

No. 14-20128

**UNITED STATES COURT OF APPEALS  
FOR THE FIFTH CIRCUIT**

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**JUAN RAMON TORRES; EUGENE ROBISON, Plaintiffs-Appellees,**

**v.**

**SGE MANAGEMENT, LLC, *et al.*, Defendants-Appellants.**

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On Appeal from the United States District Court for the  
Southern District of Texas, Houston Division, Case No. 4:09-CV-02056

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**BRIEF OF AMICUS CURIAE AARP SUPPORTING PLAINTIFFS-  
APPELLEES URGING AFFIRMANCE**

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**CERTIFICATE OF INTERESTED PERSONS CORPORATE  
DISCLOSURE STATEMENT OF AARP**

Pursuant to FRAP 26.1 and Fifth Circuit Rule 28.2.1, the undersigned counsel of record verifies that those persons or entities listed below have or may have an interest in the outcome of this case:

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The Internal Revenue Service has determined that AARP is organized and operated exclusively for the promotion of social welfare pursuant to Section 501(c)(4) (1993) of the Internal Revenue Code and is exempt from income tax. AARP is also organized and operated as a non-profit corporation pursuant to Title 29 of Chapter 6 of the District of Columbia Code 1951.

Other legal entities related to AARP include AARP Foundation, AARP Services, Inc., Legal Counsel for the Elderly, Experience Corps, d/b/a. AARP Experience and AARP Financial.

October 17, 2014

Respectfully Submitted

/s/Mary Ellen Signorille  
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## STATEMENT OF INTEREST<sup>1</sup>

Pyramid schemes that are carefully disguised as legitimate business opportunities are targeted at and prey upon the most vulnerable members of society. They impliedly promise large profits, extra income, and workplace freedom. Inevitably, however, they deliver only pain and loss to those lured in. Pyramid schemes threaten the financial security of millions of older people.

AARP, which works daily to protect people age 50+ from fraud through research, education, advocacy, and policy development, has a strong interest in this case. AARP is a nonprofit, nonpartisan organization with a membership that helps people turn their goals and dreams into real possibilities, strengthens communities, and fights for the issues that matter most to families such as healthcare, employment and income security, retirement planning, affordable utilities, and protection from financial abuse.

AARP has commissioned numerous research studies and surveys to learn what makes older people vulnerable to fraud, including business opportunity scams and pyramid schemes, and to find better ways to protect against such threats.

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<sup>1</sup> All parties have consented to AARP participating amicus curiae. Pursuant to F. R. A. P. § 29(c)(5), AARP states that this brief was not authored in whole or in part by any party or its counsel, and that no person other than AARP, its members, or its counsel contributed any money that was intended to fund the preparation and submission of this brief.

AARP has also launched the Fraud Watch Network, a campaign that provides older people access to important information and enables them to stay alert to the latest fraud threats. See Nancy LeaMond, *Fraud Watch Network: Fight ID Theft and Scams*, AARP, Nov. 12, 2013, <http://bit.ly/1sVk6a2>. Additionally, AARP has a strong interest in protecting older people in a deregulated utility marketplace, which exposes them to confusing choices and opens them to an increased number of scams.

Thus, AARP has a strong interest in supporting the district court order certifying a class to challenge an alleged illegal pyramid scheme to resell energy in violation of the Racketeer Influenced and Corrupt Organizations (RICO) Act. AARP's participation in this case will raise issues which might otherwise escape this Court's attention and will assist this Court in understanding that the inherently fraudulent operation of a pyramid scheme itself causes inevitable losses and injures older people who rely upon representations that they are instead legitimate business opportunities.

## **INTRODUCTION AND SUMMARY OF THE ARGUMENT**

Older people seeking to supplement their income are vulnerable to fraudulent and illegal schemes disguised as legitimate business opportunities that by design benefit only those few at the very top level of the scheme. *The simple fact of a pyramid scheme's existence is a deceptive representation relied upon by*

*its victims.* The seminal modern pyramid scheme case, *In re Koscot Interplanetary, Inc.*, explains:

What compels the categorical condemnation of entrepreneurial chains under Section 5 is, however, the inevitably deceptive representation (*conveyed by their mere existence*) that any individual can recoup his or her investment by means of inducing others to invest. That these schemes so often do not allow recovery of investments by means of retail sales either merely points up that there is very little positive value to be lost by not allowing such schemes to get started in the first place.

86 F.T.C. at 1132 (emphasis added).

The district court correctly identified that this RICO challenge presents a common question justifying class certification: whether “[Stream Electric] either did or did not operate an illegal pyramid scheme.” *Torres v. SGE Mgmt. LLC.*, NO. 4:09-CV-2056, 2014 U.S. Dist. LEXIS 3741, at \*9 (S.D. Tex. Jan. 13, 2014) (explaining that “[t]he defendants either did or did not form a RICO enterprise...the operation of that scheme either did or did not harm the class members. Those questions will generate answers common to the class; they do not turn based on the individual class member considered.”).

The district court further correctly rejected Defendants’ argument that individual issues predominate to defeat class certification, finding that individualized proof of reliance on a particular misrepresentation is not an element of a RICO challenge to an alleged pyramid scheme. Unlike common law fraud claims predicated on an injury caused by an individual’s reliance on a

misrepresentation, RICO fraud liability, generally, “provides a private right of action for treble damages to any person injured...through a pattern of acts indictable as mail fraud.” *Bridge v. Phoenix Bond. & Indem. Co.*, 553 U.S. 639, 647 (2008); *see also id.* at 653 (rejecting the “contention that the ‘common-law meaning’ rule dictates that reliance by the plaintiff is an element of a civil RICO claim...”).

In any event, the district court correctly recognized that each member of the class reasonably relied on defendants’ assertions that Stream Electric is a legitimate business and that they would not have participated in it if they had known it was an illegal pyramid scheme that would inevitably cause them to lose money. *See Torres*, 2014 U.S. Dist. LEXIS 3741, at \*27. (“Because it can rationally be assumed (at least without any contravening evidence) that the legality of the Ignite program was a bedrock assumption of every class member, a showing that the program was actually a facially illegal pyramid scheme would provide the necessary proximate cause.”); *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1180 (1975) (finding “[f]urthermore, such [a] plan is contrary to established public policy in that it is generally considered to be unfair and unlawful and is by its very nature immoral, unethical, oppressive, unscrupulous, and exploitative.”).

Moreover, unless claims to remedy the injuries caused by illegal pyramid schemes can proceed on a class action basis, it is unlikely they will be pursued at

all. People harmed by the inevitable loss caused by a pyramid scheme are unlikely to pursue individual claims. See Douglas Brooks, *The Pyramid Scheme Industry: Examining Some Legal And Economic Aspects Of Multi-Level Marketing*, SeekingAlpha, (Mar. 17, 2014, 03:43:36 PM), <http://ow.ly/CVILP> [hereinafter *The Pyramid Scheme Industry*]. Pursuing claims individually would be prohibitively expensive and risky. Having already suffered losses, vulnerable individuals will be unlikely to risk losing significantly more money to pursue uncertain relief that might not even return sufficient damages to compensate for the attorneys' fees and costs necessary to pursue the relief. Accordingly, AARP urges this Court to affirm the district court class certification decision.

## **ARGUMENT**

### **I. Pyramid Schemes Marketed As Legitimate Business Opportunities Are Targeted At And Harm Many Older And Entrepreneurial-Minded People Seeking To Supplement Their Income.**

Direct selling opportunities, whether legitimate or carefully disguised fraudulent pyramid schemes, are often powerfully and persuasively touted as great opportunities for retirees and older people who seek to supplement their income, work only part-time, or be their own boss. See Art Koff, *8 Work-At-Home Jobs For Retirees*, MarketWatch Feb. 7, 2013, 6:30 AM, <http://on.mktw.net/ZDGbCS>; Robert Laura, *Would You Join A Multi-Level Marketing Company For Retirement Income?*, Forbes Aug. 29, 2014, 1:22 PM, <http://onforb.es/1tUIXic>. Industry-wide,

the promise of “additional income” is usually cited as the main reason for people to participate. *See Calendar Year 2006: Direct Selling by the Numbers*, Direct Selling Ass’n, <http://bit.ly/1Cnkp2k> (last visited Oct. 15, 2014) (reporting that 36 percent selected “additional income” as the main reason they became a direct sales representative). Such opportunities also appeal and are aggressively marketed to people who believe in the fundamental promise of the American Dream: that significant monetary rewards await those who work hard. *See id.* (reporting that 31 percent of respondents indicated that the main reason they became a direct sale representative is “[i]t's your business and making money through direct sales is important to you”).

Unfortunately, widespread economic loss, not riches and success, is inevitable for most of the people that—unwittingly—participate in disguised pyramid schemes. Mathematically, pyramid schemes inexorably reach a point at which there is no longer sufficient demand for the product (or people willing to pay to invest in a chance to participate in the sales opportunity) to generate the sales or recruitment quotas necessary to cover a person’s costs to participate. *See Douglas Brooks, The Pyramid Scheme Industry: Examining Some Legal And Economic Aspects Of Multi-Level Marketing*, SeekingAlpha, Mar. 17, 2014, 03:43:36 PM, <http://ow.ly/CVILP> [hereinafter *The Pyramid Scheme Industry*]; William W. Keep & Peter J. Vander Nat, *Multilevel Marketing and Pyramid*

*Schemes in the United States: An Historical Analysis*, 6 J. of Hist. Res. in Marketing (forthcoming November 2014) (manuscript at 14). The entire pyramid begins to crumble and soon collapses entirely, leaving those at and near the bottom with no means to recover their costs. Thus, the very structure of the illegal pyramid scheme causes injury, regardless of any particular misrepresentations devised, expressed, implied, communicated, or relied upon to lure in new recruits.

**A. Older People Are Particularly Vulnerable To Marketing Techniques Used By Illegal Pyramid Schemes.**

According to the Federal Bureau of Investigation, people over 65 are targets for fraud because they tend to have assets, stronger credit, and were raised to be a more trusting and polite generation than those in more recent generations, including the Baby Boomers. *See* Fed. Bureau of Invest., *Common Fraud Schemes - Fraud Target: Senior Citizens*, <http://1.usa.gov/ZEpiHW> (last visited Oct. 13, 2014). People who fall victim to pyramid schemes and bogus business opportunities in particular share behaviors or characteristics that make them more vulnerable generally to the common marketing techniques used to lure in participants. *See* Karla Pak & Doug Shadel, *AARP Found. Nat. Fraud Victim Study* 38 (2011), *available at* <http://bit.ly/1w3mxex>. Compared to people in the population overall, older people who became fraud victims were significantly more likely to attend sales situations, less likely to take prevention measures like removing themselves from solicitation lists, and were more interested in the type of

persuasive statements typically used by con artists. *See id.* They are also less likely to even acknowledge that they have been the victim of fraud, and as a result, far less likely to report or otherwise complain about it. *See id.*

Older people increasingly face economic pressures that make them particularly vulnerable to pyramid schemes and the inevitable losses they extract. They often have insufficient income and assets to provide for even their most basic needs and health care costs, which typically increase substantially as people advance in age. *See* Donald L. Redfoot et. al., *Building Lifetime Middle-Class Security* 1, AARP Pub. Pol. Inst. (2013), *available at* <http://bit.ly/1sW26R6> (“Among recent retirees (ages 65–74) and older retirees (age 75 and older) debt levels increased at a faster rate than they did among households in their working years.”). At the same time, employment opportunities wane for aging people, limiting their opportunities to make up the income shortfall. Because of such challenges, the economic losses people suffer at older ages are all the more harmful because they impact an inherently more vulnerable group with limited opportunities to permit them to recover.

Aggressively marketed schemes disguised as legitimate business opportunities, couched in implied promises that solid profits will flow to all participants in a seemingly legitimate direct sales opportunity, can seem like a panacea to people struggling to make ends meet, particularly in a challenging

economic climate with a tight job market. Indeed, the Direct Sales Association reported that “[t]he industry experienced a surge of new direct selling independent representatives at the height of the recession.” *2013 Direct Selling Industry Statistics*, Direct Selling Ass’n, <http://bit.ly/1rF0eNI> (last visited Oct. 11, 2014). “As expected” by industry analysts, the number of participants tapered off in 2010 and 2011, “[d]ue to normal attrition and the fact that some people join the industry for the short term...” *Id.*<sup>2</sup>

Plainly put, older people are prime targets for pyramid schemes, with inevitably devastating consequences. A recent post by a multi-level marketing proponent, brushing aside concerns raised about significant monetary losses for most participants, argues that direct sales positions offer compelling and legitimate social benefits for retirees. *See* Laura, *supra*. The author made the alarming observation that combined with the need for extra income, “the makings of a massive trend are in place” in light of “eye-opening statistics like AARP’s estimate that half of all baby boomers (76 million) are interested in starting a business...”

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<sup>2</sup> The Direct Sales Association suggests that people join the industry for the short term and leave after they have met their short term financial goals. To the contrary, the evidence suggests that people drop out of the industry at alarmingly high rates because they lose money. *See* Keep & Vander Nat, *supra*, at 18.

*Id.*<sup>3</sup> Enjoyment of the social interaction that comes with the direct sales role does not, however, justify maintaining an illegal pyramid scheme that dooms its participants to significant economic loss.

Furthermore, the harm wrought by pyramid schemes is not merely economic. Participants are aggressively trained and encouraged to sell to and recruit those with whom they have an existing rapport or trust relationship. The “word of mouth from a trusted source” marketing tool is alarmingly effective:

Word of mouth is the primary driver behind 20-50% of all purchasing decisions. . . . messages passed within tight, trusted networks have less reach but greater impact . . . in part, because there’s usually a high correlation between people whose opinions we trust and the members of networks we most value. That’s why old-fashioned kitchen table recommendations and their online equivalents remain so important.

Jacques Bughin et al., *A New Way to Measure Word of Mouth Marketing*, McKinsey Quarterly (April 2010), available at <http://bit.ly/1uDkv52>. By encouraging people to exploit relationships of trust, pyramid schemes victimize whole families and social circles. See FINRA, *Investor Alert: Avoiding Investment Scams* (2013), available at <http://bit.ly/1zbbWTE> (recognizing that while only 30 percent of all Americans make investments based on the advice of friends and family, 70 percent of those who lose money to an investment or business

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<sup>3</sup> Although maintaining social interactions is essential to promote successful aging, AARP strongly disagrees that such interactions excuse or justify illegal pyramid schemes.

opportunity rely primarily on the advice of relatives or friends). This exacerbates the injuries by potentially destroying personal relationships and depleting overall family economic resources in addition to an individual's own finances.

**B. People Are Harmed By Pyramid Schemes That They Would Not Participate In If They Could Distinguish Them From Legitimate Business Opportunities.**

Because the very structure of pyramid schemes inevitably causes losses to people drawn into them, they are illegal in every state and violate Section 5 of the Federal Trade Commission (FTC) Act. *See* 15 U.S.C. § 45 (2012). The FTC has issued consumer advisories to warn people to avoid such schemes. Unfortunately, it can be difficult for the average person—or even an enforcement agency—to differentiate an illegal pyramid scheme from a legitimate business opportunity.

The FTC has not issued regulations precisely defining the line that indicates a multi-level marketing program is in fact an illegal pyramid scheme. *See The Pyramid Scheme Industry, supra*. This regulatory structure is in part the result of significant lobbying and advocacy efforts aimed at preventing “overregulation” and imposition of burdensome requirements on small but so-called legitimate businesses. *See* Business Opportunity Rule, 76 Fed. Reg. 76815, 76816 (Dec. 8, 2011) (providing the Business Opportunity Rule applies to Multi-level marketing programs only if they charge initial fees of greater than \$500); Fed. Trade Comm'n, *Staff Summary of Fed. Trade Comm'n Activities Affecting Older Am.'s*:

*Jan. 1999-Aug. 2001: A Comm'n Staff Rep. to the United States S. Spec. Comm. on Aging* (Oct. 2001), available at <http://1.usa.gov/1xTvmb8> .

Businesses that fall below that threshold have no obligation to report or publish financial reports or other information that would help prospective participants evaluate the legitimacy of the implied representations that a person can make money participating in a particular program. *See The Pyramid Scheme Industry, supra*. The FTC advisories regarding pyramid schemes strongly encourage people to carefully evaluate such information. *See generally* Aditi Jhaveri, *The Telltale Signs of a Pyramid Scheme*, Fed. Trade Comm'n, May 13, 2014, <http://www.consumer.ftc.gov/blog/telltale-signs-pyramid-scheme>.

Unfortunately, as the regulations stop short of categorically defining illegal pyramid schemes or requiring accurate and reliable reporting of net profits for each level of participants in the program, the advisories stop short of explaining that the absence of such information should alert people to avoid it as a likely illegal pyramid scheme. *See The Pyramid Scheme Industry, supra*.

As a result, people who are considering participating in carefully disguised illegal pyramid schemes are forced to rely on the persuasively deceptive marketing materials circulated by the company to recruit them. Even a well-educated and cautious person may be unable to avoid pyramid schemes disguised as legitimate business opportunities. *See generally* Fed. Trade Comm'n Bureau of Consumer

Protection, *Multi-Level Marketing*, <http://1.usa.gov/1g7tFNY> (last visited Oct. 13, 2014) (advising that companies should conduct internet searches about companies and sift through multiple search pages in an effort to determine whether the company is fraudulent). Indeed, even prominent multi-level marketing industry companies, such as Avon and Tupperware, recognize that the line between legitimate multi-level marketing and pyramid schemes has become increasingly blurred. See Max Ehrenfreund, *Avon Splits with Trade Group, Citing Risk of Pyramid Schemes*, WashingtonPost.com, Sept. 16, 2014, <http://wapo.st/1maIgAB> (reporting that Avon and Tupperware have severed ties to the Direct Sales Association in light of their concerns that the association may make them appear to be pyramid schemes); Keep & Vander Nat, *supra*, at 14 (explaining that “Tupperware, relabeled its model to be direct-to-consumer—neither direct selling nor MLM—to distance itself from an industry its CEO described as dominated by ‘buying clubs and what looked like pyramid schemes...’”).

Tragically, the promise implied by the very existence of a pyramid scheme—that it is possible for every participant to make money—is illusory. Nevertheless, the industry forcefully implies that there are billions of dollars for would-be participants to share. See *2013 Direct Selling Industry Statistics*, *supra* (reporting \$13.67 billion in “estimated direct retail sales” in 2013 “defined as the dollar amount paid by the ultimate consumers of the products or services” based on

“survey data and extrapolated data from secondary sources...”). Reporting such robust sales figures may appear to imply significant economic success for the sales force. Unfortunately, the sales figures reported are gross sales, not sales net of significant fees and expenses paid by participants. The exaggerated sales figures also do not reflect the grim reality that the distribution of net profits benefits only one half to one percent of participants. *See The Pyramid Scheme Industry, supra*. Experts estimate that 99 percent of the people who participate in the industry do not make a profit selling products and services and end up losing money in fees. *Id.* Thus, contrary to the implication that everyone can earn significant profits, the structure of the scheme guarantees the opposite is true for almost every person duped into participating. *Id.*

The gross sales figures are also exaggerated in that they include sales made to participants trying to earn a profit by reselling the product. Multi-level marketing companies have been criticized for failing to enforce policies (if they have such policies at all) to prevent sales people from purchasing and stockpiling products, rather than reselling them, in order to earn bonuses and other forms of compensation tied primarily to the recruiting of additional sales people. *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1132 (1975) (holding that promising rewards for recruitment were unfair and deceptive under Section 5 of the Federal Trade Commission Act and that the pyramid scheme caused an estimated \$44

million in losses to its unwitting victims). While companies are not prohibited from reporting gross sales figures that include product consumption by its direct sales force, the company's failure to enforce a policy discouraging such stockpiling is an indication that product sales are merely part of the ruse designed to help disguise an inherently fraudulent pyramid scheme that will produce economic loss to all but the top insider tiers of participants. *See The Pyramid Scheme Industry, supra.*

**II. The Court Is Justified In Inferring That People Seeking To Supplement Their Income Through Seemingly Legitimate Business Opportunities Do Not Knowingly Become Involved In Illegal Pyramid Schemes In Which They Will Almost Certainly Lose Money.**

Appellants argue that class certification is inappropriate in this case because the fraud allegations necessitate individualized proof of each participant's reliance on a misrepresentation, based upon common law principles applicable to fraud actions. The district court properly rejected this argument. Appellants' argument regarding reliance under the common law is flawed for several reasons. First, it is overstated and second, common law fraud elements are irrelevant to RICO claims.

Proof of first party reliance on a fraud is not a necessary element to make out a claim for either a common law or RICO fraud claim. As the Supreme Court has noted, "the common law has long recognized that plaintiffs can recover in a variety of circumstances where, as here, their injuries result directly from the defendant's fraudulent misrepresentations to a third party." *Bridge v. Phoenix Bond. & Indem. Co.*, 553 U.S. 639, 652 (2008).

More importantly, the elements of a common law fraud claim are irrelevant to a RICO claim. *See id.* at 656. *Bridge* explained that RICO’s statutory scheme is not based upon and did not incorporate the elements of common law fraud.

Congress chose to make mail fraud, not common-law fraud, the predicate act for a RICO violation. And ‘the mere fact that the predicate acts underlying a particular RICO violation happen to be fraud offenses does not mean that reliance, an element of common-law fraud, is also incorporated as an element of a civil RICO claim.’

*Id.* at 654 (Thomas, J., concurring in part and dissenting in part) (quoting *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 476 (2006)). Indeed, the Court noted, while common law fraud suits generally require injured parties to demonstrate injury caused by their reliance upon a misrepresentation, a RICO challenge requires only a showing of proximate cause of the injury. *Bridge* at 654. “[W]hether characterized as an element of the claim or as a prerequisite to establishing proximate causation, [reliance] simply has no place in a remedial scheme keyed to the commission of mail fraud, a statutory offense that is distinct from common-law fraud and that does not require proof of reliance.” *Id.* at 656.

Moreover, a RICO fraud claim incorporates a flexible proximate cause analysis that makes class certification appropriate. The district court recognized this difference when it certified the class only as to the RICO claims, stating that “[b]ecause it can rationally be assumed (at least without any contravening evidence) that the legality of the Ignite program was a bedrock assumption of

every class member, a showing that the program was actually a facially illegal pyramid scheme would provide the necessary proximate cause...” for a RICO fraud claim. *Torres v. SGE Mgmt. LLC.*, NO. 4:09-CV-2056, 2014 U.S. Dist. LEXIS 3741, at \*27 (S.D. Tex. Jan. 13, 2014). The district court recognized that “although the litany of reasons any individual class member signed up to become an [Independent Associate (IA)] may vary, common sense compels the conclusion that every IA believed they were joining a lawful venture.” *Id.* This conclusion is consistent with the holding of *Bridge* that reliance upon a misrepresentation may contribute to establishing proximate cause rather than be a necessary element to prove the predicate illegal act under a RICO fraud claim.

Requiring proof of individualized reliance on a misrepresentation in a RICO challenge, as Appellants argue, would undermine enforcement of the statute, which the Supreme Court recognized was enacted as “an aggressive initiative to supplement old remedies and develop new methods for fighting crime.” *Sedima v. Imrex Co.*, 473 U.S. 479, 498 (1985). Congress “provided a private right of action for treble damages to any person injured in his business or property by reason of the *conduct* of a qualifying enterprise’s affairs through a pattern of acts indictable as mail fraud.” *Bridge*, 553 U.S. at 647 (emphasis added). Nothing in the statute limits the private right of action to illegal conduct upon which a plaintiff can prove individual reliance. *See id.* at 661 (holding “a plaintiff asserting a RICO claim

predicated on mail fraud need not show, either as an element of its claim or as a prerequisite to establishing proximate causation, that it relied on the defendant's alleged misrepresentations.”). Indeed, the RICO treble damages provision is designed to incentivize enforcement against illegal enterprises in addition to making whole all of the victims of the fraud. *See Sedima*, 473 U.S. at 498.

The prevalence of such fraud in the deregulated energy market further supports the district court’s class certification order. Stream Electric is an energy reseller that peddles its sales in utility deregulated states, such as Texas. Deregulated utility markets have traditionally been sources of fraud like pyramid schemes because the costs of the utility are obscured from consumers. *See, e.g., FTC v. Futurenet*, Civ. No. 98-1113 GHK (AIJx) (C.D. Cal. 1998), available at <http://1.usa.gov/1CxzNZY> (noting that part of the settlement agreement was to stop fraudulent sales of deregulated power). *See also* Barbara R. Alexander, *An Analysis of Retail Electric and Natural Gas Competition: Recent Developments and Policy Implications for Low Income Consumers*, 5-7 (2013), available at <http://ow.ly/CTdik>.

### **III. Preserving Access To RICO Class Actions To Challenge Illegal Pyramid Schemes Is Essential To Protect Vulnerable Older And Entrepreneurial-Minded People.**

Class action relief is essential to battle and deter illegal pyramid schemes and to provide a remedy for the injuries they cause. Refusing to acknowledge that people injured by pyramid schemes relied upon the implied legitimacy of the programs by requiring plaintiffs pursuing a RICO action to prove additional individual reliance on even more misrepresentations would unduly insulate illegal pyramid schemes and doom millions more people to inevitable losses. It also sends the wrong message to would-be lawbreakers, who will know that there is little, if any, risk to initiating a disguised pyramid scheme and every reason to anticipate handsome financial rewards for their wrongdoing.

A class action is appropriate where it is “superior to other available methods for fairly and efficiently adjudicating the controversy.” Fed. R. Civ. P. 23(b)(3). As the Supreme Court has recently instructed, “the office of a Rule 23(b)(3) certification is not to adjudicate the case, rather, it is to select the ‘method’ best suited to the adjudication of the controversy ‘fairly and efficiently.’” *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S.Ct. 1184, 1191 (2013). Fairness and efficiency means finding the best, most reliable and effective means, among all of the alternatives, of adjudicating Plaintiffs’ claims. In this case, that is through a class action. *See Webster v. Omnitrition Int’l*, 79 F.3d 776 (9th Cir. 1996).

The true value of a private class action is that it protects injured parties who would not bring private litigation either because they do not know their rights or because the amount of potential recovery does not justify the cost of the action. *See Amchem Prods. v. Windsor*, 521 U.S. 591, 617 (1997) (“The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone’s (usually an attorney’s) labor.”) (quoting *Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997)). Class treatment is particularly appropriate where realistically, absent class litigation, there will be no litigation at all. As Judge Posner of the Seventh Circuit has noted, “a class action has to be unwieldy indeed before it can be pronounced an inferior alternative . . . to no litigation at all.” *Carnegie v. Household Int’l. Inc.* 376 F.3d 656, 661 (7th Cir. 2004). The Supreme Court recognized in *Eisen v. Carlisle & Jacquelin* that:

The class action is one of the few legal remedies the small claimant has against those who command the status quo.... The matter touches on the issue of the credibility of our judicial system. Either we are committed to make reasonable efforts to provide a forum for adjudication of disputes involving all of our citizens...or we are not. There are those who will not ignore the irony of courts ready to imprison a man who steals some goods in interstate commerce while unwilling to grant a civil remedy against the corporation which has benefited, to the extent of many millions of dollars, from collusive, illegal pricing of its goods. . . . When the organization of a modern

society, such as ours, affords the possibility of illegal behavior accompanied by widespread, diffuse consequences, some procedural means must exist to remedy – or at least to deter – that conduct.

417 U.S. 156, 186, n.8 (1974) (Douglas, J., dissenting) (internal citation and quotation marks omitted).

**A. Public Enforcement Actions Alone Are Inadequate To Protect Against Or Deter The Proliferation Of Illegal Pyramid Schemes.**

In part because of the fact-intensive and time-consuming investigation needed to identify and prosecute illegal pyramid schemes, public enforcement agencies have pursued relatively few enforcement actions to shut down pyramid schemes and obtain compensation for their victims. *See* Stephen Gandel, *Herbalife and the FTC's uneven history with pyramid schemes*, *Fortune*, Mar. 13, 2014, 5:39 PM, <http://ow.ly/CSDsj> (reporting that between 2001 and March 2014, “the FTC has charged just five companies with running pyramid schemes, and three of those cases dated back to investigations that started in the 1990s.”).<sup>4</sup>

Preventing the harm caused by pyramid schemes is unlikely to be addressed or remedied without private class action relief. Specific regulation categorically defining and prohibiting pyramid schemes has been deemed to be ineffective

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<sup>4</sup> In March 2014, after this article was published, the FTC formally initiated an investigation into Herbalife for operating a pyramid scheme. *See* Press Release, *Herbalife Comments On FTC Inquiry*, Mar. 12, 2014, <http://hrbl.me/1rvrHLa> (confirming that Herbalife received a Civil Investigative Demand from the FTC earlier that day).

because it would be both overbroad and easy to evade. *See* Business Opportunity Rule, 73 Fed. Reg. 16110, 16113 (Mar. 26, 2008) (explaining narrowing of proposed regulation of multi-level marketing). Public enforcement actions, brought pursuant to Section 5 of the Fed. Trade. Comm'n. (FTC) Act, are inadequate to deter such schemes or remedy the inevitable injuries they cause because too few are pursued. Public enforcement agencies have insufficient resources to address the vast array of illegal unfair and deceptive marketplace practices, and successful pyramid scheme enforcement actions require fact-intensive and time-consuming investigations on a case by case basis. *See id.* at 16125.

The lack of enforcement is not evidence that pyramid schemes are not a problem, however. In fact, the opposite is true:

Of the ten most prevalent types of consumer complaints received by the FTC, purchasing a membership in a pyramid schemes ranked seventh, with an estimated 2.55 million incidents and 1.55 million individual victims in the preceding year (the 95 percent interval ranged from .8 to 2.3 million individual victims, effecting between .4 percent and 1.1 percent of the US adult population). The amount lost per individual ranked pyramid schemes second among the ten fraud types. Most notably, pyramid scheme victims were the 'least likely to complain,' despite recognizing that they had been victims of consumer fraud.

Keep & Vander Nat, *supra*, at 19 (quoting Fed. Trade Comm'n Staff Report, *Consumer Fraud in the United States: An FTC Survey* (Aug. 2004)).

Thus, in a lax enforcement environment, the proliferation of illegal pyramid schemes can flourish without significant risk of consequence:

The viability of a Federal remedy, however, will depend, if not upon congressional enactment, then upon the willingness of courts to recognize the serious potential hazards of entrepreneurial chains and to permit summary excision of their inherently deceptive elements, without the time-consuming necessity to show occurrence of the very injury which justice should prevent. To require too large an evidentiary burden to condemn these schemes can only ensure that future generations of self-made commercial messiahs will dare to be great and dare anyone to stop them.

*In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181-82 (1975). This Court should not impose the burden Appellants seek.

**B. People Injured By Illegal Pyramid Schemes Are Unlikely To File Individual Claims, Leaving Them Without Remedies If Individualized Proof Of Reliance Is Required.**

A limited number of individual lawsuits would fail to provide remedies for most of the people injured by a pyramid scheme and would have little punitive or deterrent impact. The \$16 million reward derived by those at the top of the alleged pyramid scheme in this case would more than justify any downside risk of individual enforcement. Only the threat of a class action lawsuit provides any realistic deterrent or compensatory value. *See Sedima v. Imrex Co.*, 473 U.S. 479, 493 (1985) (“Private attorney general provisions such as [18 U.S.C.] § 1964(c) are in part designed to fill prosecutorial gaps.”).

In the context of pyramid schemes, the reality that few, if any, individual actions will be filed is amplified. It is unlikely that many people who unwittingly participated in an illegal pyramid scheme that is carefully disguised as a legitimate

business opportunity will understand that their losses were inevitable. Other than those who initiate a pyramid scheme, participants generally do not know they are part of an illegal scheme. Indeed, the district court reasonably inferred that plaintiffs would not willingly enter into an illegal scheme. *See Torres v. SGE Mgmt. LLC.*, NO. 4:09-CV-2056, 2014 U.S. Dist. LEXIS 3741, at \*30 (S.D. Tex. Jan. 13, 2014).

It is not surprising that participants may be unaware that the opportunity was in fact an illegal pyramid scheme considering that a multi-level marketing business will almost certainly and vigorously defend its legitimacy, as do the Appellants. The only logical alternative is to admit that it drew victims into an illegal scheme. As a result, and consistent with industry wide training and persuasion techniques, participants who lose money may believe that their loss is due to some personal failure rather than being the inexorable result of an illegal pyramid scheme.

Additionally, those who discover that a particular so-called “business opportunity” is actually an illegal pyramid scheme are also unlikely to file individual claims to recover their losses. They may be reluctant to blame or be blamed by friends and family. As business ethics professor Daryl Koehn notes, “[i]n normal circumstances, they would return the product to the store for a refund. But, in this case, purchasers may opt to swallow the loss, instead of confronting a beloved child or friend and demanding their money back.” *Ethical Issues*

*Connected With Multi-Level Marketing Schemes*, 29 J. of Bus. Ethics 153, 158 (2001), available at <http://bit.ly/1wHo6Pa> (explaining that the exploitation of familial and social relationships to generate recruitment inherent in multi-level marketing creates problems for prosecuting and protecting against fraudulent multi-level marketing companies).

### CONCLUSION

AARP respectfully urges this Court to uphold the district court's decision to certify the class and to remand the case for further proceedings on the merits.

October 17, 2014

Respectfully Submitted,  
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## CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 28.1(e)(2) or 32(a)(7)(B) because this brief contains 5,813 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced 14-point typeface using Microsoft Word 2010.

Dated: October 17, 2014

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## **CERTIFICATE OF SERVICE AND FILING**

I hereby certify that on October 17, 2014, the foregoing Brief of Amicus Curiae AARP Supporting Plaintiffs-Appellees Urging Affirmance was electronically filed with the Clerk of the Court for the United States Court of Appeals of the Fifth Circuit using the appellate CM/ECF system which will send notice of such filing to all registered CM/ECF users.

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