Burns v. Ferro

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Jeffrey A. Babener, principal attorney in the Portland, Oregon, law firm Babener & Associates, and editor of www.mlmlegal.com, represents many of the leading direct selling companies in the United States and abroad.

Burns v. Ferro

Case: Burns v. Ferro (1991)

Subject Category: Consumer Protection

Agency Involved: Private Civil Suit

Court: Superior Court of Delaware

Case Synopsis: The Superior court was asked if summary judgment was appropriate to determine if a financing company could be held liable as an intermediary for promoting an airplane pyramid scheme.

Legal Issue: Is summary judgment appropriate to decide if a financing company can be liable as an intermediary for promoting an airplane pyramid scheme?

Court Ruling: The Superior Court held that material questions of fact surrounded the questions presented, and summary judgment was therefore not appropriate. Chrysler First Financial made loans to consumers that were used to purchase portions of an illegal pyramid scheme. Because it was unclear whether Chrysler was an "intermediary" as defined under state law, summary judgment was inappropriate.

Practical Importance to Business of MLM/Direct Sales/Direct Selling/Network Marketing/Party Plan/Multilevel Marketing: Anyone found to be promoting an illegal pyramid scheme might be found to be jointly liable for the harm to the public, including financing companies and third party promoters.

Burns v. Ferro, 1991 WL 53834 (1991) (Not Reported): The Superior Court held that material questions of fact surrounded the questions presented, and summary judgment was therefore not appropriate. Chrysler First Financial made loans to consumers that were used to purchase portions of an illegal pyramid scheme. Because it was unclear whether Chrysler was an "intermediary" as defined under state law, summary judgment was inappropriate.

1991 WL 53834 (Del.Super.)

James M. BURNS, Jr., Carol L. Burns, Larry Larraga, William Jenkins, Jr., and

James L. Larks,

v.

John J. FERRO, Robert Jorge, Mike R. a/k/a Mike Ritchie, Kim E. a/k/a Kim

Ferro, and Chrysler First Financial Services Corporation, a corporation of the

State of New York.

No. C.A. 88C-SE-178.

Superior Court of Delaware.

Submitted: Feb. 27, 1991.

Decided: March 28, 1991.

OPINION AND ORDER

GOLDSTEIN, Judge.

*1 This case arises as a result of an illegal "airplane" pyramid scheme. Plaintiffs, investors in the scheme, brought this action alleging violations of the Delaware Pyramid or Chain Distribution Schemes Act, the Delaware Consumer Fraud Act, the Delaware Uniform Deceptive Trade Practices Act and the Delaware Securities Act. The matter is presently before the Court on defendant's Chrysler First Financial Services Corporation ("Chrysler First"), motion for full or partial summary judgment.

FACTS

In 1987, several of the plaintiffs attended meetings concerning buying into an "airplane" pyramid scheme which, promoters represented, would return $40,000 on the purchase of a "seat" for $5,000, if each purchaser would bring in two other persons who, in turn, would produce others to buy "seats" on the airplane. Under the scheme, a prospect paid $5,000 to join the investment group as a "junior sales executive." After recruiting two other investors who were willing to pay $5,000, the original investor

moved up the ladder to a "senior sales executive" position. When each new junior sales executive introduced two new investors into the group, the original investor was promoted to "branch manager." The branch manager eventually became a "division manager", to whom the eight new junior sales executives each paid $5,000 for a total payment of $40,000. At that point, the original investor left the group or started the process anew.

Co-defendants, John Ferro ("Ferro") and Robert Jorge ("Jorge"), made the sales presentations promoting the scheme. They assured potential investors that they could obtain the necessary financing through several sources, including Chrysler First; that the investment was risk-free; and that the "airplane" scheme was legal as long as investors declared the income. Jorge passed out Chrysler First application forms at some of the meetings and introduced potential investors to Larry Doub, a branch manager of Chrysler First, who attended several sales meetings and also participated as an investor.

Chrysler First employees approved the personal line of credit for the plaintiffs, knowing the money would be used to buy an "airplane seat." Plaintiffs each obtained a $5,000 line of credit from Chrysler First, and each plaintiff bought a "seat" for $5,000.

Plaintiffs did not recover any money under the plan because the police arrested Ferro and Jorge for operating an illegal pyramid scheme. Plaintiffs filed separate suits which the Court consolidated into one action. After an arbitration hearing and order, plaintiffs moved for a trial de novo. Chrysler First then filed this motion for full or partial summary judgment.

SCOPE OF REVIEW

In deciding a motion for summary judgment, the function of this Court is to determine whether the record contains any genuine issue of material fact. The moving party must show that uncontested facts entitle him to judgment as a matter of law. Super.Ct.R. 56(c). Oliver B. Cannon & Sons, Inc. v. Dorr-Oliver, Inc., Del.Super., 312 A.2d 322, 325 (1973).

*2 Summary judgment is inappropriate when the record indicates that a material fact is in dispute. A motion for summary judgment must, therefore, be denied if it appears to the Court that further inquiry into the facts is necessary to clarify the application of the law to the circumstances of the case. Ebersole v. Lowengrub, Del.Supr., 180 A.2d 467 (1962).

CHRYSLER FIRST PERSONALINE CREDIT AGREEMENT

The first issue for determination is whether the notice provision contained in the credit agreements between Chrysler First and plaintiffs is enforceable on the facts of this case. The Chrysler First Personaline Credit Agreement provides:

[i]f the proceeds of the loan are applied in whole or in substantial part to a purchase of goods or services from the seller who referred the consumer to the lender, then the following notice is applicable:

NOTICE

Any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained with the proceeds hereof, recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder.

Plaintiffs argue that Chrysler First is liable for any claims that they have against Ferro and Jorge by operation of the notice provision.

Chrysler First contends that the notice provision is directed toward sellers of goods, and not against financial institutions. Noting that the provision applies only to purchases of goods and services, Chrysler First argues that the sale of "seats" on an airplane is neither goods nor services. Finally, Chrysler First argues that plaintiffs, who knowingly participated in the illegal scheme, should not be able to recover losses arising out of an illegal or fraudulent contract.

I am persuaded that the sale of "airplane seats" by defendants is not the sale of goods and services. Therefore, the notice provision subjecting a holder of the credit agreement to liability would not apply to Chrysler First in this instance.

Furthermore, it is well-settled law that a court will not aid a contractual claim founded on a violation of the law. Affiliated Enter., Inc. v. Waller, Del.Super., 5 A.2d 257, 259 (1939). Where parties to a contract are in pari delicto, a court will "leave them where it finds them," and will refuse to enforce the contract. Morford v. Bellanca Aircraft Corporation, Del.Super., 67 A.2d 542, 547 (1949). See also: Ring v. Spina, 148 F.2d 647, 653 (2d Cir.1945); Fields v. Hunter, D.C.Ct.App., 368 A.2d 1156, 1159 (1977); Schnoor v. Griffin, N.M.Supr., 439 P.2d 922, 927 (1968). A plaintiff who participates in a fraudulent scheme may not sue and recover for injuries that arise out of the same transaction. 37 C.J.S. Fraud s 60(d). It would be far easier to turn straw into gold than to turn $5,000 into $40,000 legally under this scheme. [FN1]

The fact that plaintiffs had knowledge of the pyramid scheme is not in dispute. They participated in promoting the "airplane" by recruiting new members to perpetuate the scheme. Plaintiffs, therefore, may not seek relief on this contract as a matter of law. Chrysler First's motion for summary judgment on this issue is GRANTED.

DELAWARE PYRAMID OR CHAIN DISTRIBUTION SCHEMES ACT

*3 The next issue is whether Chrysler First is entitled to summary judgment on the issue of whether it violated the Delaware Pyramid or Chain Distribution Schemes Act, 6 Del.C., s 2561 et seq.

Section 2563(a) of the Act provides that "[n]o person, either directly or through the use of agents or other intermediaries, shall promote, sell, attempt to sell, offer or grant participation in a pyramid or chain distribution scheme." Section 2561(1) defines "pyramid or distribution scheme" as a "sales device whereby a person, upon a condition that he part with money, property or any other thing of value, is granted a franchise license, distributorship or other right which person may further perpetuate the pyramid...."

Chrysler First argues that no evidence exists to indicate that it offered participation, made representations or promoted the "airplane" scheme to plaintiffs. Rather, Chrysler First insists that Ferro

and Jorge conducted all presentations and handled the promotion of the "airplane." Chrysler First, therefore, contends that it did not violate the Delaware Pyramid or Chain Distribution Schemes Act as a matter of law.

Plaintiffs, on the other hand, argue that they are entitled to summary judgment on this issue because the court previously found the "airplane" to be an illegal pyramid scheme in State v. Ferro, Del.Super., No. IN87-11-1138, J. Bifferato (April 15, 1988).

Summary judgment is inappropriate on this issue. I agree with plaintiffs' contention that the "airplane" scheme violates the Act as a matter of law. A question of fact exists, however, as to whether Chrysler First was an intermediary as defined by the statute, or whether it actually participated in and/or promoted the scheme. Summary judgment on this issue is DENIED.

DELAWARE CONSUMER FRAUD ACT

The Delaware Pyramid or Chain Distribution Schemes Act, 6 Del.C. s 2562, makes it an unlawful practice under the Delaware Consumer Fraud Act, 6 Del.C. s 2513, to make use of a pyramid scheme.

Chrysler First maintains that if it did not violate the Delaware Pyramid or Chain Distribution Schemes Act, then it did not commit an unlawful practice in violation of the Consumer Fraud Act. Emphasizing that the focus of the Consumer Fraud Act is on the unlawful practice of merchants, Pack & Process, Inc. v. Celotex Corp., Del.Super., 503 A.2d 646, 658 (1985), Chrysler First contends that it is not a merchant and, therefore, not within the scope of the statute.

Chrysler First's initial argument must fail because this Court has determined that the issue of Chrysler First's liability under the Delaware Pyramid Schemes statute is not susceptible to summary judgment. Before the Court can determine whether Chrysler First committed an unlawful practice in violation of the Consumer Fraud Act, the factual issues regarding Chrysler First's involvement in the scheme must be resolved.

Furthermore, the record shows that issues of material fact exist as to whether Chrysler First is a merchant under the Consumer Fraud Act, whether their financing allowed the "airplane" to operate, and whether Chrysler First employees participated in the "airplane" scheme in violation of the statute. Summary judgment on this issue is DENIED.

DELAWARE UNIFORM DECEPTIVE TRADE PRACTICES ACT

*4 Chrysler First next seeks summary judgment on the issue of whether it violated the Delaware Uniform Deceptive Trade Practices Act, 6 Del.C. s 2531 et seq. [FN2] Plaintiffs claim that Chrysler First engaged in unlawful deceptive trade practices "in that, in the course of their business, they willfully represented that the investment scheme had characteristics and benefits which it did not have and otherwise created a likelihood of confusion by false representations and omissions of material fact."

Chrysler First contends that it is entitled to summary judgment on this issue because plaintiffs lack standing, arguing that a plaintiff must have a business or trade interest at stake in order to bring an

action under the Deceptive Trade Practices Act. Plaintiffs, on the other hand, argue that consumers do have standing to sue under the Act.

Delaware caselaw is in conflict on this issue. In Roberts v. American Warranty Corp., Del.Super., 514 A.2d 1132 (1986), the court held that consumers have standing to bring a claim under the 6 Del.C. s 2531. See also: Norm Gershman's Things to Wear, Inc. v. Mercedes-Benz of North America, Inc., Del.Super., 558 A.2d 1066 (1989).

In opposition to Roberts, however, several Delaware cases have held that consumers do not have standing to sue under the Delaware Uniform Deceptive Trade Practices Act. See, Wald v. Wilmington Trust Co., Del.Super., 552 A.2d 853, 854 (1988); Griffith v. Brown P. Thawley, Inc., Del.Super., C.A. No. 81C-MR-9, Christie, J. (April 20, 1983); Galasso Import Co. v. Porter, Del.Super., C.A. No. 79A-JA-19, Stiftel, J. (April 23, 1980); Sexton v. J.C. Penney Co., Inc., Del.Super., C.A. No. 77C-DE-74, Walsh, J. (Nov. 15, 1978).

The Delaware Uniform Deceptive Trade Practices Act must be "construed in conformity with the common law of unfair competition" in the absence of legislative intent to the contrary. Sexton, slip op. at 3. So construed, the Act provides a remedy for harm to business interests rather than to consumers. Wald, supra, at 855. Consumers are not without recourse however. The Delaware Consumer Fraud Statute, 6 Del.C. s 2511 et seq. provides protection for consumers against deceptive practices. As stated by the court in Wald, "[t]he Uniform Deceptive Trade Practices Act must logically have some different aim." Id.

After careful review of the conflicting authorities, I conclude that plaintiffs do not have standing to sue under the Uniform Deceptive Trade Practices Act given the facts of this case. Plaintiffs have also sought relief under the Consumer Fraud Act in this action. Any remedy for the harm alleged will be considered under 6 Del.C. s 2511 et seq. Chrysler First's motion for summary judgment on this issue is GRANTED.

DELAWARE SECURITIES ACT

Finally, Chrysler First contends that it did not violate the Delaware Securities Act, 6 Del.C. s 7301 et seq., as a matter of law, and is, therefore, entitled to summary judgment on the issue. Although Chrysler First concedes that a pyramid promotion is a security under s 7302(a)(13), it maintains that no evidence exists to indicate that Chrysler First actually sold the security to plaintiffs in violation of the Act.

*5 Plaintiffs reassert their position that many factual issues remain unresolved as to Chrysler First's involvement and participation in the airplane scheme.

I am convinced that plaintiffs have the more persuasive argument on this issue. Summary judgment on the Securities Act violation is, therefore, DENIED.

CONCLUSION

In summary, the Court GRANTS Chrysler First's motion for summary judgment on the issues of notice provision under the credit agreement and under the Delaware Uniform Deceptive Trade Practices Act.

Chrysler First's motion for summary judgment under the Delaware Pyramid or Chain Distribution Schemes Act and the Delaware Consumer Fraud Act is DENIED.

IT IS SO ORDERED.

FN1. See: J. Grimm & W. Grimm, Rumpelstiltskin (P. Zelinsky ed. 1986) (German folk tale in which a strange and magical little man (not in the finance business) helps the miller's daughter (invested only with beauty) spin straw into gold for the king in return for the promise of her first- born child).

FN2. The Delaware Deceptive Trade Practices Act provides: A person engages in a deceptive trade practice when, in the course of his business, vacation or occupation, he: (5) Represents that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits, or quantities that they do not have, or that a person has a sponsorship, approval, status, affiliation or connection that he does not have; or (12) Engages in any other conduct which similarly creates a likelihood of confusion or of misunderstanding.

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