

## **The Arizona Court's Ruling (SBH Update and Moving Forward)**

As many know, there was a trial held in Phoenix Arizona several months ago on allegations made by the FTC. Some of you have heard that the federal district court in Arizona ruled against SBH and the four individual defendants in this case. This is strictly our opinion and view of the ruling and sets out a thumbnail sketch of our arguments as to why the Court did not render a fair decision. You can access the order through the link below and reach your own conclusions.

Before we get into the facts and the legal rulings, it is important to put this case in perspective. We believe that the ruling is and was the product of decades of the FTC overreaching its authority and failure to rein in government regulators who should be committed to helping businesses that they believe are not complying with regulatory requirements.

In April 2021, the Supreme Court reversed almost four decades of precedent unanimously tossed out Section 13 of the FTC Act, holding that the FTC lacked authority (overreached) to impose monetary sanctions and seize business and assets of corporations and individuals. The Court noted that the Government had limited authority to seek damages under Section 19 of the Act if, but only if, the FTC could prove that an award of damages was “*necessary* to redress consumer injury.” Necessity is determined on an *individual* basis.

The FTC strayed far from one of its primary missions---to *prevent* violations of the FTC Act. Indeed, the FTC provides general guidance on issues but refuses to provide advice to companies and individuals who need help. Instead, the agency tries to identify companies that it believes are violating the Act and builds a case rather than work with a company to help them correct their practices. Before this case was filed, SBH and its principals was notified by their bank that the FTC had served investigative subpoenas. Through its counsel, SBH offered to have the FTC come in and audit SBH's business practices. However, the FTC did not accept the offer, conducted an investigation and filed its lawsuit six months later. Thousands of people lost their businesses as a result. Most would agree that this constitutes overreach.

### **The FTC's Failure to File a Class Action is a Fatal Procedural Flaw**

The FTC should be required to file a class action like any other litigant representing thousands of people seeking damages or other relief. Congress and the Courts adopted a specific procedure to pursue class actions. This is Rule 23 of the Federal Rules of Civil Procedure. This rule does not provide an exception for government agencies (such as the EEOC), which routinely files class actions to enforce statutes. Congress provides protections to defendants through different statutes to assure that the class action system is not abused. However, the FTC does not follow that procedure because they would have to show that consumer claims were similar and that both their claims for liability and damages could be fairly and adequately represented by class members. The class members have to prove damages to justify an award of class wide damages.

In a case where the Government alleges false or misleading marketing practices, we believe that the Court has to consider the experience and sophistication of the consumers before determining whether they should be entitled to damages. Thus, someone who has no sales

experience and does not care about building a business or making a lot of money should not be treated the same as someone who wants to make a million dollars, had prior direct sales experience or prior experience in MLM sales are in a different class.

We will appeal the FTC's failure to follow Rule 23, which would have protected SBM from awarding damages without any evidence from "class members" to support a damages verdict.

### **The Alleged Pyramid Scheme**

This was a very odd case in an area of law that is poorly defined and lends itself to government overreach. Generally, the standard for an illegal pyramid scheme requires that people who participate in the pyramid are encouraged to recruit others and encourage their "down-line" to buy products and recruit. In other words, sales was not encouraged. The pyramid ultimately rewards only those who successfully recruit but ultimately cannot provide success or support people at the bottom and mid-level of the pyramid.

Any SBH affiliate knows that SBH, J. Noland and the company's other leaders were all about sales and encouraged SBH affiliates to recruit if that was something that they wanted to build a business. SBH had Zone 1 calls *every business day*, sponsored numerous training sessions that were designed to help people regardless of whether they were experienced and simply wanted to buy SBH products at wholesale, or those who wanted to develop a business that could either provide a supplemental income, replace their income or become a source of significant wealth. All of the affiliates were lumped into one class of "victims" and the FTC simply generalized its evidence as to all the witnesses regardless of whether they ever intended to actively pursue selling SBH products to the public at large or simply buy products for their friends and family. In other words, the Courts should view Number 1's differently from #3's when it comes to training and marketing to these sub-classes.

So what was the evidence at trial? The case started with complaints by Luke Curry and members of his team who alleged that they suffered losses as a result of SBH's compensation plan. At trial, however, the FTC did not present any live testimony by any of these folks. In fact, the trial judge did not even discuss any of their allegations! That is because the FTC did not produce a *single* affiliate to testify. This is probably because we marked evidence contradicting their claims and were and showing that their claims were vindictive and unfounded. Most importantly, none of these witnesses ever produced any documents or evidence that would actually prove damages in a court of law. Think about it. If you have no proof of damages by any of the members of your class, how do you prove a case?

Instead of proving its case with witnesses, the FTC relied on an expert witness retained by the FTC in these sorts of cases and also presented various agency bureaucrats to testify to various statistics.

The problem with experts is determining bias and guarding against "experts" who may slant their testimony to satisfy the party that retains them. This particular expert routinely testifies for the FTC and overlooked significant issues in the case. In a case involving marketing practices, the expert listened to only one Zone 1 call and did not know how many Zone 1 calls were made. Instead, the expert focused on marketing designed for Number 3's and uncritically accepted the truth of witness statements from Luke Curry's group—again, people who

presented no evidence of damages and a number of which gave or admitted to giving false affidavits in this case.

Similarly, the expert had no idea of how much money was made by affiliates who engaged in retail sales. Importantly, with the FTC's resources, the expert could have circulated surveys or other means to determine the level of retail sales—information that would have been helpful in disproving the FTC's allegations and provides some insight into how the average SBH affiliate made profits.

The expert did not know about the attempt by almost a thousand affiliates to file a class action to intervene in the case. About 250 affiliates filed declarations indicating that they did not agree with claims that they were misled. The Court denied the class action request, which effectively denied 1,000 affiliates a voice in the litigation. The Court also refused to admit the Proposed Intervenors' Declarations into evidence because they were hearsay and made for purposes of litigation.

After the Receiver took over the company, the Company was shut down for nearly 4 months and then restarted after the Receiver discontinued sales of G-Burn for regulatory reasons related to one of its ingredients, as well as AM-PM and Click (both new products) because they contained CBD. We believe that none of these products should have been banned and accounted for a significant amount of the volume at the time the receivership was imposed. The Receiver also discontinued payment of commissions to affiliates for new sales and refused to pay commissions earned by affiliates. Both the expert and the Court noted that SBH product sales declined by 95% under the Receiver. From that, the Court concluded that "the dramatic change suggests the primary motivation for purchasing SBH products was not true consumer demand, such as a desire to resell the products in retail transactions or consume the products for personal satisfaction, but the hope that such purchases would lead to (or maximize or preserve the availability of) commissions." This logic ignored the obvious—the Receiver was *unreliable*. Affiliates were unable to get their products, unable to get their past due commissions and denied commissions for future sales. Along with all of this, a global pandemic happened about the same time.

### **Contempt and the Contempt Judgment**

At a high level, Jay Noland was sued by the FTC in 2002 for working as a sales person in an MLM company for marketing practices that he did not establish or commit. At that time, he could not afford to continue paying exorbitant attorneys' fees and was misled into signing an order that imposed compliance obligations that are almost impossible to meet in a multi-level business.

The 2002 Order defined "Retail Sales" as "not including sales made by participants in a multi-level marketing program to *other participants or recruits* or to such a participant's own account." (emphasis supplied) Similarly, the 2002 Order defined "prohibited marketing scheme" as the right to sell a product or service and the right to receive, in return for recruiting other participants into the program, rewards unrelated to the sale of products or services to ultimate users. Significantly, rewards were "unrelated to the sale of products or services to ultimate users if rewards are not based primarily on revenues from retail sales." These provisions imposed a higher standard than the controlling case law.

Thus, even if the FTC was unable to prove that he ran an illegal pyramid scheme, most MLM organizations in the industry would have violated the Court Order. In sum, the FTC's pressed the contempt matter to secure a monetary penalty.

The Courts enforce contempt of a court order differently than a civil case. There is no discovery and the standards are different. To be held in contempt, the evidence must be shown by clear and convincing evidence, as opposed to preponderance of the evidence, the standard of proof in most civil cases. However, the decisions have held that courts may award a higher measure of damages than in the typical civil case. In this case, the Court awarded \$6829 in damages for a violation of the Merchandise Rule and nothing for the Cooling off Rule. Dkt. 579 at 105. Even though the Court was barred from awarding monetary relief under Section 13(b) of the FTC Act, the Court awarded \$7.2 million as a civil compensatory judgment. The Court did not require a claims process, which virtually assures that most affiliates, including the 1,000 Proposed Intervenor, would be entitled to "damages" whether they suffered losses or not. It is difficult to accept the proposition that people who actually filed a lawsuit protesting the FTC action would somehow be awarded damages by the Court. Notably, the Court also awarded \$986,000 for VOZ purchasers based on failure by prior counsel, Daryl Williams, to oppose summary judgment in the case.

If someone is generally aware of a contempt order, the courts have held people liable for failing to prevent violations of the order. The courts now require that court orders now be personally served on all officers, directors and management to assure that adequate measures be taken to prevent recurrent misconduct.

SBH executives believed that SBH complied fully with the Order. The 2002 Order was provided to David Eisenstein, who served as SBH's General Counsel. Eisenstein reviewed and approved SBH's compensation and marketing materials. SBH executives took steps, through Zone 1 calls to correct people regarding sales representations, to control expectations about sales and to train them to sell effectively.

Similarly, all affiliates knew to go to their Team Leader to solve problems or to forward complaints to the three Senior Field Advisors, who frequently resolve problems even before going into the ticketing system. SBH helped people who overcommitted in buying Founders' Packs or Global Ambassador Packs with Team leaders either buying the packs and arranging for others to buy out a Founder or Global Ambassador.

### **Permanent Injunction and Compensatory Civil Judgment**

Permanent injunctions can be issued by courts under Section 13(b) to protect the public. However, such injunctions should not issue if lesser restraints can be imposed. Appeals courts allow trial judges broad latitude in determining when such injunctions should issue. Thus, the appellate courts typically sustain permanent injunctions because most litigants cannot show that they are capable of imposing effective controls in this businesses and that the controls would prevent future recurrences of allegedly illegal behavior.

The Court issued a permanent ban prohibiting J. Noland, Scott Harris, Tommy Sacca and Lina Noland from engaging in any MLM business. We objected to this proposed sanction as violating the First Amendment right to free speech and the right to associate with others. The Court did

not, as requested by the FTC, prohibit J. Noland from engaging in general business coaching, although he did indicate that J. Noland could not conduct business coaching on behalf of MLM's regardless of whether the MLM's are owned or operated by Defendants.

To reach this result, the Court relied on a case called *Nat. Soc. Of Pro. Eng'rs v. United States*, 435 U.S. 679, 697-98 (1978) where such limitations on speech are allowed to "fashion appropriate restraints on the Society's future activities and to eliminate its consequences....The First Amendment does not make 'make it... impossible ever to enforce laws against agreements in restraint in trade....'" Our view is that the trial court erred because a complete ban was inappropriate in light of evidence that SBH could impose controls that would effectively protect against claims that false and misleading representations caused consumers to become SBH affiliates or to buy products.

At trial, Judge Lanza appeared to be quite interested in our Docu-Sign Agreement, which required all potential affiliates to methodically review their Terms and Conditions, checking boxes that thoroughly explained the risks as well as the benefits of becoming and serving as SBH affiliates. Affiliates would have been required to maintain records of their retail sales, would not be allowed to buy more inventory unless they had sold 70% of their inventory and other measures to avoid the claims that can be made against MLM companies.

Unfortunately, Judge Lanza essentially held that he did not trust that such controls would be effective in light of Defendants conduct in the case, citing testimony in the case. The Court did not credit Defendants with the fact that they received legal advice that led them to believe that SBH was compliant. Unfortunately, advice of counsel is not a defense to claims in this case. However, it is a factor that should have been considered. Judge Lanza placed unfair weight on whether Jay Noland properly expressed remorse. However, Jay Noland thought he had done everything possible to comply with the Order, paying attorneys and relying on their advice. In the electronic age, however, there was no dispute about volumes of SBH sales, by whom and the commissions paid, or the amount of overhead and amounts paid to SBH executives. Some delivery records were destroyed through the Receiver's negligence. A Compliance Manager would be responsible for compliance, assuring the integrity of electronic records and assuring that violations of procedure were swiftly and decisively addressed by the Company. Simply put, compliance with legal standards could be assured.

## **Conclusion**

We plan to further review the record and confer with counsel regarding an appeal in this case. Our view is that FTC is hostile to MLM's and took advantage of a 20 year old order to obtain the kind of result that it could have never obtained without the 2002 Order.

Nevertheless, we are committed to somehow finding proper justice through the legal system and will explore all legal means possible.

**We truly appreciate you all.**