 [p. 896, line 37 herein], substitute 'indication' for 'inclination'
26. Finding 418, line 15, substitute 'insistence' for 'insistance'
27. Finding 421, line 11, substitute 'dollar' for 'dollars'
28. Finding 433, p. 219, line 26; p. 220, line 11 [p. 907, line 19; line 35 herein], substitute 'echelons' for 'exchelons'
29. Finding 441, p. 224, line 4 [p. 910, line 34 herein], substitute 'principle' for 'principal'
30. Finding 453, p. 260 [p. 932 herein], substitute 'variance' for 'varience'
31. Finding 483, p. 288, line 26 [p. 954, line 22 herein], substitute 'thought' for 'though'
32. P. 293, line 11 [p. 957, line 3 herein], substitute 'was' for 'were'
33. P. 296, line 6 [p. 959, line 13 herein], substitute 'rounds' for 'rouds'
34. P. 299, line 27 [p. 961, line 16 herein], delete 'in'
35. P. 301, line 11 [p. 962, line 11 herein], substitute 'Blachly' for 'Blachy'
36. P. 304, line 25 [p. 964, line 4 herein], substitute 'attendant' for 'attenant'
37. P. 306, line 14 [p. 965, line 6 herein], substitute 'proposes' for 'proposeds'
38. P. 306, line 33 [p. 965, line 18 herein], substitute 'members' for 'embers'
39. P. 308, line 21 [p. 966, line 16 herein], substitute 'Promotes' for 'Promoter'
40. P. 309, line 30 [p. 966, line 44 herein], substitute 'inseverable' for 'inservable'
41. P. 330, line 32 [p. 981, line 20 herein], delete comma
42. P. 330, line 34 [p. 981, line 21 herein], delete 'that'
43. P. 335, line 18 [p. 984, line 12 herein], substitute 'Carburetor' for 'Carburator'
44. P. 336, line 4 [p. 984, line 36 herein], substitute 'caused' for 'causing'

45. P. 336, line 30 [p. 985, line 18 herein], substitute 'role' for 'roll'
46. P. 337, line 8 [p. 985, line 39 herein], delete 'where'
47. P. 337, lines 1920 [p. 986, line 7 herein], substitute 'Commission's finding' for 'Commission found'
48. P. 337, line 34 [p. 986, line 19 herein], add apostrophe after 'petitioners'
49. P. 338, line 39 [p. 987, line 15 herein], delete 'of'
50. P. 341, line 19 [p. 989, line 19 herein], substitute 'Lenox' for 'Lennox'
51. P. 343, line 14 [p. 990, line 24 herein], add 'be allowed' at end of line
52. P. 351, lines 1819 [p. 966, line 29 herein], substitute 'competed for' for 'completed with in'
53. P. 353, line 32 [p. 998, line 23 herein], substitute 'is this' for 'as this is'
54. P. 364, line 6 [p. 1006, line 27 herein], substitute 'and' for 'as'
55. P. 364, line 13 [p. 1006, line 34 herein], delete 'd' from 'entered'
56. P. 365, line 10 [p. 1007, line 20 herein], substitute 'or' for first 'of'
57. P. 370, line 12 [p. 1011, line 2 herein], insert 'from' between 'that' and 'the'
58. P. 375, line 22 [p. 1014, line 23 herein], delete first 's' from 'ssuccessors'

FN* Petitions for review filed on Jan. 3, 1975 by Holiday Magic, Inc. and by Sam Olivo on Jan., 7, 1975, C.A. 9th.

FN** By order of the Commission issued Aug. 29, 1974, the complaint in this matter was amended to substitute Sam Olivo, Executor of the Estate of William Penn Patrick, for deceased respondent Patrick for the purpose of effecting restitution of such funds as are in the estate of decedent Patrick and are subject to any order of restitution entered in these proceedings. See p. 347 herein.

FN*** See Errata Sheet pp. 10751078, herein.

FN1 Complaint counsel during the course of the hearing seemed to take the position that any contravention of public policy would per se be a violation of Section 5 of the Federal Trade Commission Act as an unfair act and practice and an act of unfair competition. If public policy is contravened this does not mean per se that there is a violation of the Federal Trade Commission Act unless the public policy involved specifically relates to those matters over which the Federal Trade Commission would

have jurisdiction under the Federal Trade Commission Act. The charges here, however, as enunciated by the complaint, do suggest that the public policy referred to involves deception in the sense that the plan as alleged is conducive to inducing participants to erroneously believe they will receive substantial financial gains not dependent on their efforts. Furthermore, Count II specifically indicates that the nature of the lottery 'is contrary to the public policy of the United States, is false, misleading and deceptive.' This phraseology suggests it is inherent deception that is violative of public policy and is therefore within the purview of the Federal Trade Commission Act.

FN1a Complaint counsel however contends the evidence actually establishes, as set forth in the findings, that 'most participants' must have been deceived because of the inherency of the deception and otherwise. (See also the conclusions.)

FN2 The abbreviations used in this decision are as follows: RXRespondents' Exhibit; CXCommission Exhibit; Tr.Transcript of Record.

FN3 At Tr. 956090 percent purchased by his Masters.

FN4 Testimony of Gay at Tr. 10615 that Pangerl won 5 automobiles, watches, rings, diamond lapel pins, and two trips around the world for two. He didn't take the trip because they were of long duration and it took too much time away from recruiting. At Tr. 9562, 9570, Pangerl claimed to have recruited 200 Masters and 50 Generals.

FN5

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

FN6 See also *McNamara v. Gargett*, 36 N.W. 218; *Davis v. Seeley*, 38 N.W. 901 (Mich.); *Merril v. Packer*, 45 N.W. 1076 (Iowa); *Schmuele v. Waters*, 125 Ind. 265, 25 N.E. 281; *Shirley v. Ulsh*, 2 Ohio Cir. Ct. Rep. 401; *Hubbard v. Freiburger*, 94 N.W. 727 (Mich.); *Bonisteel v. Saylor*, 17 Ont. App. 505; *Commonwealth v. Allen*; 404 S.W.2d 464 (Ky., 1966); *State of New York v. ITM, Inc.*, 52 Misc. 2d 39, 275 N.Y.S.2d 303(1966); *Sherwood & RobertsYakima, Inc. v. Leach*, 67 Wash. 2d 630, 409 P.2d 160 (1965).

FN7 Actually, it is more than a geometric progressionit is a continuing series of geometric progressions. Since the way the plan is described, the participants continue to start new geometric progressions of five each of the ensuing months as well.

FN* Footnote in original:

'The illustrative calculations set forth in the Government's brief are not challenged.

'By way of a simple illustration, if the first fifteen recipients of the opening wedge, that is, the initial letter in turn each sent out or mailed fifteen letters the number of such letters put in circulation would reach 225. On the second step, the number increases to 3,375, and on the fifth step to the somewhat

astounding total of 11,390,625. * * * The mathematical certainty that the 'referral' plan of merchandising is inevitably doomed to failure is obvious. To this the Government adds by way of argument, 'Such is the natural vice and structure of quicksand found present in all 'endless chain' transactions.'

From an analysis of the record, the Government's use of 15 as the base seems ultra conservative. Some purchasers provided as many as 100 references, majority around 50 or 60.'

FN** Footnote in original:

'In a very similar case involving the referral selling of stereo sets the 8th Circuit had this to say:

'The referral plan cannot succeed even if used for only a short time unless at some point customers subsequent to the first one are not allowed to earn the set. As the Government brought out at the trial, once the plan is set in motion the referrals spiral due to the principle of geometric progression. If each person who purchases a set can earn it by referring names, no profit will be made; hence, no funds would be available to satisfy referral commitments. The only method of halting the progression is to withhold the referral privilege for customers who were obtained by referral.' * * *'

FN8 The Commission has issued advisory opinions disapproving of gaming devices, which could not be classified as lotteries in the technical sense. In Opinion No. 45, wherein it was contended that one of the three essential elements of a lottery, namely consideration, was missing from the plan, the Commission advised that it did not need to decide the question of whether or not consideration would exist, so the proposal could be held to constitute a technical lottery, for it was still of the view that the plan would involve an illegal effort to sell or dispose of merchandise by means of a chance or gaming device. * * * [L]otteries are not the only method by which the public's gambling instinct may be aroused, for other methods are comprehended within the general concept of merchandising by gambling.'

And in Opinion No. 78, 'The mere fact that each participant receives a thing of value for his contribution does not negate the existence of a lottery nor change the plan's essential nature as an appeal to the public's gambling instincts. Clearly, the participants in this drawing would be motivated by the chance of receiving something of more value than the amount they contributed. Hence, the nature of the appeal is unmistakable.' (See also Opinion No. 86.)

FN9 In order for at least half to earn \$108,000, the lowest possible figure for an average would be if the other half (minus one) were producing nothing, thereby producing a minimum figure of \$54,000 a year for Generals on the average, for most generals to be earning \$108,000 a year in wholesale income.

FN10 As noted, however, the distinction in price in Holiday Magic are greater than 10 percent.

FN11 The volume discount purchase situation is somewhat more easily justified than a cumulative discount. In the Holiday Magic plan the volume discounts are cumulative.

FN12 The Ninth Circuit, initially set aside the Commission's Order for reasons not relevant herein (See *Alhambra Motor Parts v. F.T.C.*, 309 F.2d (9th Cir. 1962). The circuit court subsequently affirmed the relevant portions of said order as well as the aforesaid compliance report by its unreported order in *Alhambra Motor Parts v. F.T.C.* No. 20, 764, issued Dec. 1, 1967.

FN1 In the Matter of Adolph Coors Company, Docket No. 8845 (July 24, 1973) [83 F.T.C. 32], slip op. p. 4; aff'd No. 731567 (10th Cir. 1974); In the Matter of Grand Caillon, 65 F.T.C. 799, 80607, 81415 (1964).

FN2 The system described herein in the present tense is generally that which existed at times prior to the complaint in this matter, except where indicated. Certain of the excesses of the program have been moderated in the face of challenge by various government agencies and private litigants.

FN3 This amount would purchase a 'minikit.' An alternative would be purchase of \$39 of product and sales aids (I.D. 60)

The following abbreviations will be used throughout:

I.D. Initial Decision (Finding No.)

I.D. p. Initial Decision (Page No.)

CX Complaint Counsel's Exhibit (No.)

RX Respondents' Exhibit (No.)

Tr. Transcript (Page No.)

RB Respondents' Appeal Brief to the Commission (Page No.)

CB Complaint Counsel's Answer Brief on Appeal to the Commission (Page No.)

FN4 This amount was later raised to \$299, for which the Organizer received a 'onepack' of all Holiday Magic products, a minikit, a ten cassette library of recorded inspirational messages, a year's subscription to 'Perception' Magazine, and a twoday course in selling. (I.D. 70)

FN5 Any Organizer who achieved the volume of recruitment represented by Holiday Magic promotional materials would automatically become a workin Master by virtue of the inventory purchases of his recruits.

FN6 In addition to the above, a complex system of reimbursement exists to provide Generals with overrides or rebates on inventory purchases made by those whom the General has recruited, recruits of recruits, and so forth. As noted, General Distributors receive a monthly payment equal to 10 percent of the retail list price value of products purchased by Master Distributors whom they had recruited or who

were assigned to them, or who had been recruited by Organizers or Holiday Girls to whom they sold. When a General's Master becomes a General, the first General no longer receives the 10 percent override on the exMaster's purchases, but does continue to receive a 1 percent override on all purchases made by the new General and the new General's recruits.

FN6a The same chain mechanism was implicit in the representation made to every wouldbe General that he or she could recoup the release fee by recruiting another General, and offering that General the same inducement for signing up.

FN7 For reasons noted in detail in our decision in GerRoMar, Inc., et al., supra (pp. 1721) [pp. 153155, herein], we believe that an adequate evaluation of the lottery charge (Count II) is not possible on the record before us, and we shall, therefore, vacate those portions of the initial decision and proposed order dealing therewith. It does not appear in any event that the provisions of the law judges proposed event that the provisions of the law judge's proposed recurrence of the wrongdoing here.

FN8 'Stipulation and Order Modifying Consent Judgment with Corporate Defendants'

The amended order of the Court enjoins respondents to: * * * conduct their operations in conformity with the marketing plan most recently submitted to the Commission [SEC] and currently in effect, except to the extent that it may be hereafter determined that such marketing plan may conflict with antitrust laws and/or other laws administered by the Federal Trade Commission, in which event the corporate defendants, with the approval of Special Counsel, will make whatever modifications are necessary in order to comply with said laws.

We do not believe that the Court intended by this provision to require that the Federal Trade Commission hold new adjudicative hearings to adjudge the legality of the new marketing plan, just as it has previously held hearings stretching over 15 months and 10,708 pages of transcript to evaluate the legality of the past marketing plan. We believe that the intention of the amended paragraph was to require that Holiday Magic conform its operations to the order of the F.T.C. based on the fully litigated record, and designed to prevent future violations of law. The determination to which the District Court's order refers may be made by counsel for Holiday Magic and the Special Counsel, in consultation with the compliance staff of the Commission. If problems arise with respect to the meaning of our order that cannot be resolved with compliance staff, the Commission will, as always, be prepared to render advice. These observations refer as well to the order provisions pertaining to restraints of trade, discussed in subsequent sections of this opinion.

FN9 We have added a recordkeeping provision [Par. III(1)] requiring that respondents maintain substantiating material for any earnings claims they may choose to make. This housekeeping provision is necessary in order for the Commission to enforce effectively prohibitions on earnings misrepresentations. If respondents cannot obtain and maintain substantiating material for earnings claims, as they seem to suggest in objecting to the ALJ's disclosure requirements, they should not make

representations which suggest to prospective distributors that they do know how much participants in their program are earning.

FN10 Par. II(7) of the ALJ's order, to which respondents have not objected, and which we shall incorporate in our order [Par.II(3)] forbids respondents to require any participant to purchase product or pay other consideration (except for purchase of reasonably necessary sales aids) to participate in the marketing program. This will limit though not eliminate the financial risk to participants.

FN11 The Commission is 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 F.T.C. Act occurring prior to the entry of a ceaseanddesist order. (Heater v. Federal Trade Commission, No. 73 1750 [503 F.2d 321], Sept. 11, 1974.) With all due respect for the court, the Commission believes that the court's decision in this matter is incorrect, and the Commission will seek to obtain review of this decision by the Supreme Court.

FN12 Witness Ben Gay, a past president of Holiday Magic testifying as to the reaction of William Penn Patrick to the F.T.C. investigation, in Dec. 1969 or Jan. 1970, spoke as follows:

The subject of compromise had come up and that was the theme of his talk. He stood up. He was sitting at the end of the board table. He began shouting and screaming and pounding on the table saying that the next person who so much as uttered the word 'compromise' would be fired and that there would be no compromise with the Federal Trade Commission or any other regulatory agency * * *.

Mr. Patrick and myself were sitting in my office. I was sitting in my office after everyone else had left and when the door shut I looked at him and said, 'compromise,' because he had just said the first person who uttered the word would be fired. Then he laughed and he said, 'What do you mean?' and I said, 'The changes that were suggested are reasonable and valid and they don't make any difference to our business anyway. If the Federal Trade Commission would be happy with them, I say let them have them.' I said, 'I am trying to build a company that will be here 20 years from now,' and he said, 'Let's get something straight. I can steal more money in the next two years than you can make building an organization. It is going to take the Federal Trade Commission at least two years to get us and we are going to proceed on that line,' and he left my office. [Tr. 984144; witness adhered to these words on cross examination, Tr. 10073.]

FN13 Complaint counsel state that the Patrick Trust, which has settled, was the recipient of substantial transfers from respondent Patrick subsequent to institution of the Commission's suit. It is obviously for the California probate court to determine whether or not these funds were transferred to the trust to avoid a judgment against the individual. If so, they may properly belong to the estate. Our concern is with the estate and not with funds lawfully donated to the Trust, for a purpose other than evading a Commission order.

FN14 There is some question as to whether the change in the manual regarding retail price maintenance was initiated before or after the company had knowledge of the Commission's investigation. The administrative law judge found that the company had knowledge of the investigation no later than July 1967 (I.D. 1), and that the change in the manual regarding retail price maintenance was published in Oct. 1967. (I.D. 179) However, respondents contended in their proposed findings before the administrative law judge that the change was authorized and steps taken to effectuate it prior to the company's having knowledge of the investigation (Respondents' Proposed Findings 15254). Whether or not initiation of the alleged discontinuance occurred before, or as a result of, the Commission's investigation is not material in view of other factors recited in the text of the initial decision.

FN15 Corporate recognition of the illegality of fixing resale prices to distributors, combined with corporate desire to continue fixing such prices results in such schizophrenic corporate prose as the following, taken from a postcomplaint company manual introduced by respondents:

'That same day, Joe [a master] must pay Mary [an upandcoming holiday girl] a bonus amounting to a suggested 25 percent on all the products she purchased directly from him that month. (\$3500 times 25 percent equals \$875.) This means that Mary really only had to invest \$1,049.65 in product to become a Master now that she has a 55 percent discount.' (RX 132D, Par. 3, emphasis added)

The company president contended on crossexamination that under the rule as he construed it, Joe would not have had to pay Mary the suggested 25 percent. (Tr. 9609) We doubt if that was clear to Maryor Joe under the plan, even as amended after the complaint in this matter.

FN16 See for example In the Matter of Lenox, Inc., Docket No. 8718 (1968) [73 F.T.C. 578], aff'd 417 F.2d 126 (2d Cir. 1969); In the Matter of Adolph Coors Company, Docket No. 8845 (1973) [83 F.T.C. 32], aff'd No. 7311567 10th Cir. 1974).

FN17 It is also curious to note that in defending against allegations of illegal price discrimination respondents argue that these customer restrictions were enforced. (RB 39)

FN18 It is not clear from the record whether the restriction was intended to limit the ability of a departed partner to sell off accumulated inventory acquired as a result of a partnership dissolution.

FN19 It is not clear from the record whether the restriction was intended to limit the ability of a departed partner to sell off accumulated inventory acquired as a result of a partnership dissolution.

FN20 With more evidence regarding the effects of these restrictions, our conclusion might be different as to certain of them. Given the enormous proportions of the record, complaint counsel are hardly to be faulted for giving least attention to these most peripheral elements of the case. We do not believe, moreover, that at this point a remand for further evidence would serve any useful purpose.

FN21 Respondents argue that even assuming competition between Generals and Masters, a General could not be considered to be favored until such time as he or she had recouped the release fee. We doubt the validity of the release fee argument, since the General received in return for the release fee an additional valuable consideration denied the Master the right to recruit other Generals. Thus, at best, only a fraction of the release fee can be considered as mitigating or redressing the discrimination. The General who recruited one other would more than erase any disadvantage.

FN22 Respondents, while objecting to the findings on deception, might as easily argue that they were prejudged on the issue of pricefixing, since the Commission freely acknowledges that it had concluded long before reviewing the record in this case and in proceedings to which respondents were not privy, that entry into agreements to fix prices is illegal. Respondents seem to be objecting to the principle of stare decisis and the objection cannot be well taken.

FN* Paragraph V reported as modified by Commission order issued Jan. 21, 1975, 85 F.T.C. 89.

FN** By order the Commission dated Nov. 19, 1974, the word 'gold' was changed to 'bold.'

FTC

84 F.T.C. 748

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77 F.T.C. 1700

February 4, 1970

File No. 703 7057

Advisory Opinion Digest

No. 404. Franchise Sales Promotion Plan With Pyramiding Franchises and 'Functional Override' Commission Implications.

In a previous advisory opinion the Commission advised that a violation of Section 5 of the Federal Trade Commission Act would result from the adoption of the following proposed franchise sales promotion plan.

The plan centers around the sale of a fruit juice drink through franchise independent businessmen who will assist in the franchisor's growth by training additional franchisees. For such performance an original franchisee will be paid a 'Functional Override,' or commission, of 1 percent of the gross sales of those

they recruit and train (direct franchisees) and onehalf of 1 percent of the gross sales of those recruited and trained by direct franchisees (indirect franchisees). In addition, original franchisees will be granted loan credits and cash bonuses for persons proposed and accepted as franchisees.

Although the plan was not intended to have 'pyramid sales' implications and the 'Functional Override' was to stop with the indirect franchisees insofar as an original franchisee is concerned, a direct franchisee may become an original franchisee and indirect franchisees may become direct, and subsequently original, franchisees by sponsoring other persons as franchisees. This being so the 'Functional Override' continues throughout the chain down to the last indirect franchisee recruited who would be unable to derive any benefits from the plan for the reason that the continually expanding pyramid of franchisees would prevent the later franchisees from successfully recruiting still other participants.

A tabulation distributed through an operations manual to potential franchise purchasers indicates that an original franchisee may, in theory, benefit from the effort of at least twenty (20) other franchisees. This in the Commission's judgment is somewhat beyond the realm of possibility since an original franchise purchaser does not know the number of prior franchise purchasers nor the degree to which an available market has been saturated with franchises. The return to any given franchise participant will unquestionably be a great deal less than the theoretically achievable amount set forth. No single franchise participant can be certain what his return will be, if any, beyond perhaps that from his first few direct franchisees. Any further amount he might receive would accrue to him sheerly through chance.

FTC

77 F.T.C. 1700

http://www.mlmllegal.com/legal-cases/HolidayMagic_v_FTC1974.php