FTC v. BurnLounge: Complaint

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
WESTERN DIVISION

FEDERAL TRADE COMMISSSION,	)	Case No.
	)	
Plaintiff	)	**COMPLAINT FOR INJUNCTIVE AND**
	)	**OTHER EQUITABLE RELIEF**
v.	)	
	)	
BURNLOUNGE, INC., et al.,	)	
	)	
Defendants.	)	
	)	

Plaintiff; the Federal Trade Commission ("FTC" or "Commission"), by its undersigned attorneys, alleges:

1. Plaintiff FTC brings this action under Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), to secure a permanent injunction, rescission of contracts and restitution, disgorgement of ill-gotten gains, and other equitable relief against the Defendants for engaging in deceptive acts or practices in connection with the advertising, marketing and sale of opportunities to operate on-line digital music stores in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

JURISDICTION AND VENUE

2. This Court has subject matter jurisdiction over the FTC's claims pursuant to 15 U.S.C. §§ 45(a) and 53(b) and 28 U.S.C. §§ 1331, 1337(a) and 1345.
3. Venue in the Central District of California is proper under 15 U.S.C. § 53(b) and 28 U.S.C. § 1391(b) and (c).

PLAINTIFF

4. Plaintiff, the FTC, is an independent agency of the United States government created by statute, 15 U.S.C. §§ 41 et seq. The Commission enforces Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), which prohibits unfair or deceptive acts or practices in or affecting commerce. The Commission may initiate federal district court proceedings to enjoin violations of the FTC Act and to secure such equitable relief as is appropriate in each case. 15 U.S.C. § 53(b).

DEFENDANTS

5. Defendant BurnLounge, Inc., ("BurnLounge") is a Delaware corporation that has its principal place of business at 340 Hudson Street, 7th Floor, New York City, New York. BurnLounge has conducted business since 2005. BurnLounge conducts recruitment activities and training seminars in the Central District of California and throughout the country.
6. Defendant Juan Alexander Arnold is an individual who resides in Studio City, California. He is the chief executive officer and chairman of the board of directors of BurnLounge. At all times material to this Complaint, Juan Alexander Arnold, individually or in concert with others, directed, controlled or participated in the acts and practices of BurnLounge as set forth below.
7. Defendant John Taylor is an individual who resides in Houston, Texas. Taylor is a promoter of the business opportunities offered by BurnLounge. At all times material to this Complaint, John Taylor has participated in the acts and practices of BurnLounge as set forth below.
8. Defendant Rob DeBoer is an individual who resides in Irmo, South Carolina. He is a promoter of the business opportunities offered by BurnLounge. At all times material to this Complaint, Rob DeBoer has participated in the acts and practices of BurnLounge as set forth below.
9. Defendant Scott Elliott is an individual who resides in Forney, Texas. He is a promoter of the business opportunities offered by BurnLounge. At all times material to this Complaint, Scott Elliott has participated in the acts and practices of BurnLounge as set forth below.
10. Defendants BurnLounge, Juan Alexander Arnold, John Taylor, Rob DeBoer and Scott Elliott transact or have transacted business in the Central District of California.

COMMERCE

11. At all times material to this Complaint, Defendants' course of business, including the acts and practices alleged herein, is and has been in or affecting commerce, as "commerce" is defined in Section 4 of the FTC Act, 15 U.S.C. § 44.

DEFENDANTS' BUSINESS PRACTICES

12. Since approximately 2005, Defendant BurnLounge has operated a pyramid scheme in connection with the advertising, marketing and sale of opportunities to operate on-line digital music stores ("on-line stores").
13. Participants join BurnLounge through the purchase of product packages, of which there are three: (1) the Basic Package, which sells for $29.95 per year; (2) the Exclusive Package for $129.95 per year plus $8 per month; and (3) the VIP Package for $429.95 per year plus $8 per month. More expensive packages provide the participant with an increased ability to earn rewards through the BurnLounge compensation program.
14. The first $29.95 of each product package pays for a license to operate an on-line store. Through the on-line stores, BurnLounge sells product packages and digital music to

consumers. Consumers who purchase music receive a digital copy by downloading it through the Internet.

15. There are two basic classes of BurnLounge participants: "Retailers" and "Moguls." Participants who purchase a license to operate an on-line store become a "Retailer." Retailers who want to earn monetary rewards must pay an additional monthly fee of $6.95 to become a "Mogul."

Compensation Plan

16. All participants in BurnLounge can earn reward points under the BurnLounge compensation program for selling product packages and digital music. Participants can redeem the points for purchases through their on-line stores. Only participants who become Moguls can convert the points into dollars. For Moguls, one point equals one dollar.
17. The BurnLounge compensation program has two parts: (1) recruitment bonuses (described in Paragraphs 18 through 26), and (2) Concentric Retail (described in Paragraphs 27 and 28).
18. BurnLounge pays two types of recruitment bonuses. These bonuses are earned from selling BurnLounge product packages to new recruits. BurnLounge calls these "Product Package Bonuses" and "Mogul Bonuses."
19. Product Package Bonuses are earned by selling BurnLounge product packages with the same name. BurnLounge provides three Product Package Bonuses: (1) the Basic Bonus; (2) the Exclusive Bonus; and (3) the V.I.P. Bonus. These are respectively $10, $20, and $50 when paid to Moguls.
20. To qualify to earn Product Package Bonuses, the participant must have sold two albums to non-Moguls in the prior calendar month (with the exception that during the first month the requirement is waived).
21. The second type of recruitment bonus is the Mogul Bonus. This bonus is only paid to Moguls and is earned through sales of Exclusive and VIP Packages.
22. The Mogul Bonus is based on a binary structure. In a binary structure, each participant has a position in the pyramid immediately below which are two other positions filled by subsequent recruits. As a result, each participant in the binary structure has the potential to develop two teams of subsequent or "downline" recruits.
23. The Mogul Bonus rewards a participant for his recruitment efforts as well as the recruitment efforts of his downline.
24. In order to qualify to earn a Mogul Bonus, a Mogul must meet the following one-time requirements: (1) recruit two other participants by selling them either the Exclusive or VIP Package and (2) sell two albums to non-Moguls. To remain qualified to earn the Mogul Bonus, all Moguls must sell two albums per month to non-Moguls. The album sales requirement is waived during the first month.
25. Mogul Bonuses are earned through a point system. Sale of an Exclusive Package generates 100 points and sale of the VIP package generates 400 points for the Mogul who makes the sale and for each Mogul in his or her upline, i.e., Moguls located in a direct line in the binary structure above the Mogul actually making the sale. The points are accrued by the Mogul making the sale and his upline once the new recruit sells two

albums.

26. In order to earn a Mogul Bonus, the Mogul must accumulate 300 points in each of the two teams. The amount of the Mogul Bonus varies from $25 to $50 depending upon the package the Mogul purchased and in some cases music sales.
27. Concentric Retail, the other part of the compensation program, provides rewards for product sales through on-line stores. BurnLounge defines "product" to include digital music downloads, the first $29.95 of each of the three BurnLounge packages, and the $8 monthly fee paid as part of the Exclusive and VIP Packages.
28. Through Concentric Retail, Retailers and Moguls earn a half point (500 cents for Moguls) per album sale priced $9.90 to $19.79 or 20 percent of BurnLounge's profit margin on the sale, whichever is greater, sold through their on-line stores. When specified levels of recruitment and product sales are satisfied, Concentric Retail also rewards Retailers and Moguls for product sales by others whom they directly recruit or who are related to them indirectly through subsequent recruitment up to six levels away.
29. BurnLounge provides much larger rewards for recruiting than for sales of digital music and thus provides greater incentives to participants to recruit than to sell music to ultimate users.
30. The BurnLounge compensation program is based primarily on providing payments to participants for the recruitment of new participants, not on the retail sale of products or services.

Recruitment

31. Consistent with the incentives of the BurnLounge compensation plan which favor recruitment over music sales, the efforts of Defendants in promoting and training others to promote BurnLounge emphasizes recruitment over sales of digital music.
32. Defendants offer BurnLounge product packages for sale throughout the United States, including in the Central District of California. Defendants promote the sale of the product packages through the Internet, telephone calls and through in-person meetings.

Income Misrepresentations

33. While promoting the sale of BurnLounge product packages and while training others to promote the sale of BurnLounge product packages, Defendants have represented that substantial incomes are made by BurnLounge Moguls. For example, Defendants have made the following claims:

    [I]f you build a community that sells a few movies and sells a few games and sells a few downloads, you will have a license to print money. Don't take my word for it, go ask Blockbuster what they made on $3.95 off 1,000 stores. J.T. made $50,000 two weeks ago. He's going to make probably $700,000 this year, and he's a good old boy from Texas that can't read. (Juan Alexander Arnold, live in-person recruitment presentation, New York, New York, September 18, 2006)

    We have people all across the country that are generating, you know, part-time income, a few hundred dollars a month, to people that are earning, you know, a few hundred dollars a week, Scott, and then we've got people that are earning a few hundred dollars a day all the way up to 2, 3, $4000 a day.

[O]ver the last six months, I've had a chance to generate well over $340,000 in income. In the last 30 days, it was over $70,000. . . . So, Scott, you know, seven people in the company have - - you know, I've had a chance to work with that have generated well over $200,000 in the last six months. We've got residual checks in the company right now today that are a six-figure income, well over six figures. (John Taylor, live teleconference call, August 10, 2006)

Guys, we've made just under $300,000. Todd Ellis' next door neighbor has made $280,000. We've got a dozen people that have made over $100,000. (Rob DeBoer, live in-person recruitment presentation, Lawrenceville, Georgia, July 12, 2006)

Our professional BurnLounge team is then available to answer all questions on your behalf until we drive your personal income to $1,000 per week. (Scott Elliott, Internet pre-recorded audio message, August 11, 2006)

34. In contrast to the claims of profitability, the compensation plan used by BumLounge mathematically dictates that at any particular time the majority of Moguls will spend more money to participate in BurnLounge than they have earned through their involvement with the company, and the majority of Moguls will not have made the substantial incomes represented.
35. Defendants have failed to adequately disclose that the majority of Moguls will not make the substantial incomes represented.

VIOLATIONS OF SECTION 5 OF THE FTC ACT

COUNT I

36. As alleged in Paragraphs 12 through 35, the Defendants promote participation in BurnLounge, which has a compensation program based primarily in providing payments to participants for the recruitment of new participants, not xi the retail sale of products or services, thereby resulting in a substantial percentage of participants losing money.
37. Defendants' promotion of this type of scheme, often referred to as a pyramid scheme, constitutes a deceptive act or practice in violation of Section 5(a) Df the FTC Act, 15 U.S.C. § 45(a).

COUNT II

38. In connection with the offering and sale of the right to participate in the BurnLounge program, Defendants represent, expressly or by implication, that consumers who become BurnLounge Moguls are likely to make substantial income.
39. In truth and in fact, in numerous instances, consumers who become BurnLounge Moguls

are not likely to make substantial income.

40. Therefore, the representation set forth in Paragraph 38 is false and misleading and constitutes a deceptive act or practice in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

COUNT III

41. In connection with the offering and sale of the right to participate in the BurnLounge program, Defendants represent, expressly or by implication, that consumers who become Moguls are likely to make substantial income.
42. Defendants fail to disclose that most BurnLounge Moguls are not likely to make substantial income.
43. This additional information would be material to customers in deciding whether to participate in the BurnLounge program.
44. Defendants' failure to disclose the material information described in paragraph 42, in light of the representations made in paragraph 41, therefore constitutes a deceptive act and practice in violation of Section 5 of the FTC Act, 15 U.S.C. § 45(a).

CONSUMER INJURY

45. Consumers in many areas of the United States have suffered, and continue to suffer, substantial monetary loss as a result of Defendants' unlawful acts or practices. In addition, Defendants have been unjustly enriched as a result of their unlawful acts and practices. Absent injunctive relief, Defendants are likely to :.ontinue to injure consumers, reap unjust enrichment, and harm the public.

THIS COURT'S POWER TO GRANT RELIEF

46. Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), empowers this Court to grant injunctive and such other relief as the Court may deem appropriate to halt and redress violations of the FTC Act. The Court, in the exercise of its equitable jurisdiction, may award other ancillary relief, including but not limited to, rescission of contracts and restitution, and the disgorgement of ill-gotten gains, to prevent and remedy injury caused by Defendants' law violations.

PRAYER FOR RELIEF

WHEREFORE Plaintiff Federal Trade Commission, pursuant to Section 13(b) of the FTC Act, 15 U.S.C.§ 53(b), and the Court's own equitable powers, requests that the Court:

1. Award Plaintiff such preliminary injunctive and ancillary relief as may be necessary to avert the likelihood of consumer injury during the pendency of this action and to preserve the possibility of effective final relief, including, but not limited to temporary and preliminary injunctions and an order freezing assets and requiring an accounting;
2. Enter a permanent injunction to prevent future violations of the FTC Act by Defendants;

3. Award such relief as the Court finds necessary to redress injury to :onsumers resulting from Defendants' violations of the FTC Act, including, but not Limited to, rescission or reformation of contracts, restitution, the refund of monies paid, and the disgorgement of ill-gotten monies; and
4. Award Plaintiff the costs of bringing this action, as well as such other and additional relief as the Court may determine to be just and proper.

Respectfully submitted,

WILLIAM BLUMENTHAL
General Counsel

CHRIS M. COUILLOU
DAVID C. FIX
GERALD S. SACHS
KENNETH ABBE
(Local Counsel)

Attorneys for Plaintiff
Federal Trade Commission

Jeffrey A. Babener, of Portland, Oregon, is the principal attorney in the law firm of Babener & Associates. For more than 25 years, he has advised leading U.S. and foreign companies in the direct selling industry, including many members of the Direct Selling Association. He has lectured and published extensively on direct selling and many of his writings will be found at www.mlmlegal.com, of which he is Editor. He is a graduate of the University of Southern California Law School, where he was an Editor of the USC Law Review.

Main Library || **MLM Legal** || **Babener & Associates** || **MLM Articles** || **Power Index**