

NO. 96-CI-5809

JEFFERSON CIRCUIT COURT

DIVISION TWO (2)

COMMONWEALTH OF KENTUCKY, EX REL.
A.B. CHANDLER, III, ATTORNEY GENERAL

PLAINTIFF

V.
FINDINGS OF FACT,
CONCLUSIONS OF LAW AND
ORDER

TRAVELMAX INTERNATIONAL, ET AL.

DEFENDANTS

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This matter initially came before the court on December 6, 1996 for a hearing on the Commonwealth's Motion for a Temporary Injunction, a Temporary Restraining Order having been entered ex parte on October 7, 1996. As additional time was required for the taking of testimony, the court adjourned and continued testimony on January 13, 14 and 15, 1997. The Commonwealth was represented by the Hon. Harold J. Turner. The Defendant, Travelmax International (hereinafter "Travelmax"), was represented by the Hon. Jeffrey Babener, the Hon. Stephen Pence, and the Hon. Joseph Whittle. Individual defendants were also represented by counsel. The proceedings were recorded at 30-2-96-VCR-082-A-1, 30-2-97-VCR-005-A-1 through 3.

FINDINGS OF FACT

Expert testimony was presented to this court by Dale Paisley, Chief Financial Officer of Travelmax, Al Anolik, a well-recognized travel attorney and Dr. Charles King, Marketing

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Professor from the University of Illinois. This testimony was supplemented by the Commonwealth's expert, Dr. William Keep, Assistant Professor of Marketing from the University of Kentucky. These experts painted a picture of Travelmax for the court.

Defendant Travelmax is a relatively new company. However, in its short existence, it has risen rapidly through the ranks of the travel industry, earning an estimated 5 million dollars per month in travel sales and an additional 3 million dollars a month in the sale of the travel-related "products," which are the subject of dispute in this action. It is both accredited and bonded. The company seems to be adequately capitalized, has a growing physical plant and is continually updating its technology. Since January of 1996, it has been publicly traded on the NASDAQ exchange and is subject to the disclosure requirements and scrutiny of the SEC. The key to the success of this company appears to be the use of multi-level marketing to increase its sales force and provide for deeper market penetration. This sales force is also self-funded in that the representatives purchase training products and promotional materials from the company, from which they hope to grow their business and earn commissions. However, the problem recognized by the Commonwealth seems to be that, in addition to earning commissions from promoting travel and the use of Travelmax for bookings, representatives also earn commissions by inducing others to participate in the program and buy Travelmax materials.

Investigators John Ansman, Skip Hockensmith, Kathy Parrish,

and legal secretary Cherry Trumbo all attended Travelmax organizational meetings held in Jefferson County and described the program. Their function in this regard was merely to serve as a conduit for information to the Attorney General's Office and not to impose value judgments on the proceedings. From their testimony and from viewing tapes and transcripts of Travelmax proceedings, the court believes it has an understanding of how the Travelmax sales force is developed. The purchase of an "at-cost sales kit" entitles the buyer to become an outside sales representative, to distribute business cards to anyone and everyone, encouraging the public to book their travel through Travelmax. Those cards bear the representative's PIN number, which must be read to the inside travel agent when booking travel. When the travel is actually taken by the consumer, the representative receives 40% of Travelmax's commission. However, there appears to be no method of self-tracking agent commissions for these bookings. The representative must rely on Travelmax.

If the representative wishes to expand his/her business, then he/she can purchase the ITA tutorial. Upon completion of the program, the participant becomes an Independent Travel Agent and is entitled to the benefits and privileges associated with the second identification card. These include courtesy upgrades in flight seating and hotel accommodations. Apparently, it is industry practice for resorts and airlines to provide such benefits to agents to encourage them to tout the particular services involved. Such a purchase also applies to the \$800

necessary to activate a "business center". It was the testimony of Dr. King that, as a company in the early stages of building its sales force, the bulk of sales will be in the area of these type of training materials.

Another option available to a Travelmax participant is the purchase of the so-called "VIP Getaways" package. This is a binder containing discount coupons for travel. These can be used by the participant, re-sold or given away piecemeal as promotional material. This also counts as a "business center."

Finally, Travelmax's most recent development is the charities package. This package is used to instruct the representatives as to how they might solicit the business of individual members of charitable organizations, by offering commissions to the charity upon purchase by its members. The representatives also earn commissions. The charities package is also a "business center."

The three Travelmax products are known as a "tri-pack". After much debate, even the Commonwealth's expert conceded that they are valuable products. Commissions are also earned upon the sale of these products to others. The Commonwealth investigators all testified that more emphasis was placed upon these type of sales than upon travel sales. The testimony of the Commonwealth's expert, Dr. Keep, was that the incentive to do an act is based upon the method of earning the most money. In this instance, he urged that, because more money could be made faster upon the sales of the tri-packs, the incentive to sell would be

directed to this area to the exclusion of travel. The tapes and transcripts of the Travelmax organizational meetings held in Jefferson County do not support such a conclusion.

While it is true that the explanations given of the Travelmax compensation plan were all given in terms of "downline" sales, only two other members need be recruited and then that part of the business could be completely ignored. Of course, the larger the downline, the bigger and more effective the sales force, inuring to the benefit of both the members and Travelmax as a whole, not merely in terms of actual product sales but in terms of placing an active sales force into the marketplace.

While it is true that the breakaway conversations following the organizational meeting appear to be directed toward the issue of maximizing commissions, it is necessary to note that this was also the focus of the investigators' questions.

Further, there was extensive testimony as to the safeguards that Travelmax has put into place to insure that its representatives conduct themselves within the law and within the bounds of basic ethics in their recruitment activities. These include, the publication and dissemination of a policy and procedure manual, the existence of a compliance department, a history of disciplinary action by that department. There are also specific rules in place for the protection of the consumers of Travelmax products, such as the use of the so-called "Amway 70% Rule" to prevent inventory loading, and a generous refund policy. In fact, the industry as a whole, as represented by the

Direct Sales Association has adopted a Code of Ethics.

All of the investigators indicated that earnings representations were made. However, the court could find no evidence of such representations that were not mere explanations of the way the compensation plan works or specific examples as to how the plan worked for individuals. The company deems these "testimonials", reflecting what individuals have actually made rather than what "you" as the consumer can make. Dr. King found no false earnings claims to have been present in the Travelmax materials that he reviewed. He was of the opinion that any income claims are acceptable, if they can be documented. He specifically stated that the large check seized from Bill Johnson was not an income claim if it accurately reflected his earnings in Travelmax. Further, no one was able to testify that the check had been used at any Travelmax meetings.

The Commonwealth called only one witness who claimed to have been dissatisfied with his dealings with Travelmax, Glenn Perkins, a resident of Indiana. Mr. Perkins indicated that he had not promptly received all of the materials that he ordered from the company, nor had he received a refund. He indicated that he learned of the Temporary Restraining Order on the night that he resigned from the organization. Similarly, the testimony of Mr. Anolik indicated that, upon learning of the Temporary Restraining Order, Delta Airlines pulled its business from Travelmax, pending the outcome of the Kentucky cases. In addition, Mr. Jimmy Taylor appeared to be very satisfied with the

Travelmax program and indicated that he looked forward to the conclusion of this litigation so that he might proceed with his opportunity. Thus, any number of people have been harmed by these proceedings to varying degrees.

CONCLUSIONS OF LAW

It is the issue of harm that the court must examine in determining the Commonwealth's entitlement to a Temporary Injunction. K.R.S. 367.190 (2) states that, "[u]pon application of the Attorney General, a restraining order shall be granted whenever it reasonably appears that any person will suffer immediate harm, loss or injury from a method, act or practice prohibited by K.R.S. 367.170," those being unfair trade practices. The enforcement provisions of K.R.S. 367.190 are applied to so-called pyramid schemes by K.R.S. 367.834.

The Commonwealth's primary contention herein is that the Travelmax program is a pyramid distribution plan in violation of K.R.S. 367.832. There are two main authorities for guidance in this area. The first of these is the statutory language. K.R.S. 367.830, devoted to definitions, states that a pyramid distribution plan, "...means any plan, program, device, scheme or other process by which a participant gives consideration for the opportunity to receive compensation or things of value in return for inducing other persons to become participants in the program." K.R.S. 367.830 (6), specifically excludes from the definition of "consideration", "...the purchase of goods or

services furnished at cost to be used in making sales and not for resale, nor does it include time and effort spent in pursuit of sales or recruiting activities." The term "compensation", as defined in K.R.S. 367.830 (5) specifically excludes payments made on purchases for "...actual use or consumption."

Based upon the statute, the court's first inquiry must be, does a Travelmax participant give consideration? If a participant follows the path that the court has previously outlined, beginning with the purchase of an at-cost sales kit, the answer to this query would appear to be "No." However, the Attorney General's Office would encourage the court to ask, what happens to the person who launches in full-tilt, and purchases the kit and all three products of the tri-pak? The participant does give consideration, but not necessarily for the "opportunity." The participant may find intrinsic value in the products in and of themselves, exclusive of whether he/she ever sells any travel bookings. Indeed, all of the experts concur that the Travelmax products have value. Finally, it appears that the compensation flowing to the participant is not from inducing third parties to join Travelmax, but rather for selling Travelmax's products.

The other resource available to the court in its determination of Travelmax's status as a pyramid distribution plan is the infamous case of Dare To Be Great, Inc. v. Commonwealth ex. rel. Hancock, Ky., 511 SW 2d 224 (1974). As described in the Court of Appeals Opinion, "[t]he actual method

of operation was that agents for Dare to Be Great attracted the interest of prospective customers with bizarre activities designed to indicate to the prospective customer that the agent had prospered greatly from his participation in the program." at 226. The Commonwealth would interpret the singing of "If I Were A Rich Man", the popular tune from the musical "Fiddler on the Roof", by a single presenter in a single meeting as being a "bizarre" activity as that engaged in by the Dare to Be Great agents. It was the testimony of Michael Sheffield, the Defendant's expert in the area of multi-level marketing and product development, that enthusiasm in a sales meeting is normal and that there was nothing ethically questionable by this presenter's "performance."

The Court of Appeals went on to discuss the so-called "Go-Tours", where groups of prospects were taken to resorts where the actual sales meetings were held. The Court of Appeals stated, "[o]n these Go-Tours the inspirational qualities of the motivational tapes faded into the background." at 226. The Court of Appeals interpreted the facts as being that, upon reaching the sales meeting, the focus turned from the benefits of using the product to the amounts that could be earned by recruiting others into the program. In fact, participants were discouraged from making sales on their own. Some never even received the product that they ordered. The Court of Appeals concluded, based upon the above factual basis, that, "[t]he motivational tapes were only incidental to the program and their

chief function was to provide the appellants with a flimsy and transparent claim of legitimacy for their fraudulent enterprise." Supra at 226.

The facts connected with Travelmax do not lead to a similar conclusion. The court can find no such shift in focus in terms of the videotape and transcriptions. These presentations were virtually the same in terms of content, concentrating on travel. Although the investigators testified that they believed the emphasis to have been on selling, none of them could point to a specific example of such, other than the explanation of the company's compensation plan. Also, with reference to the Travelmax program, it appears that a representative could get started in production right away, without having to wait for a delivery. Although Mr. Perkins testified that he did not receive his products promptly, his order did show up. In the meantime, he was completely free to begin soliciting travel business. Based upon the foregoing, the court is unable to conclude that a pyramid distribution scheme has been operated by Travelmax in Kentucky.

The Commonwealth has also alleged violations of K.R.S. 367.805, with regard to the sale of business opportunities. K.R.S. 367.801(5) clearly defines "Business opportunity" as one where the offeror grants leave for the purchaser to sell under certain specific circumstances. First, the purchaser must be required to pay \$500 or more for the opportunity. Second, the offeror has made an earnings representation to the purchaser in

excess of the amount paid for the opportunity. Finally, the offeror claims that he knows the market and knows the product will sell, that he/she will assist in the business opportunity, or that he will buy back any inventory.

It is evident to the court that the \$500 threshold has not been met. The purchase of a \$25 sales kit is the only requirement. Other purchases are at the option of the consumer. While he/she may maximize his/her profits by buying, utilizing and selling the other products offered by Travelmax, such purchases are not required. Further, the court can find no evidence of earnings representation. K.R.S. 367.801(5)(b) specifically states that, "[t]he offeror has represented that the consumer/investor will earn, can earn or is likely to earn..." some amount. In this instance the facts indicate that statements were made as to what certain individuals had earned, but not that every Travelmax representative would earn that much. In the descriptions of the compensation plan, examples were given as to possible earnings, but none of those rise to the level of promises of earnings. Therefore, the court cannot find a violation of this particular statute.

Finally, the Commonwealth has asserted that Travelmax has violated K.R.S. 367.652 by failing to register as a professional fund raiser. Subsection (6) of that statute states that a "Professional solicitor" means "a person who for compensation or other financial consideration solicits contributions in this state, directly or indirectly, for or on behalf of a charitable


organization." This definition cannot apply to Travelmax. The company is not in the business of raising funds for charities. It is in the business of travel. It has initiated a program which is beneficial to charities. However Travelmax is not soliciting contributions, but paying a portion of earned commissions to the charities. It is, in effect, a contributor itself. Therefore, as it is soliciting travel business from persons associated with charity members, and, in turn paying sums to the charity, it cannot be said to be in violation of the statute.

Thus, the court can find no violation of the consumer protection statutes and, therefore no threat of harm to the public. The compliance procedures of the Company are sufficient to provide for the protection of the citizens of the Commonwealth, pending the outcome of the other litigation in this matter. The court strongly encourages the Attorney General's office to take full advantage of the apparent willingness of Travelmax to cooperate in overseeing its Kentucky operations.

ORDER

IT IS HEREBY ORDERED AND ADJUDGED that the Commonwealth's motion for a temporary injunction is OVERRULED.

IT IS FURTHER ORDERED that the temporary restraining order entered herein is DISSOLVED.



JAMES M. SHAKE, JUDGE
JEFFERSON CIRCUIT COURT

3.7.97

DATE

cc: Harold J. Turner
Stephen Pence/Joseph M. Whittle
Jeffrey Babener
David A. Lambertus
Don H. Major
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ENTERED IN COURT

MAR 7 1997

TONY MILLER, CLERK

By



Deputy Clerk