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17 UNITED STATES DISTRICT COURT
18 CENTRAL DISTRICT OF CALIFORNIA
19 WESTERN DIVISION

20 FEDERAL TRADE COMMISSION,)

21 Plaintiff)

22 v.)

23 BURNLOUNGE, INC.,
a corporation;
24 JUAN ALEXANDER ARNOLD,
an individual;
25 JOHN TAYLOR,
an individual;
26 ROB DEBOER,
an individual; and
27 SCOTT ELLIOTT,
an individual;

28 Defendants.)

Case No.

**COMPLAINT FOR INJUNCTIVE
AND OTHER EQUITABLE RELIEF**

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

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

10 **JURISDICTION AND VENUE**

11 2. This Court has subject matter jurisdiction over the FTC's claims
12 pursuant to 15 U.S.C. §§ 45(a) and 53(b) and 28 U.S.C. §§ 1331, 1337(a) and
13 1345.

14 3. Venue in the Central District of California is proper under 15 U.S.C.
15 § 53(b) and 28 U.S.C. § 1391(b) and (c).

16 **PLAINTIFF**

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

23 **DEFENDANTS**

24 5. Defendant BurnLounge, Inc., ("BurnLounge") is a Delaware
25 corporation that has its principal place of business at 340 Hudson Street, 7th Floor,
26 New York City, New York. BurnLounge has conducted business since 2005.
27 BurnLounge conducts recruitment activities and training seminars in the Central
28 District of California and throughout the country.

1 6. Defendant Juan Alexander Arnold is an individual who resides in
2 Studio City, California. He is the chief executive officer and chairman of the
3 board of directors of BurnLounge. At all times material to this Complaint, Juan
4 Alexander Arnold, individually or in concert with others, directed, controlled or
5 participated in the acts and practices of BurnLounge as set forth below.

6 7. Defendant John Taylor is an individual who resides in Houston,
7 Texas. Taylor is a promoter of the business opportunities offered by BurnLounge.
8 At all times material to this Complaint, John Taylor has participated in the acts and
9 practices of BurnLounge as set forth below.

10 8. Defendant Rob DeBoer is an individual who resides in Irmo, South
11 Carolina. He is a promoter of the business opportunities offered by BurnLounge.
12 At all times material to this Complaint, Rob DeBoer has participated in the acts
13 and practices of BurnLounge as set forth below.

14 9. Defendant Scott Elliott is an individual who resides in Forney, Texas.
15 He is a promoter of the business opportunities offered by BurnLounge. At all
16 times material to this Complaint, Scott Elliott has participated in the acts and
17 practices of BurnLounge as set forth below.

18 10. Defendants BurnLounge, Juan Alexander Arnold, John Taylor, Rob
19 DeBoer and Scott Elliott transact or have transacted business in the Central
20 District of California.

21 **COMMERCE**

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

26 **DEFENDANTS' BUSINESS PRACTICES**

27 12. Since approximately 2005, Defendant BurnLounge has operated a
28 pyramid scheme in connection with the advertising, marketing and sale of

1 opportunities to operate on-line digital music stores (“on-line stores”).

2 13. Participants join BurnLounge through the purchase of product
3 packages, of which there are three: (1) the Basic Package, which sells for \$29.95
4 per year; (2) the Exclusive Package for \$129.95 per year plus \$8 per month; and
5 (3) the VIP Package for \$429.95 per year plus \$8 per month. More expensive
6 packages provide the participant with an increased ability to earn rewards through
7 the BurnLounge compensation program.

8 14. The first \$29.95 of each product package pays for a license to operate
9 an on-line store. Through the on-line stores, BurnLounge sells product packages
10 and digital music to consumers. Consumers who purchase music receive a digital
11 copy by downloading it through the Internet.

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

16 **Compensation Plan**

17 16. All participants in BurnLounge can earn reward points under the
18 BurnLounge compensation program for selling product packages and digital
19 music. Participants can redeem the points for purchases through their on-line
20 stores. Only participants who become Moguls can convert the points into dollars.
21 For Moguls, one point equals one dollar.

22 17. The BurnLounge compensation program has two parts: (1)
23 recruitment bonuses (described in Paragraphs 18 through 26), and (2) Concentric
24 Retail (described in Paragraphs 27 and 28).

25 18. BurnLounge pays two types of recruitment bonuses. These bonuses
26 are earned from selling BurnLounge product packages to new recruits.
27 BurnLounge calls these “Product Package Bonuses” and “Mogul Bonuses.”

28 19. Product Package Bonuses are earned by selling BurnLounge product

1 packages with the same name. BurnLounge provides three Product Package
2 Bonuses: (1) the Basic Bonus; (2) the Exclusive Bonus; and (3) the V.I.P. Bonus.
3 These are respectively \$10, \$20, and \$50 when paid to Moguls.

4 20. To qualify to earn Product Package Bonuses, the participant must
5 have sold two albums to non-Moguls in the prior calendar month (with the
6 exception that during the first month the requirement is waived).

7 21. The second type of recruitment bonus is the Mogul Bonus. This
8 bonus is only paid to Moguls and is earned through sales of Exclusive and VIP
9 Packages.

10 22. The Mogul Bonus is based on a binary structure. In a binary
11 structure, each participant has a position in the pyramid immediately below which
12 are two other positions filled by subsequent recruits. As a result, each participant
13 in the binary structure has the potential to develop two teams of subsequent or
14 “downline” recruits.

15 23. The Mogul Bonus rewards a participant for his recruitment efforts as
16 well as the recruitment efforts of his downline.

17 24. In order to qualify to earn a Mogul Bonus, a Mogul must meet the
18 following one-time requirements: (1) recruit two other participants by selling them
19 either the Exclusive or VIP Package and (2) sell two albums to non-Moguls. To
20 remain qualified to earn the Mogul Bonus, all Moguls must sell two albums per
21 month to non-Moguls. The album sales requirement is waived during the first
22 month.

23 25. Mogul Bonuses are earned through a point system. Sale of an
24 Exclusive Package generates 100 points and sale of the VIP package generates
25 400 points for the Mogul who makes the sale and for each Mogul in his or her
26 upline, *i.e.*, Moguls located in a direct line in the binary structure above the Mogul
27 actually making the sale. The points are accrued by the Mogul making the sale
28 and his upline once the new recruit sells two albums.

1 26. In order to earn a Mogul Bonus, the Mogul must accumulate 300
2 points in each of the two teams. The amount of the Mogul Bonus varies from \$25
3 to \$50 depending upon the package the Mogul purchased and in some cases music
4 sales.

5 27. Concentric Retail, the other part of the compensation program,
6 provides rewards for product sales through on-line stores. BurnLounge defines
7 “product” to include digital music downloads, the first \$29.95 of each of the three
8 BurnLounge packages, and the \$8 monthly fee paid as part of the Exclusive and
9 VIP Packages.

10 28. Through Concentric Retail, Retailers and Moguls earn a half point
11 (50¢ cents for Moguls) per album sale priced \$9.90 to \$19.79 or 20 percent of
12 BurnLounge’s profit margin on the sale, whichever is greater, sold through their
13 on-line stores. When specified levels of recruitment and product sales are
14 satisfied, Concentric Retail also rewards Retailers and Moguls for product sales by
15 others whom they directly recruit or who are related to them indirectly through
16 subsequent recruitment up to six levels away.

17 29. BurnLounge provides much larger rewards for recruiting than for
18 sales of digital music and thus provides greater incentives to participants to recruit
19 than to sell music to ultimate users.

20 30. The BurnLounge compensation program is based primarily on
21 providing payments to participants for the recruitment of new participants, not on
22 the retail sale of products or services.

23 **Recruitment**

24 31. Consistent with the incentives of the BurnLounge compensation plan
25 which favor recruitment over music sales, the efforts of Defendants in promoting
26 and training others to promote BurnLounge emphasizes recruitment over sales of
27 digital music.

28 32. Defendants offer BurnLounge product packages for sale throughout

1 the United States, including in the Central District of California. Defendants
2 promote the sale of the product packages through the Internet, telephone calls and
3 through in-person meetings.

4 **Income Misrepresentations**

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

9 [I]f you build a community that sells a few movies and sells a few
10 games and sells a few downloads, you will have a license to print
11 money. Don't take my word for it, go ask Blockbuster what they
12 made on \$3.95 off 1,000 stores. J.T. made \$50,000 two weeks ago.
13 He's going to make probably \$700,000 this year, and he's a good old
14 boy from Texas that can't read. (Juan Alexander Arnold, live in-
15 person recruitment presentation, New York, New York, September
16 18, 2006)

17
18 We have people all across the country that are generating, you know,
19 part-time income, a few hundred dollars a month, to people that are
20 earning, you know, a few hundred dollars a week, Scott, and then
21 we've got people that are earning a few hundred dollars a day all the
22 way up to 2, 3, \$4000 a day.

23

24 [O]ver the last six months, I've had a chance to generate well over
25 \$340,000 in income. In the last 30 days, it was over \$70,000. . . .

26

1 So, Scott, you know, seven people in the company have - - you
2 know, I've had a chance to work with that have generated well over
3 \$200,000 in the last six months. We've got residual checks in the
4 company right now today that are a six-figure income, well over
5 six figures. (John Taylor, live teleconference call, August 10, 2006)

6
7 Guys, we've made just under \$300,000. Todd Ellis' next door
8 neighbor has made \$280,000. We've got a dozen people that have
9 made over \$100,000. (Rob DeBoer, live in-person recruitment
10 presentation, Lawrenceville, Georgia, July 12, 2006)

11
12 Our professional BurnLounge team is then available to answer all
13 questions on your behalf until we drive your personal income to
14 \$1,000 per week. (Scott Elliott, Internet pre-recorded audio message,
15 August 11, 2006)

16
17 34. In contrast to the claims of profitability, the compensation plan used
18 by BurnLounge mathematically dictates that at any particular time the majority of
19 Moguls will spend more money to participate in BurnLounge than they have earned
20 through their involvement with the company, and the majority of Moguls will not
21 have made the substantial incomes represented.

22 35. Defendants have failed to adequately disclose that the majority of
23 Moguls will not make the substantial incomes represented.

1 **VIOLATIONS OF SECTION 5 OF THE FTC ACT**

2 **COUNT I**

3 36. As alleged in Paragraphs 12 through 35, the Defendants promote
4 participation in BurnLounge, which has a compensation program based primarily
5 on providing payments to participants for the recruitment of new participants, not
6 on the retail sale of products or services, thereby resulting in a substantial
7 percentage of participants losing money.

8 37. Defendants’ promotion of this type of scheme, often referred to as a
9 pyramid scheme, constitutes a deceptive act or practice in violation of Section 5(a)
10 of the FTC Act, 15 U.S.C. § 45(a).

11 **COUNT II**

12 38. In connection with the offering and sale of the right to participate in
13 the BurnLounge program, Defendants represent, expressly or by implication, that
14 consumers who become BurnLounge Moguls are likely to make substantial
15 income.

16 39. In truth and in fact, in numerous instances, consumers who become
17 BurnLounge Moguls are not likely to make substantial income.

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

21 **COUNT III**

22 41. In connection with the offering and sale of the right to participate in
23 the BurnLounge program, Defendants represent, expressly or by implication, that
24 consumers who become Moguls are likely to make substantial income.

25 42. Defendants fail to disclose that most BurnLounge Moguls are not
26 likely to make substantial income.

27 43. This additional information would be material to customers in
28 deciding whether to participate in the BurnLounge program.

1 44. Defendants' failure to disclose the material information described in
2 paragraph 42, in light of the representations made in paragraph 41, therefore
3 constitutes a deceptive act and practice in violation of Section 5 of the FTC Act, 15
4 U.S.C. § 45(a).

5 **CONSUMER INJURY**

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

11 **THIS COURT'S POWER TO GRANT RELIEF**

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

18 **PRAYER FOR RELIEF**

19 WHEREFORE Plaintiff Federal Trade Commission, pursuant to Section
20 13(b) of the FTC Act, 15 U.S.C. § 53(b), and the Court's own equitable powers,
21 requests that the Court:

22 1. Award Plaintiff such preliminary injunctive and ancillary relief as may
23 be necessary to avert the likelihood of consumer injury during the pendency of this
24 action and to preserve the possibility of effective final relief, including, but not
25 limited to temporary and preliminary injunctions and an order freezing assets and
26 requiring an accounting;

27 2. Enter a permanent injunction to prevent future violations of the FTC
28 Act by Defendants;

1 3. Award such relief as the Court finds necessary to redress injury to
2 consumers resulting from Defendants' violations of the FTC Act, including, but not
3 limited to, rescission or reformation of contracts, restitution, the refund of monies
4 paid, and the disgorgement of ill-gotten monies; and

5 4. Award Plaintiff the costs of bringing this action, as well as such other
6 and additional relief as the Court may determine to be just and proper.

7 Dated _____
8

9 Respectfully submitted,
10 WILLIAM BLUMENTHAL
11 General Counsel

12 _____
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14 DAVID C. FIX
15 GERALD S. SACHS
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