

Brown v. Hambric

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Brown v. Hambric

Case: Brown v. Hambric (1995)

Subject Category: Pyramid

Agency Involved: Private Civil Suit

Court: New York City Court

Case Synopsis: The New York City Court of Yonkers was asked if a contract with pyramid scheme could be voided for lack of consideration.

Legal Issue: Can a contract with a pyramid scheme be voided for lack of consideration?

Court Ruling: The New York City Court of Yonkers decided yes, a contract with a pyramid scheme could be voided for lack of consideration. NU-Concepts sold travel agent training plans that provided no training or education, only the right to sell the program to others. The purchaser wanted the training program, and did not want anything to do with the pyramid selling aspects of the program. The City Court held that NU-Concepts never intended to fulfill its representations that induced the plaintiff to purchase the program. Their representations of education and training amounted to unconscionably and gross misrepresentation, and rescission of the agreement was warranted.

Practical Importance to Business of MLM/Direct Sales/Direct Selling/Network Marketing/Party Plan/Multilevel Marketing: To be valid, a contract must contain an exchange of value, consideration. The value of the right to sell further distributorships might not be enough to make a contract valid in some jurisdictions.

Brown v. Hambric, 638 N.Y.S.2d 873 (1995): The New York City Court of Yonkers decided yes, a contract with a pyramid scheme could be voided for lack of consideration. NU-Concepts sold travel agent training plans that provided no training or education, only the right to sell the program to others. The purchases wanted the training program, and did not want anything to do with the pyramid selling aspects of the program. The City Court held that NU-Concepts never intended to fulfill its representations that induced the plaintiff to purchase the program. Their representations of education and training amounted to unconscionably and gross misrepresentation, and rescission of the agreement was warranted.

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638 N.Y.S.2d 873

Elizabeth BROWN, Plaintiff,

v.

James E. HAMBRIC, Defendant.

City Court of Yonkers.

Nov. 27, 1995.

THOMAS A. DICKERSON, Justice.

The plaintiff, Elizabeth Brown ["Brown"] wanted to be a travel agent.

Travel agents sell air transportation, cruises, hotel accommodations, tours and much, much more. Travel agents are professionals and fiduciaries and are expected to be knowledgeable of the travel services they sell [see e.g., *Pellegrini v. Landmark Travel Group*, 165 Misc.2d 589, 592, 628 N.Y.S.2d 1003 (1995) ("Travel agents are best viewed as information specialists upon whom consumers rely for the provision of accurate information and confirmation of travel arrangements")].

To become a professional travel agent, however, requires years of training and participation in advanced educational programs such as those provided by the Institute of Certified Travel Agents ["ICTA"] and the American Society of Travel Agents ["ASTA"], accreditation by supplier organizations such as the Airlines Reporting Corporation ["ARC"] and the Cruise Lines International Association ["CLIA"], compliance with state and local licensing and registration requirements and obtaining bonding and comprehensive insurance. [FN1]

FN1. For a discussion of travel agents; Friedheim, *Travel Agents*, Travel Agent Magazine Books, New York, 1992.

[1] Brown asked the defendant, James E. Hambric ["Hambric"], for his advise on how to become a professional travel agent. Hambric was an Independent Travel Consultant ["ITC"] working for NU-Concepts In Travel ["NU-Concepts"] with headquarters in Santa Fe Springs, California. Hambric was an agent for NU-Concepts and authorized to sponsor and recruit new ITCs. Hambric convinced Brown that the NU-Concepts "fast start plan" would provide her with the kind of training and education necessary to become a professional travel agent.

Hambric gave Brown the NU-Concepts In Travel "Passport To Success" Distributor Manual ["the Manual"] which described the NU-Concepts opportunity.... The Manual promised that NU-Concepts would provide support, education and training....

*875 In addition to selling travel services (NU-Concepts Independent Travel Agents) are strongly encouraged to sell distributorships ["Or you can make a good deal more money by developing your contacts into Independent Distributors of the NU-Concepts in Travel Independent Distributor Network ... you teach your contacts--a firm foundation of 5-7 people ... to follow the simple steps you have followed ... Then, with your help, they each teach 5-7 contacts who teach their contacts.... (and so on and so on) ..."]

Relying upon the Manual and Hambric, Brown purchased the NU-Concepts travel agent package for \$537.75....

NU-Concepts failed and refused to provide Brown with the support, education and training promised and paid for. Neither NU-Concepts nor Hambric provided the promised supervisory and training support. In addition, Hambric as Brown's sponsor, refused to attend scheduled training sessions, refused to communicate with NU-Concepts personnel on Brown's behalf and did not stay current with NU-Concepts information...

As a consequence Brown was forced to purchase her own educational programs at a cost of \$490.08 ...
DISCUSSION

Based on the foregoing the Court finds that the plaintiff has asserted the following cognizable causes of action against the defendant: (1) breach of contract; (2) violation of New York State General Business Law Section 359- fff [pyramid schemes prohibited]; (3) rescission based upon (a) want of consideration, (b) failure of consideration, Copr. unconscionability and (d) misrepresentations; and (4) violation of New York State General Business Law Section 349 [deceptive and unfair business practices].

Pyramid Schemes

[2][3] There is nothing "new" about NU-Concepts. It is an old scheme [FN2], simply, repackaged for a new audience of gullible consumers mesmerized by the glamour of the travel industry and hungry for free or reduced cost travel services. Stripped of its clever disguise as a recruiter and educator of outside travel agents, NU-Concepts is nothing more than a pyramid scheme [see e.g., *Nguyen v. FundAmerica, Inc.*, 1990 WL 165257 (N.D.Cal.1990), Fed.Sec.L.Rep. 95,498 ("a pyramid scheme) is one in which a participant pays money to the company or its representatives and in return receives (1) the right to sell

products, and (2) the right to earn rewards for recruiting other participants into the scheme ... "); SEC v. Steed Industries, Inc., 1974 WL 472 (N.D.Ill.1974), Fed.Sec.L.Rep. 94,917 ("... a pyramid promotion or endless chain scheme ... is the recruitment of investors ... who in form will be distributors of ... products but who in fact will devote their efforts almost entirely (to locating) ... other investors ... to recruit ..."); SEC v. Glenn W. Turner, 474 F.2d 476, 482 (9th Cir.1973) ("Dare To Be Great ... scheme is a gigantic and successful fraud "); In Re Omnitrition, 1993 WL 271466 (N.D.Cal.1993), Fed.Sec.L.Rep. 97,655 (" ... Omnitrition sells distributorships in an endless chain of recruitment. Through slick advertising and personal sales solicitations, Omnitrition misrepresents the likelihood of achieving financial security ..."); Kugler v. Koscot Interplanetary, Inc., 120 N.J.Super. 216, 293 A.2d 682 (1972) (cosmetics fraud); State v. Phase II Systems, Inc., 109 Misc.2d 598, 440 N.Y.S.2d 454, 455 (1981) (" ... members ... can make money just by bringing into the organization new people willing to become a salesperson ..."); Note, New York Creates A Private Right Of Action To Combat Consumer Fraud: Caveat Venditor, 48 Brooklyn L.R. 509, 558-559, f.n. 209 ("Pyramid solicitations are sham money making schemes whereby individuals are induced to participate in a plan for making money by means of recruiting others, with the right to encourage or solicit new memberships in the pyramid passed on as an inducement for others to join.")

FN2. See Kugler v. Koscot Interplanetary, Inc., 120 N.J.Super. 216, 233, 293 A.2d 682 (1972) (cosmetics pyramid scheme).

"Fraud is infinite in variety. The fertility of man's invention in devising new schemes of fraud is so great, that the courts have always declined to define it ... All surprise, trick, cunning, dissembling and other unfair way that is used to cheat anyone is considered as fraud."

Breach Of Contract

[4] Brown wanted to be a professional travel agent. NU-Concepts and Hambric *876 knew this and convinced Brown to become an ITC as a means of fulfilling her goal. Amongst the many promises made by NU-Concepts which were relied upon by Brown was the delivery of "Adequate training (which included) education regarding NU-Concepts in Travel Rules and Regulations, Compensation Plan, product information, sound business strategies and ethical behavior." In addition, Hambric, Brown's ITC sponsor, was to perform as a "bonafide sales supervisor and/or sales trainer in the sale or delivery of products to the ultimate consumer". NU-Concepts and Hambric failed and refused to provide the support, training and education contracted for.

[5] The law in New York State recognizes a contractual relationship between student and college, university or trade school [see e.g., *Andre v. Pace University*, 161 Misc.2d 613, 620, 618 N.Y.S.2d 975 (1994) (breach of contract to provide computer programming course); *Paladino v. Adelphi University*, 89 A.D.2d 85, 454 N.Y.S.2d 868, 873 (1982) (breach of contract when school provides no educational services or fails to provide specified services); *James v. SCS Business & Technical Institute*, N.Y.L.J., January 15, 1993, p. 28, col. 4 (N.Y.Civ.1992) (failure to provide promised educational services or training); *Joyner v. Albert Merrill School*, 97 Misc.2d 568, 411 N.Y.S.2d 988, 992 (1978) (failure to provide promised employment); *Village Community School v. Adler*, 124 Misc.2d 817, 478 N.Y.S.2d 546, 548 (1984) (failure to provide tutorial and guidance services)].

The courts in New York State are required to be vigilant and carefully examine the reality of educational contracts [see e.g., *Andre*, supra, at 161 Misc.2d 619, 618 N.Y.S.2d 975; *Joyner*, supra, at 97 Misc.2d 574, 411 N.Y.S.2d 988 ("courts must carefully examine) commercial consumer transactions to guard against predatory practices calculated to take advantage of the unwary consumer"); *Albert Merrill School v. Godoy*, 78 Misc.2d 647, 648, 357 N.Y.S.2d 378 (action against pro se consumer requires "further probing by the court "); *Educational Beneficial v. Reynolds*, 67 Misc.2d 739, 745, 324 N.Y.S.2d 813 (N.Y.Civ.1971) (concern that "consumers who are victims of gross inequality of bargaining power shall be protected against overreaching")].

NU-Concepts and Hambric breached their contract with plaintiff in such a manner as to strike at the very heart of the bargain contracted. The defendant is liable for all appropriate damages flowing from its breach of contract including, but not limited to, the cost of obtaining alternative educational services.

Violation Of G.B.L Section 359-fff

[6] New York State General Business Law Section 359-fff ["GBL Section 359- fff"] prohibits "chain distributor schemes" which are defined as

"... a sales device whereby a person, upon condition that he make an investment, is granted a ... right to ... recruit for profit ... one or more additional persons who are also granted such ... right upon condition of making an investment and may further perpetuate the chain of persons who are granted such ... right ..." [McKinneys General Business Law, Art. 23-A, Section 359- fff].

Notwithstanding passing reference to the availability of commissions on the sale of travel services through Jetaway Travel [The Manual at p. 4], the primary compensation for ITCs is from selling distributorships ["you can make a good deal more money ... you teach your contacts ... 5-7 people ... they each teach 5-7 contacts who teach their contacts ..." (The Manual at p. 19) which must be divided and passed up the line to a chain of sponsoring ITCs [The Manual at pp. 20-23]. The promised training and education is never delivered nor is it intended to be since NU-Concepts is a pyramid scheme and not a real recruiter and trainer of outside travel agents.

As such NU-Concepts violated GBL Section 359-fff [see e.g. *Phase II Systems, Inc.*, supra, at 109 Misc.2d 598, 440 N.Y.S.2d 456 ("There is sufficient indication herein that defendants are participating in a scheme where the emphasis is not on the sale of a product, but on recruiting new organizational rows to boost existing members."); Compare: *USA v. Bestline Products Corp.*, 412 F.Supp. 754 (N.D.Cal.1976) (pyramid scheme; commissions paid to upline distributors who perform no supervisory functions violates order); *Edmisten v. Challenge, Inc.*, 54 N.C.App. 513, 284 S.E.2d 333 (1981) *877 (North Carolina pyramid scheme statute); *Love v. Durastill of Richmond*, 242 Va. 186, 408 S.E.2d 892 (1991) (Virginia pyramid scheme statute); *State v. Ferro*, 1988 WL 39996 (Del.Super.1988) (Delaware pyramid scheme statute)] and is liable to Brown for all damages permitted thereunder.

Demand For Rescission

[7] The failure of NU-Concepts and Hambric to deliver the promised training and educational services was so complete that rescission of the distributorship agreement is justified. Whether viewed as a want of consideration or a failure of consideration, it is clear that Brown received little of value from NU-Concepts and Hambric [22 N.Y.Jur.2d, Contracts, Sections 328, 439, 464].

Rescission may also be granted upon a showing of unconscionability [see e.g., James, supra; Albert Merrill, supra, at 78 Misc.2d 647, 357 N.Y.S.2d 378; Educational Beneficial, supra, at 67 Misc.2d 739, 324 N.Y.S.2d 813; State v. ITM, 52 Misc.2d 39, 275 N.Y.S.2d 303, 311 (1966) (endless chain transaction based on unconscionable contracts)] and/or misrepresentations which are deceptive or fraudulent in nature [see e.g., Andre, supra, at 161 Misc.2d 620-621, 618 N.Y.S.2d 975; James, supra; Albert Merrill, supra; Joyner, supra, at 97 Misc.2d 568, 411 N.Y.S.2d 988; Paladino, supra, at 89 A.D.2d 85, 454 N.Y.S.2d 868].

In this case the failure of NU-Concepts and Hambric to deliver the promised support, training and education amounts to unconscionability and gross misrepresentations [see e.g., Hertz Corp. v. Attorney General, 136 Misc.2d 420, 518 N.Y.S.2d 704, 707 (1987) ("The concept has been employed primarily in the area of consumer protection, in an attempt to deal with the 'never ending stream of consumer gypsters and fraudulent operators ..!')].

Violation of GBL Section 349

[8][9] New York State General Business Law Section 349 prohibits deceptive business practices and applies to pyramid schemes [see e.g., Teller v. Bill Hayes, Ltd, 213 A.D.2d 141, 630 N.Y.S.2d 769, 773 (1995) (GBL Section 349 applies to pyramid schemes); Goldberg v. Manhattan Ford Lincoln-Mercury, Inc., 129 Misc.2d 123, 492 N.Y.S.2d 318, 321 (1985); Phase II Systems, supra; ITM, supra; Kugler, supra (New Jersey Consumer Fraud Act applies to cosmetics pyramid scheme)] and to educational contracts [see e.g., Andre, supra, at 161 Misc.2d 623-624, 618 N.Y.S.2d 975; James, supra; Matter of State of New York v. Interstate Tractor Trailer Training, 66 Misc.2d 678, 321 N.Y.S.2d 147, 151-152 (1971) ("The representations ... have no basis in fact and would clearly tend to deceive or mislead those persons seeking to better themselves in a new field of employment ")].

[10] GBL Section 349 is a broad, remedial statute [see e.g., Oswego Laborer's Local 214 Pension Fund v. Marine Midland Bank, N.A., 85 N.Y.2d 20, 623 N.Y.S.2d 529, 647 N.E.2d 741 (1995)]; see also Note: Caveat Venditor, supra] directed towards giving consumers a powerful remedy. The elements of a violation of GBL Section 349 are (1) proof that the practice was deceptive or misleading in a material respect and (2) proof that plaintiff was injured [see Givens, Practice Commentaries, McKinney's General Business Law Article 22-A, p. 565; McDonald v. North Shore Yacht Sales, Inc., 134 Misc.2d 910, 513 N.Y.S.2d 590 (1987); Geismar v. Abraham & Strauss, 109 Misc.2d 495, 439 N.Y.S.2d 1005 (1981)]. There is no requirement under GBL Section 349 that plaintiff prove that defendant's practices or acts were intentional, fraudulent or even reckless. Nor does plaintiff have to prove reliance upon defendant's deceptive practices.

[11] Clearly, the many promises made by NU-Concepts and Hambric [e.g., that NU-Concepts creates tremendous opportunities for persons interested in becoming travel agents, that NU-Concepts will provide the training and education necessary to become a professional travel agent, that NU-Concepts

will provide supervisors and trainers] were false, misleading and deceptive. Brown relied upon these misrepresentations, paid NU-Concepts and Hambric \$537.75 and was forced to pay an additional \$490.08 for educational services which were not delivered. *878 Hambric has violated GBL Section 349 and is liable to Brown for all damages permitted thereunder. DAMAGES

The plaintiff is awarded the following damages;

First, damages will include \$490.08 representing the costs of obtaining the promised training and educational services which Hambric refused to deliver;

Second, the Court finds that Hambric has violated GBL Sections 349 and 359- fff. Pursuant to GBL Section 349(h) the Court finds that Hambric has wilfully violated GBL Section 349. Although the Court would like to treble plaintiff's actual damages of \$490.08, the maximum increase permissible [see Hart v. Moore, 155 Misc.2d 203, 587 N.Y.S.2d 477, 480 (1992)] is \$509.92 raising the plaintiff's recoverable damages to \$1,000.

[Portions of opinion omitted for purposes of publication.]

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