

Complaint

86 F.T.C.

Appearances

For the Commission: *Harold E. Kirtz, Karen G. Bokart and Charles W. Corddry, III.*

For the respondent: *Michael J. Henke, Vinson, Elkins, Searls, Connolly & Smith, Wash., D.C.*

ORDER DENYING MOTION FOR RECONSIDERATION

Respondent American General Insurance Company and intervenor Fidelity and Deposit Company of Maryland move for reconsideration of an order by the Commission, dated Dec. 5, 1972 [81 F.T.C. 1052], vacating the administrative law judge's initial decision and remanding the case for further proceedings. The administrative law judge filed an initial decision sustaining the complaint in this matter on Aug. 7, 1975.

Respondent and intervenor have failed to make a sufficient showing why the Commission should grant their motion for reconsideration, especially after the lapse of almost three years from the date of issuance of the order they seek to challenge. Accordingly,

It is ordered, That the aforesaid motion for reconsideration be, and it hereby is, denied.

IN THE MATTER OF

KOSCOT INTERPLANETARY, INC., ET AL.

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

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

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

COMPLAINT

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

COUNT I

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PAR. 11. In truth and in fact:

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

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

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

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

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

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

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

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

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

COUNT II

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

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

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

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

c. By restricting the sellers from whom respondents' distributors

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

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

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

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

COUNT III

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

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

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

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

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

COUNT IV

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

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

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

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

Appearances

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

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

INITIAL DECISION BY DONALD R. MOORE, ADMINISTRATIVE
LAW JUDGE

MARCH 20, 1975

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

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PRELIMINARY STATEMENT

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

* * * * *

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

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

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

* * * * *

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

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

FINDINGS OF FACT

I. *Respondents and Their Business*

A. *The Corporate Respondents*

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

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

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

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

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

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

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

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

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

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

CX - Commission exhibit.

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

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

RX - Respondents' exhibit.

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

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

Having heard and observed the witnesses and having careful

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

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

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

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

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

B. The Individual Respondents

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

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

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

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

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

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

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

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

Ben Bunting
Hobart Wilder
Malcolm Julian
Raleigh P. Mann

The role of each may be outlined as follows:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

C. Jurisdictional Findings

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

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

II. *Unfair and Deceptive Practices*

A. Introduction

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

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

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

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

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

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

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

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

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

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

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

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

