

1 ROBERT C. SCHUBERT S.B.N. 62684
2 JUDEN JUSTICE REED S.B.N. 153748
3 AARON H. DARSKY S.B.N. 212229
4 SCHUBERT & REED LLP
5 Three Embarcadero Center, Suite 1650
6 San Francisco, California 94111
7 Telephone: (415) 788-4220
8 Facsimile: (415) 788-0161

9 DOUGLAS M. BROOKS
10 GILMAN AND PASTOR, LLP
11 60 State Street, 37th Floor
12 Boston, MA 02109
13 Telephone: (617) 742-9700
14 Facsimile: (617) 742-9701

15 EDWARD L. MANCHUR
16 200 Broadway, Suite 304
17 Lynnfield, MA 01940
18 Telephone (781) 599-4000

19 Attorneys for individual and
20 representative plaintiff Dawn Minton

21 SUPERIOR COURT OF THE STATE OF CALIFORNIA
22 FOR THE CITY AND COUNTY OF LOS ANGELES

23 DAWN MINTON, Individually, On Behalf Of
24 Herself And All Others Similarly Situated,
25 Plaintiff,

26 vs.

27 HERBALIFE INTERNATIONAL, INC.,
28 HERBALIFE INTERNATIONAL OF AMERICA,
INC., FREEDOM LIFESTYLES, INC.,d/b/a/ THE
FREEDOM GROUP, FREEDOM LIFESTYLES
GROUP, INC, FREEDOM LIFESTYLES,LLC,
KURT and CINDY O'CONNELL, and DOES 1
through 50, inclusive

Defendants.

Case No. **BC338305** (Lead Case)
Consolidated with Case No. BC338306

**PLAINTIFF'S FIRST AMENDED AND
CONSOLIDATED CLASS ACTION
COMPLAINT FOR DAMAGES AND
INJUNCTIVE RELIEF**

(1) FRAUD AND DECEIT; (2) VIOLATIONS
OF ENDLESS CHAIN SCHEME, CALIFORNIA
PENAL CODE § 327; (3) VIOLATIONS OF
CALIFORNIA SELLER ASSISTED MARKETING
PLAN LAW, CALIFORNIA CIVIL CODE §
1812.200, ET SEQ.; (4) UNLAWFUL
BUSINESS PRACTICES IN VIOLATION OF
BUSINESS AND PROESSIONS CODE § 17200,
ET SEQ,

JURY TRIAL DEMANDED

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

REBECCA ADAMS, Individually On Behalf Of
Herself And All Others Similarly Situated,

Plaintiff,

vs.

HERBALIFE INTERNATIONAL, INC.,
HERBALIFE INTERNATIONAL OF AMERICA,
INC., HERBSFORLIFE MARKETING
d/b/a/VERTICAL SKIP MARKETING, NETWORK
CONSULTANTS LLC, PAUL MICHAELS, MARK
ZUCKERBROD, and DOES 1-50,

Defendants.

Case No. BC338306

Individual and representative plaintiff, Dawn Minton, on behalf of herself and all others similarly situated, and individual and representative plaintiff, Rebecca Adams, on behalf of herself and all others similarly situated, based on the investigation of their counsel, review of public filings and promotional materials and information supplied by other victims of the fraudulent endless chain schemes described herein, allege upon information and belief as follows:

NATURE OF CLAIMS

1. These claims are brought by each plaintiff for common law fraud and violations of the California Endless Chain Scheme law (California Penal Code Section 327), the California Seller Assisted Marketing Plan law (California Civil Code Section 1812.200, et seq.), and the California Unfair Competition Law (California Business and Professions Code Section 17200, et seq.).

2. Defendants Herbalife International, Inc. and Herbalife International Of America, Inc. (hereinafter collectively referred to as the “Herbalife Defendants” or simply “Herbalife”) operate a multi-level distribution system – referred to as the Herbalife Sales and Marketing Plan (the “Herbalife Plan”) - in which distributors can supposedly earn money both by selling Herbalife products and by recruiting other distributors. Distributors who successfully recruit specified numbers of other distributors and purchase required amounts of Herbalife products earn increasing amounts of commissions and bonuses based on purchases by their “downline” distributors.

1 3. The compensation structures of multi-level marketing companies like Herbalife
2 lend themselves readily to the opportunity for abuse, to the extent that distributors are incentivized
3 to focus their attention primarily on recruiting new distributors rather than on making retail sales of
4 products. Such abuses include encouraging distributors to purchase more products than they can
5 feasibly sell to bona fide retail customers in order to meet volume requirements (a practice known
6 as “inventory loading”) and making deceptive earnings claims. A multi-level sales organization in
7 which the members obtain monetary benefits primarily from the recruitment of new members
8 rather than selling goods to bona fide consumers is an endless chain scheme. Endless chain
9 schemes are inherently deceptive because most participants are doomed to failure.

10 4. Herbalife actively encourages and assists certain high level Herbalife distributors to
11 develop and sell promotional and marketing systems, known as “Lead Generation Systems,” to
12 lower level distributors. Lead Generation Systems (“LGS”) are ostensibly intended to assist
13 Herbalife distributors to grow their distributorships. In reality, Lead Generation Systems constitute
14 an additional and substantial source of income for the high level Herbalife distributors who sell
15 them, and a means for Herbalife to disassociate itself from conduct by the promoters of the LGS
16 which would be considered promoting or operating an endless chain scheme or otherwise
17 fraudulent or deceptive.

18 5. This lawsuit concerns two Herbalife sponsored Lead Generation Systems: The
19 Freedom Group and Vertical Skip Marketing.

20 6. Defendants Freedom Lifestyles, Inc.,d/b/a The Freedom Group, Freedom Lifestyles
21 Group, Inc, Freedom Lifestyles,LLC, Kurt and Cindy O’Connell (hereinafter, the “Freedom Group
22 Defendants”) developed and sold a Herbalife Lead Generation System known as “The Freedom
23 Group” (hereinafter referred to as the “FG System” or simply “FG”).

24 7. Defendants Herbsforlife Marketing D/B/A/Vertical Skip Marketing, Network
25 Consultants LLC, Paul Michaels, Mark Zuckerbrod (hereinafter, the “VSM Defendants”) also
26 developed and sold a Herbalife Lead Generation System known as “Vertical Skip Marketing”
27 (hereinafter referred to as the “VSM System” or simply “VSM”).

1 13. As further set forth below (in the section “Class Action Allegations”) Adams brings
2 this action in her individual and representative capacities on behalf of a proposed class and
3 appropriate subclasses of Herbalife distributors at the Supervisor level or higher in the United
4 States who, during the period February 1, 1999 to the present, purchased Herbalife products and/or
5 promotional materials from the VSM System and who incurred resulting losses (the “VSM
6 Class”). Adams is a member of the VSM Class.

7
8 **Herbalife Defendants**

9 14. At all times relevant, defendant Herbalife International, Inc. was a corporation
10 organized and existing under the laws of the State of Nevada having its principal place of business
11 at 1800 Century Park East, Los Angeles, California 90067. Herbalife International, Inc. is an
12 indirect, wholly-owned subsidiary of Herbalife Ltd., a corporation organized under the laws of the
13 Cayman Islands, with a principal place of business at 1800 Century Park East, Los Angeles,
14 California 90067. Herbalife Ltd. is a publicly held corporation traded on the New York Stock
15 Exchange under the symbol “HLF.”

16 15. At all times relevant, defendant Herbalife International of America, Inc. was a
17 corporation organized and existing under the laws of the State of California, having its principal
18 place of business at 1800 Century Park East, Los Angeles, California 90067. At all relevant times,
19 Herbalife International of America, Inc. had common and/or overlapping management with and
20 was and is owned and controlled by Herbalife International, Inc. Defendants Herbalife
21 International, Inc. and Herbalife International of America, Inc. are collectively referred to herein as
22 "Herbalife" or the “Herbalife Defendants” except where the context indicates otherwise.

23 16. At all times relevant, the Herbalife Defendants had common and/or overlapping
24 management with FLG and VSM as described more fully herein.

25 **FG Defendants**

26 17. Kurt and Cindy O'Connell (collectively, “the O'Connells” and, individually,
27 “Kurt” and “Cindy”) have been Herbalife distributors since April, 1996. In 1998, the O'Connells
28

1 were members of the Newest Way to Wealth Lead Generation System distributors group. In
2 February, 1999, they developed the Lead Generation System known as the Freedom Group. The
3 O'Connells are among Herbalife's top producers in America, and, in May, 2000, they became
4 members of the Herbalife President's team (currently around 600 Members). The O'Connells
5 became Herbalife Corporate Distributors and incorporated as a Nevada corporation in January,
6 2001, as Freedom Lifestyles Group, Inc., with Cindy as President, Secretary and Treasurer.
7 Freedom Lifestyles, LLC was incorporated also in Nevada, on December 18, 2000, with the
8 Freedom Group as the manager, but its status is currently listed as revoked by the Nevada
9 Secretary of State. The O'Connells registered as a Wisconsin corporation on April 13, 2001, as
10 Freedom Lifestyles, Inc., with Cindy as President, Secretary and registered agent. On September
11 4, 2002, the registered agent/office was changed to Kurt O'Connell at 1060 Breezewood Lane,
12 Suite 3, Neenah WI 54956. The O'Connells also operate under the name of CKC Associates,
13 which appears to be for banking purposes.

14 18. During the Class Period, the O'Connells had the ability to and did in fact, control,
15 conduct or participate in the affairs of the Freedom Group, the Freedom Lifestyles Group, Inc.,
16 Freedom Lifestyles Inc. and Herbalife. As upper level Herbalife distributors, the O'Connell's met
17 with the officers and directors of Herbalife to set Herbalife's policies, procedures and regulations
18 governing all distributor representations and solicitations. The O'Connell's were actively
19 involved in the conception, formation and/or operation of the FG System, authorized the use of
20 the FG System, the fraudulent business opportunity complained of herein, made the
21 misrepresentations alleged herein, and drafted and/or adopted the fraudulent FG promotional
22 materials discussed below. On information and belief, in addition to the bonuses and
23 commissions paid by Herbalife to the O'Connell's pursuant to the Herbalife Plan, the O'Connell's
24 are also paid additional amounts by Herbalife in connection with their roles as featured speakers
25 at Herbalife conventions and seminars and receive substantial discretionary bonuses from
26 Herbalife.

VSM Defendants

19. Vertical Skip Marketing, (“VSM”) is a business entity which operates an internet website at www.how2bsuccessful.com (the “VSM website”). The VSM website claims that VSM was founded by the Individual Defendants. The VSM website is owned by Herbsforlife Marketing, a business entity believed to be controlled by the Individual Defendants located at 4418 Gable Drive, Encino, CA 91316. Payments for the sales leads purchased on the VSM website by the plaintiff were made to Network Consultants LLC (“Network Consultants”), a Limited Liability Company organized under the laws of the State of Nevada., having its principal place of business in California. Network Consultants, Herbsforlife Marketing, and the Individual Defendants operated under the d/b/a or fictitious name VSM and distributed and disseminated the VSM promotional materials described herein. VSM is a closely held corporation used by individual defendants Michaels and Zuckerbrod and others to promote and sell VSM and disseminate the VSM promotional materials.

20. Defendant Paul Michaels (“Michaels”) was a one of Herbalife’s top distributors. Michaels is listed with the Nevada Secretary of State as a manager or member of defendant Network Consultants, LLC. Michaels and defendant Zuckerbrod were actively involved in the conception, formation and operation of the VSM System as alleged herein. As an upper level Herbalife distributor, Michaels met with the officers and directors of Herbalife to set Herbalife’s policies, procedures and regulations governing all distributor representations and solicitations. At all times relevant, Michaels had the ability to and did in fact, control, conduct or participate in the affairs of defendants Herbalife and Network Consultants LLC. Michaels authorized the use of the VSM System, the fraudulent business opportunity complained of herein, made the misrepresentations alleged herein, and drafted and/or adopted the fraudulent VSM promotional materials discussed below. Michaels is believed to be a California resident.

21. Defendant Mark Zuckerbrod (“Zuckerbrod”) is one of Herbalife’s top distributors. During times relevant hereto, Zuckerbrod represented that he earned \$1,000,000 from his Herbalife business. Zuckerbrod is listed with the Nevada Secretary of State as a manager or member of defendant Network Consultants, LLC. Zuckerbrod and defendant Michaels were actively involved

1 in the conception, formation and operation of the VSM System as alleged herein. As an upper
2 level Herbalife distributor, Zuckerbrod met regularly with the officers and directors of Herbalife to
3 set Herbalife's policies, procedures and regulations governing all distributor representations and
4 solicitations. At all times relevant, Zuckerbrod had the ability to and did in fact, control, conduct
5 or participate in the affairs of defendants Herbalife, and Network Consultants LLC. Zuckerbrod
6 authorized the use of the VSM System, the fraudulent business opportunity complained of herein,
7 made the misrepresentations alleged herein, and drafted and/or adopted the fraudulent VSM
8 promotional materials discussed below. Zuckerbrod is believed to be a California resident.

9 **Other Defendants**

10 22. Various persons and/or firms named as Doe defendants herein have participated in
11 the violations alleged herein and may have performed acts and made statements in furtherance
12 thereof. The defendants have exclusive possession and control of this information.

13 23. The true names and capacities of Defendants Does 1 through 50, inclusive are
14 unknown to plaintiffs, and plaintiffs will seek leave to amend this complaint to allege such names
15 and capacities as soon as they are ascertained.

16 24. The O'Connell's, Michaels and Zuckerbrod are occasionally referred to herein as
17 the "Individual Defendants."

18 **FACTS COMMON TO ALL CAUSES OF ACTION**

19
20 **Background of Herbalife**

21 25. Herbalife began operations in 1980. In its Prospectus dated December 13, 2005
22 ("Prospectus"), Herbalife characterizes itself as a "global network marketing company that sells
23 weight management, nutritional supplement and personal care products," and states that its mission
24 is "changing people's lives by providing a financially rewarding business opportunity to
25 distributors and quality products to distributors and customers who seek a healthy lifestyle." The
26 term "network marketing" is a synonym for "multilevel marketing," which is discussed in more
27 detail below. Herbalife states that it sells products in over 60 countries through a network of over
28 one million distributors. Herbalife reports that in the year ending December 31, 2004 its unaudited

1 “retail sales” were approximately \$2.146 billion. The reported retail sales figures in its Prospectus
2 and Herbalife’s other public filings were derived by assuming that 100% of the products sold to
3 Herbalife distributors were sold by them to consumers at 100% of Herbalife’s “suggested retail
4 prices.” Herbalife acknowledges, however, that it does not monitor the actual retail prices charged
5 by distributors, and relies on distributor certifications as to their retail sales. Moreover, unknown
6 quantities of Herbalife products are consumed or stockpiled by Herbalife distributors, given away
7 as promotions, or sold at or below cost or at small mark-ups (including auctions on E-bay), with
8 the result that Herbalife’s actual retail sales are much less than reported by Herbalife, and its
9 audited “net sales” were \$1.309 billion.

10 26. The Prospectus represents that Herbalife markets 130 products under various trade
11 names. That document also discloses that Herbalife creates and sells to distributors various
12 marketing materials purportedly to assist Herbalife distributors in marketing Herbalife products
13 and recruiting new Herbalife distributors. These marketing materials include sales aids,
14 informational audiotapes, videotapes, CDs and DVDs, as well as start-up kits called “International
15 Business Packs,” the purchase of which is a prerequisite to obtaining an Herbalife distributorship.

16 27. The Prospectus represents that Herbalife’s products are distributed exclusively
17 through a “network marketing system” consisting of over one million distributors. Approximately
18 20-25% of Herbalife distributors advance to the “Supervisor” level or higher in Herbalife’s
19 multilevel marketing plan. There is substantial “turnover” or attrition among Herbalife’s
20 distributors and Supervisors. At the end of January, 2005, over 90% of Herbalife’s distributors
21 who had not reached the level of Supervisor did not renew their distributorships. In addition, 60%
22 of Herbalife’s Supervisors, approximately 300,000, failed to renew. As a result, it is crucial for
23 Herbalife to continue recruiting large numbers of new distributors and Supervisors.

24 28. The Herbalife network marketing system is jointly managed by Herbalife’s
25 executive officers and a select group of distributors at the President’s Team level or above,
26 including the Individual Defendants. At one point this group of distributors was referred to as “the
27 A team.” Later it was known as the “Strategy and Planning Group.” Herbalife’s senior
28

1 distributors, including the Individual Defendants, are deeply and intimately involved in its sales,
2 training, motivation and strategic planning efforts.

3 29. The management role of Herbalife’s high level distributors is emphasized in
4 Herbalife’s publicly filed documents. For instance, Herbalife’s February 5, 1997 Form S-3 (the
5 “1997 Prospectus”) states that “Mark Hughes and the Company’s top distributors ... are committed
6 to training and motivating Herbalife’s distributors.” The 1997 Prospectus reported that Herbalife’s
7 “most senior distributors consist of approximately 260 distributors (as of December 31, 1996) who
8 comprise the President’s Team and who work closely with Mark Hughes to develop and
9 implement new initiatives and strategies for increasing sales and distributor productivity
10 throughout the Company’s entire distributor organization.”

11 30. This joint management of Herbalife’s network marketing system continued
12 throughout the Class Period, including after the death of Mr. Hughes. For instance, Herbalife’s
13 Form 10-K Annual Report to Shareholders for the year ending December 31, 2001 (the “Year 2001
14 10-K”) states that “[m]embers of the President’s Team work closely with us to develop and
15 implement new initiatives and strategies for increasing sales and distributor productivity
16 throughout our entire distributor organization.” The 2005 Prospectus reports that “[w]e and our
17 distributor leadership conduct thousands of training sessions annually throughout the world to
18 educate and motivate our distributors.”

19 31. In the Prospectus, Herbalife acknowledges that “some key supervisors who have
20 attained the highest levels within our distributor network are responsible for their organization’s
21 generation of a substantial portion of our sales and for recruiting a substantial number of our
22 distributors.” Distributors whose downlines constitute such a large portion of a multi-level
23 marketing firm’s business have substantial influence and ‘clout,’ based in part on the implicit
24 threat that if the Distributors terminated their association with the company, it would have a
25 material adverse effect on the company’s sales. As Herbalife states in the Prospectus, “[t]he loss
26 of a group of leading supervisors, together with their downline organizations ... could negatively
27 impact sales of products, impair our ability to attract new distributors and harm our financial
28 condition and operating results.”

1 **The Herbalife Sales and Marketing Plan**

2
3 32. Herbalife pays its distributors pursuant to the “Herbalife Sales and
4 Marketing Plan” (the “Herbalife Plan”). The entry level in the Herbalife Plan is the distributor
5 level. To become a distributor, a person must be “sponsored” by an existing distributor, and must
6 purchase a “distributor kit.” Distributors are only entitled to purchase and sell Herbalife products.
7 A distributor who also wishes to sponsor other distributors and earn royalties and bonuses on the
8 purchases of those distributors must become a “Supervisor.” In order to qualify as a Supervisor, a
9 distributor must purchase, from Herbalife or another distributor, Herbalife products representing
10 4,000 volume points in one month, or 2,500 volume points in two consecutive months. One
11 “volume point” is equivalent to one dollar (U.S. \$1) at Herbalife’s suggested retail prices. A
12 Supervisor must re-qualify once each year (by again purchasing 4,000 volume points in one month
13 or 2,500 volume points in two consecutive months) in order to maintain her “Supervisor” status
14 and continue receiving royalties and bonuses.

15 33. Supervisors who maintain their purchase requirements are paid “royalty
16 overrides” and various production bonuses on purchases of Herbalife products by their “downline
17 organizations.” By meeting various volume and recruitment targets, Supervisors can ascend in the
18 Herbalife hierarchy from “World Team,” “Global Expansion Team,” and “Millionaire Team” to
19 “President’s Team.” The President’s Team includes an additional five levels, the highest being the
20 “Chairman’s Club,” the requirements for which include having at least five recruits who meet the
21 volume requirements for the President’s Team. Distributors who reach the higher levels of the
22 Herbalife Plan and recruit large downline organizations can earn royalties and bonuses far in
23 excess of any retail profits they might earn by selling Herbalife products to consumers. However,
24 the number of distributors who reach the higher levels is quite small. For example, in 1997, there
25 were only 260 Herbalife President’s Team members out of a total of 115,000 Supervisors. In 1998
26 there were 397 President’s Team members out of a total of 139,000 Supervisors. According to the
27 Prospectus, in 2004 there were 762 President’s Team members and 24 Chairman’s Club members,
28 out of a total of 201,100 Supervisors.

1 34. Herbalife only recently started to disclose on its Internet website,
2 www.herbalife.com, the average payments it makes to its distributors and Supervisors, as well as
3 the percentage of distributors who reach each level in the Herbalife Plan. However, this disclosure
4 is false and misleading in that it purports to show a spurious category called “Active Leaders” that
5 lumps active supervisors (with very low payments) in with the highest volume distributors at the
6 beginning of the endless chain and averages their payments. Even worse, the income disclosure
7 does not adequately disclose that in order to qualify for average annual payments of \$561.00, a
8 Supervisor can spend thousands of dollars purchasing marketing materials, “qualified” sales leads,
9 and website hosting services from lead generation systems such as FG and VSM. Instead, at
10 relevant times hereto, in its marketing and promotional materials, including on its Internet web
11 site, www.herbalife.com, Herbalife displayed “testimonial” earnings claims by successful
12 distributors at the beginning of the endless chain scheme claiming five figure monthly incomes and
13 failed to disclose any statistics on expenses incurred by Supervisors.

14 35. The Federal Trade Commission found the practice of representing by implication,
15 the use of hypothetical examples, or otherwise, that distributors in multi-level marketing programs
16 earn or achieve any stated amounts of profits, earnings or sales in excess of the average profits,
17 earnings, or sales of all distributors, to be an “unfair or deceptive act or practice” in violation of
18 law, unless the average profits, earnings or sales or the percent of all distributors who actually
19 achieved such stated profits, earnings or sales is clearly and conspicuously disclosed. With its
20 earnings testimonials, however, Herbalife merely provides a disclaimer, in small print, stating,
21 “The income testimonials presented are applicable to the individuals depicted and are not a
22 guarantee of your income nor are they typical.” These disclaimers are woefully inadequate to
23 advise prospective distributors that their chance of achieving the incomes portrayed in the
24 testimonials is vanishingly small.

25 **Herbalife Fails to Enforce Retail Sales Rules**

26 36. The compensation structures of multi-level marketing companies like Herbalife
27 lend themselves readily to the opportunity for abuse, to the extent that distributors are incentivized
28 to focus their attention primarily on recruiting new distributors rather than on making retail sales of

1 products. Such abuses include encouraging distributors to purchase more products than they can
2 feasibly sell to bona fide retail customers in order to meet volume requirements (a practice known
3 as “inventory loading”) and making deceptive earnings claims. A multi-level sales organization in
4 which the members obtain monetary benefits primarily from the recruitment of new members
5 rather than selling goods to bona fide consumers is an endless chain scheme. Endless chain
6 schemes are inherently deceptive because most participants are doomed to failure.

7 37. Herbalife’s compensation structure, as set forth in the Herbalife Plan, is readily
8 subject to these abuses. The potential payout for distributors who sponsor large downline
9 organizations far exceeds the “retail profits” a distributor could feasibly earn by simply retailing
10 Herbalife products. Accordingly, the Herbalife Plan incentivizes distributors to spend most of
11 their time and energy in the recruitment of new distributors as opposed to the retail sale of
12 Herbalife products to consumers. In fact, Herbalife has failed to properly monitor and police the
13 Herbalife Plan and has failed to ensure that most Herbalife products are actually retailed to bona
14 fide consumers who are not participants in Herbalife.

15 38. In order to avoid being characterized as an endless chain scheme, Herbalife has
16 purported to adopt rules which require most of a distributor’s product purchases to be retailed to
17 consumers (“Retail Sales Rules”). Among other things, the Retail Sales Rules require distributors
18 to certify that they have sold at least 70% of their prior product purchases before making a new
19 order and that they have made retail sales to at least ten customers per month. However, Herbalife
20 has failed to adequately enforce its Retail Sales Rules so as to ensure that the majority of its
21 products are actually retailed to bona fide consumers.

22 39. There is no effective and enforceable requirement that Herbalife distributors
23 actually make retail sales of Herbalife products. Ostensibly, Herbalife requires distributors to
24 “certify” that they have complied with the retail sales requirements. However, such “certification”
25 is accomplished merely by clicking on a box on an order form, and upline distributors, with
26 Herbalife’s knowledge, approval and acquiescence, routinely instruct new participants that actual
27 compliance with the Retail Sales Rules is not necessary.

1 generation systems which are the subject of this Complaint, such that California law should apply
2 to the claims alleged herein.

3 **Background of Herbalife's Lead Generation Systems**

4
5 45. Beginning in the late 1980's, Herbalife began aggressively expanding overseas.
6 Herbalife's sales trend in new markets has been characterized by an initial period of rapid growth,
7 as new distributors are recruited, followed by a decline in sales. In its public filings, Herbalife
8 explains these sales declines as due to adverse publicity and increased regulatory scrutiny and
9 other factors. In fact, the pattern of initial rapid sales growth followed by sales decline
10 accompanied by adverse publicity and increased regulatory scrutiny is a fundamental characteristic
11 of endless chain schemes. The opening of a new market results in an initial wave of recruitment as
12 new distributors get caught up in the excitement of potentially earning large amounts of royalties
13 and bonuses. Most of these distributors are inevitably disappointed when the huge financial
14 returns fail to materialize. By continuously opening new markets, however, Herbalife was able to
15 keep a sufficient number of Supervisors sufficiently incentivized to keep sales increasing.

16 46. As set forth below, Herbalife has admitted that this continuous opening of new
17 markets was an essential component of its business strategy. Following this strategy, from 1992
18 through 1996, Herbalife commenced operations in twenty-three (23) new countries.

19 47. Herbalife's expansion strategy worked until approximately 1995: Some markets
20 declined after an initial period of explosive growth, but these declines were more than offset by
21 sales increases in new markets, such that Herbalife's total sales increased substantially every year.
22 As Herbalife expanded into new markets through 1995, its worldwide sales continued to increase.
23 Herbalife's United States sales increased as well during this period, but remained a relatively
24 constant 33% to 36% of total worldwide sales. However, in 1996 Herbalife's United States sales
25 experienced a dramatic drop, both in absolute terms and as a percentage of worldwide sales.
26 Herbalife United States sales declined from \$333.6 million in 1995 (36.1% of worldwide sales) to
27 \$279.6 million in 1996 (23.3% of worldwide sales). Herbalife no longer reports its United States
28 sales separately – U.S. sales are included with North and South America sales – but the Prospectus
states that U.S sales constitute about 19% of total worldwide sales.

1 48. As stated in its February 5, 1997 Form S-3 and its March 30, 1999 Form 10-K, in
2 1996, Herbalife determined that it needed to develop new initiatives to enhance sales in the U.S.
3 market and other markets that had followed the trend of initial rapid growth followed by sales
4 declines. Such “sales revitalization” initiatives were to include extensive training and motivational
5 programs and the creation of new “regional planning and strategy groups that include senior
6 distributors.”

7 49. One of Herbalife’s new initiatives was to encourage and facilitate the development
8 by senior distributors of “Lead Generation Systems” (“LGS”). The term “Lead Generation
9 Systems” is used within Herbalife to refer to distributor-developed promotional systems, the use of
10 mass mailings, telephone solicitations, sign-posting, sales scripts and other techniques designed to
11 increase recruitment of new distributors.

12 50. One of the largest and most prominent Lead Generation Systems in Herbalife was
13 the “Newest Way to Wealth” program (“NWTW”). The O’Connell’s first participated in NWTW
14 in 1998, then broke away from NWTW and created the FG System, which is essentially a clone of
15 NWTW.

16 51. Lead Generation Systems were ostensibly intended, as stated by Herbalife’s then
17 CEO, Francis X. Tirelli, in a letter to President’s Team distributors, to take advantage of “21st
18 Century communications vehicles” such as the Internet and computerized mailing and telephone
19 systems. In fact, however, the use of Lead Generation Systems was consciously intended by
20 Herbalife and its senior distributors (a) to permit senior distributors to use more aggressive
21 promotional materials and methods than those previously utilized and approved by Herbalife, (b)
22 to provide Herbalife with a plausible defense (i.e., the “overzealous distributor” defense) in the
23 event of regulatory problems with the distributor-generated promotional materials, and (c) to
24 enable senior distributors to supplement their income through the sale of promotional materials to
25 their downlines, and thereby provide an additional incentive for senior distributors to remain with
26 Herbalife.

27 52. In effect, Herbalife unleashed its senior distributors and expressly and tacitly
28 directed and encouraged them to use deceptive and coercive techniques to recruit new distributors.

1 Herbalife tacitly agreed to refrain from enforcing its rules against using deceptive earnings claims
2 and other misrepresentations to recruit new distributors, and to refrain from enforcing its Retail
3 Sales Rules. Moreover, Herbalife participated in the conduct of the LGS through its ongoing
4 consultations with the top distributors by adopting rules which permitted distributors to develop
5 their own promotional materials, and by refraining from enforcing the requirement that such
6 distributor-developed promotional materials comply with Herbalife’s standards and be pre-
7 approved by Herbalife’s compliance department.

8 53. In a memorandum sent to President’s Team members in mid to late 2001 (the exact
9 date being unknown to plaintiff), Frank Tirelli, Herbalife’s CEO, asserted that Lead Generation
10 Systems were “[o]ne of our greatest opportunities [but] also one of our greatest risks” (the “Tirelli
11 Memo”). Tirelli characterized Lead Generation Systems as one side of the “Golden Triangle of
12 Success” (the other sides being “products” and the “Home Office”) and noted that he had been
13 communicating this message at every corporate and distributor event he had attended. Tirelli
14 further stated that “Herbalife is committed to take full advantage of all the collective innovative
15 and creative solutions in the marketplace with respect to Lead Generation Systems.” Tellingly,
16 the Tirelli Memo warned that “LGS should be an augment to the Herbalife mission and business
17 and should not become more important economically than the Herbalife opportunity.”

18 54. The Tirelli Memo was sent in 2001, in an effort to ‘close the barn door after the
19 horses were gone.’ By that time the Newest Way to Wealth, the FG and other LGS had been in
20 existence for several years, and indeed had constituted a key part of Herbalife’s business strategy
21 to revitalize sales and the recruitment of new distributors and Supervisors. For the first time,
22 Herbalife, in the Tirelli Memo, adopted a series of guidelines, effective January 1, 2002, governing
23 the use of LGS. These guidelines included review by Herbalife of every LGS to ensure
24 compliance with legal regulations, industry standards and Herbalife’s own standards (although
25 Tirelli emphasized that he would be personally involved in all decisions and was committed to the
26 “innovative and creative use of LGS”); a requirement that at least 50% of every LGS should be
27 focused on Herbalife’s products; an understanding that the purpose of LGS was to “augment the
28 Herbalife mission and business and should not become more important economically than the

1 Herbalife opportunity;” and a requirement that “all LGS should stay within the Chairman’s Club
2 lineage.”

3 55. The new guidelines were addressed to the actual kinds of problems Herbalife was
4 now forced to recognize that it had with LGS in general and with the FG and VSM Systems in
5 particular. When Tirelli referred to LGS as “one of our greatest risks” he was referring to the
6 adverse impact of regulatory scrutiny and exposure to civil lawsuits which would likely be
7 prompted due to the use of deceptive LGS promotional materials and the emphasis on recruiting
8 new distributors over retail selling. The admonition that at least 50% of a LGS should be devoted
9 to extolling the merits of Herbalife’s products is particularly telling, since, as Herbalife knew, the
10 primary focus of Herbalife’s LGS, including the FG and VSM Systems, was the recruitment of
11 new distributors. In fact, as Herbalife knew, FG and VSM materials explicitly advised participants
12 to spend at least 80% of their time and efforts in recruiting new distributors, and only 20% in
13 retailing. Moreover, in the case of FG, Tirelli’s admonition that a LGS should not become “more
14 important economically than the Herbalife opportunity” reflected an accomplished fact: *a given*
15 *LGS was in fact more economically important to a given new distributor recruit than the*
16 *opportunity to become an Herbalife distributor.*

17 56. Herbalife’s LGS initiative in the United States had a significant impact on its
18 financial performance. In 1997, Herbalife’s United States reported “retail” sales were \$298.7
19 million, approximately 20% of Herbalife’s total reported world-wide retail sales of \$1,490.7
20 million. As set forth in the following chart, the United States share of Herbalife’s sales has
21 increased every year since 1997, notwithstanding an absolute decline in sales in 2001:
22
23
24
25
26
27
28

1 **Herbalife International, Inc.**

2 **U.S. Retail Sales vs. Worldwide Retail Sales**

3

4 Year	Total Worldwide Retail Sales (in millions)	U.S. Retail Sales (in millions)	U.S. Sales as a percentage of Total Retail Sales
5 1993	693.1	247.0	35.6%
6 1994	884.0	295.0	33.4%
7 1995	923.6	333.6	36.1%
8 1996	1,200.1	279.6	23.3%
9 1997	1,490.7	298.7	20.0%
10 1998	1,644.8	364.5	22.2%
11 1999	1,793.5	416.1	23.2%
12 2000	1,764.9	453.0	25.7%
13 2001	1,656.2	441.7	26.7%

14

15

16

17 57. In addition, Herbalife's LGS initiative has resulted in the decrease in sales of
18 "official" Herbalife corporate promotional literature, presumably due to the increasing sales of
19 distributor-generated LGS promotional literature (which is not publicly reported). As
20 demonstrated in the following chart, prior to the commencement of the LGS initiative in 1997,
21 Herbalife's sales of promotional literature had averaged approximately 5% of total reported retail
22 sales. Since then such sales have declined every year, both in absolute terms and as a percentage
23 of total reported retail sales:

24

25

26

27

28

1 **Herbalife International, Inc.**

2 **Sales of Promotional Literature**

3

4 Year	5 “Retail Sales” (in 6 millions)**	7 Sales of Literature, 8 Promotional and 9 Other (in millions)	10 Promotional Literature 11 as a percentage of total 12 Retail Sales
13 1994	14 884.0	15 49.2	16 5.6%
17 1995	18 923.6	19 35.3	20 3.8%
21 1996	22 1,200.1	23 60.4	24 5.0%
25 1997	26 1,490.7	27 69.4	28 4.6%
1998	1,644.8	67.9	4.1%
1999	1,793.5	46.6	2.6%
2000	1,764.9	50.8	2.8%
2001	1,656.2	25.0	1.5%

16 ** Based on the numbers set forth in this chart, plaintiff believes that Herbalife’s senior
17 distributors are earning tens of millions of dollars in the sale of LGS promotional materials,
18 including the sale of FG and VSM materials.

19 58. Herbalife’s LGS initiative, with its emphasis on recruiting more distributors, has
20 also resulted in an increasing percentage of Herbalife’s sales being comprised of purchases by
21 Supervisors who are meeting their initial and/or annual qualifying purchase requirements. As set
22 forth above, in order to rise to the rank of Supervisor, a distributor must initially qualify by
23 purchasing 4,000 points worth of Herbalife products in one month, or 2,500 points worth of
24 Herbalife products in two consecutive months, and a Supervisor must re-qualify every year in
25 order to maintain his or her Supervisor status. Since the inception of Herbalife’s LGS initiative in
26 1997, the percentage of Herbalife’s reported “retail” sales which can be accounted for by
27 Supervisors meeting their qualifying purchase requirements has increased from 32.4% of total
28 sales to no less than 40.5%, as set forth in the following chart:

{00007388.DOC ; 1}

Herbalife International, Inc. Total Retail Sales*
Compared to Minimum Qualifying Purchases by Supervisors

Year	Supervisors	Minimum qualifying purchases by Supervisors (in millions)*	“Retail” Sales (less promo literature) (in millions)**	Percentage of Retail Sales by qualifying Supervisors
1997	115,000	460	1,421.3	32.4%
1998	139,000	556	1,576.9	35.3%
1999	147,000	588	1,746.9	33.7%
2000	160,000	640	1,714.1	37.3%
2001	165,000	660	1,631.2	40.5%

* To become a Herbalife Supervisor, the distributor must purchase at least 4,000 “points” (approximately equivalent to the suggested retail price, i.e., 1 point equals \$1) worth of Herbalife products in one month, or 2,500 points in two consecutive months. The figures in this column are derived by multiplying the number of Supervisors in a given year by 4,000. Accordingly, the minimum qualifying sales are understated, since some Supervisors qualify by purchasing a total of 5,000 points over two months.

** Herbalife reports “retail sales” based on the suggested retail sale prices reflected on its invoices to its distributors. Herbalife does not monitor or collect information from its distributors concerning actual retail sales and does not know how much of the products sold to distributors are actually retailed or at what prices such products are retailed.

59. The emphasis on recruitment is also demonstrated in that while Herbalife’s sales have been decreasing for the past two years (and the rate of sales growth was increasing for years before that), the number of Supervisors has continued to increase, as set forth in the following chart:

1 **Herbalife International, Inc.**

2 **Year-to-year Growth in Number of Supervisors and Retail Sales**

3

4

5

6

7

8

9

10

11

12

13

14

15

16

Year	Supervisors	Increase over previous year	“Retail” Sales (in millions)**	Increase (decrease) over previous year
1991	12,000		191.0	
1992	18,000	50.0%	405.1	112.1%
1993	41,000	127.8%	693.0	71.1%
1994	75,000	82.9%	884.0	27.6%
1995	90,000	20.0%	923.6	4.5%
1996	99,000	10.0%	1,200.0	29.9%
1997	115,000	16.2%	1,490.7	24.2%
1998	139,000	20.9%	1,644.8	10.3%
1999	147,000	5.8%	1,793.5	9.0%
2000	160,000	8.8%	1,764.9	(1.6%)
2001	165,000	3.1%	1,656.2	(6.2%)

17

18 ** Herbalife reports “retail sales” based on the suggested retail sale prices reflected on its

19 invoices to its distributors. Herbalife does not monitor or collect information from its distributors

20 concerning actual retail sales and does not know how much of the products it sells to distributors

21 are actually retailed or at what prices.

22 60. Issues concerning Lead Generation Systems have continued to be a concern at the

23 highest management levels at Herbalife. At a Herbalife Board of Directors meeting on July 31,

24 2002, the Board was updated on Herbalife’s “Internet, Enterprise and Lead Generation System

25 plans.” At a meeting on September 20, 2002, a presentation was made to the Board concerning

26 “Internet Lead Generation systems and initiatives available to augment information technology

27 performance.” On April 23, 2003 the Board formed a committee “to review, analyze and

28 understand the issues relating to new and existing lead generation systems.”

1 65. In fact, the FG System is a fraudulent scheme designed to exhort Herbalife
2 distributors to instantly achieve “Supervisor” status under the Herbalife compensation structure by
3 making a qualifying purchase of Herbalife products, to focus most of their efforts on recruiting
4 new distributors, and to ignore retailing. The FG scheme benefits Herbalife because the qualifying
5 purchases of Herbalife products necessary to reach the Supervisor level generate substantial sales
6 for Herbalife. The FG scheme benefits the O’Connells because the qualifying purchases by new
7 Supervisors result in additional royalty and bonus income for them, and it benefits the FG
8 Defendants because it realizes additional profits from the sale of substantial amounts of FG
9 promotional materials. The actual operation of the FG System in conjunction with the Herbalife
10 Plan is an endless chain sales scheme, where rewards are paid in connection with recruitment of
11 new participants and the purchase of Herbalife products and FG promotional materials, rather than
12 the sale of Herbalife products to bona fide consumers.

13 66. It was part of the FG scheme to cause distributors to disseminate uniform and
14 standardized promotional materials which fraudulently projected the successful expansion and
15 operation of the Herbalife businesses of FG members

16 67. It was part of the FG scheme for participants to disseminate the FG promotional
17 materials through the use of the mail, posting signs along public roads, purchasing newspaper ads
18 and distributing various flyers and to follow up the mailings with telephone calls, using detailed
19 FG sales scripts. These materials represent that participants in FG can earn from \$1,200 to \$8,000
20 per week to work at home. The FG System called for two mailings, a “First Package” and a
21 “Second Package,” each of which was to be followed up with a scripted telephone call.

22 68. It was also part of the FG scheme, through the use of the uniform and standardized
23 promotional materials, to exhort FG members to become Supervisors under the Herbalife Plan by
24 making the minimum qualifying purchase, and to make substantial purchases of FG promotional
25 materials. FG promotional materials were sold in various packages (e.g. the “Blue Book” and the
26 “Freedom Manual”) and participants were told that a significant portion of their earnings would be
27 derived from the sale of packages of promotional materials to their recruits. FG also provided
28 participants with pre-selected Herbalife product orders, designed to meet the Supervisor purchase

1 qualifications. The FG System also involved efforts to keep new recruits motivated for as long as
2 possible, despite the failure of the system to live up to the expectations created by the promotional
3 materials, so as to increase their purchases of Herbalife products and FG promotional materials.
4 These efforts included numerous conference calls with the O'Connells and the extensive use of
5 Herbalife's "touchfon" voice messaging system, both of which were used to transmit additional
6 training in recruitment techniques and motivational messages intended to boost distributor morale.

7 69. It was also part of the FG scheme to make fraudulent projections concerning the
8 earnings a new Herbalife distributor would or could reasonably expect to earn. The FG
9 promotional materials tout that "we can teach people to reach a six figure income in 18-24 months
10 if they can put in at least 20 hours per week and are committed to the advertising and following the
11 system." The FG Plan is entirely premised on the recruitment of new distributors. The FG
12 materials state that "In the Freedom Group it is easier to get Supervisors than consumers."

13 70. The FG System calls for distributors to make wholesale purchases of at least the
14 minimum amount of products necessary to achieve and thereafter maintain their status as
15 Supervisors, regardless of whether the distributor is actually making retail sales, a practice, known
16 as "inventory loading."

17 71. FG System distributors are encouraged by Defendants to sponsor recruits with
18 distributor kits, significant purchases of the FG System marketing tools and hundreds if not
19 thousands of dollars of "wholesale" product purchases from Herbalife. The FG System
20 emphasizes through its uniform promotional materials the need to continue the on-going
21 recruitment and sponsoring of new distributors into the FG System and the maintenance of
22 personal wholesale product purchase volumes. The common practice of FG System distributors is
23 to meet much of their purchase volumes by selling products to other recruits, by using the products
24 personally, and by inventory loading, rather than by retailing to the mythical "end consumer."

25 72. All of the various techniques endorsed by the FG System to "retail" products are
26 actually methods of "prospecting" for new distributors. Retail selling is virtually non-existent and,
27 in any event, secondary to recruitment.

28

1 73. The Individual Defendants sponsor promotional seminars and distribute
2 promotional literature, video tapes and audio cassettes through which prospects are recruited and
3 trained to join the FG System and to induce others to also join. In the uniform and standardized
4 promotional materials distributed in connection with the FG System, and at promotional events
5 sponsored by Herbalife, FG members deliver “rags-to-riches” testimonials and claim extraordinary
6 monthly incomes, exhorting the prospects to become Herbalife Supervisors and join the FG
7 System.

8 74. Defendants' representations as to the probabilities of success and their income
9 projections were and are false. Despite defendants' claims, there is in fact little chance that most
10 individuals who purchase the FG System distributorships will even recoup their initial investment.

11 75. In connection with the FG System, defendants have uniformly failed to disclose, in
12 the First Package, the Second Package, conference calls, the “touchfon” voice messages or
13 otherwise, the following material facts:

14 a. That investments of money and time in the Herbalife Plan and the FG
15 System are exceedingly risky because the Herbalife Plan, including the FG System as employed in
16 connection with the Herbalife Plan, constitutes an endless chain sales scheme, that such schemes
17 inevitably collapse after a period of explosive growth, and most people in endless chain schemes
18 lose money;

19 b. That the rate of attrition among Herbalife distributors is over 90% a year,
20 and the rate of attrition among Herbalife Supervisors is approximately 60% a year;

21 c. That the Federal Trade Commission found the practice – employed by
22 Herbalife and the FG Defendants - of representing by implication, the use of hypothetical
23 examples, or otherwise that distributors in multi-level marketing programs earn or achieve any
24 stated amounts of profits, earnings or sales in excess of the average profits, earnings, or sales of all
25 distributors, to be an "unfair or deceptive act or practice" in violation of law, unless the average
26 profits, earnings or sales or the percent of all distributors who actually achieved such stated profits,
27 earnings or sales is clearly and conspicuously disclosed;

1 d. That in order for plaintiff and members of the Class to effectively evaluate
2 the Herbalife Supervisor positions as business opportunities, each of the defendants should have
3 disclosed the following information but failed to do so:

4 (1) The actual bases for the earnings claims made in the FG promotional
5 materials;

6 (2) The number and percentages of Supervisors who actually achieved
7 the earnings or ranges of earnings represented by the defendants, as well as the total number of
8 distributors who acquired interests in each rank of the Herbalife Plan on an annual basis and by
9 geographical area;

10 (3) The number and percentages of distributors who reached each rank
11 in the Herbalife Plan as compared to the total number of distributors who acquired interests in the
12 Herbalife Plan on an annual basis and by geographical area;

13 (4) The average income actually earned by distributors at each rank of
14 the Herbalife Plan on an annual basis and by geographical area;

15 (5) The average payments and expenses actually made and incurred by
16 distributors at each rank of the Herbalife Plan on an annual basis and by geographical area;

17 (6) The number and percentages of distributors at each level of the
18 Herbalife Plan who voluntarily terminated or failed to renew their positions, who were terminated
19 or refused renewal by Herbalife for any reason, who ceased to be "active", or who otherwise
20 abandoned their positions in the Herbalife Plan on an annual basis and by geographical area; and

21 (7) all other material information which could affect the decision of a
22 reasonable businessperson;

23 e. That those FG distributors who have achieved the levels of incomes
24 represented by defendants did so in large part because of the enormous revenues generated from
25 the sales of FG promotional materials, revenues which are not generally available to victims of the
26 FG promotional scheme, and by “discretionary” payments by Herbalife to high level distributors
27 such as the O’Connell’s; and
28

1 f. That the FG and Herbalife approved business method of posting signs along
2 public streets was illegal in most municipalities and could result in fines and prosecution of the FG
3 participant. In fact, the O'Connells paid over \$200,000 in fines and restitution in January 2004 to
4 the State of Wisconsin to settle a lawsuit brought by the Wisconsin Attorney General's Office in
5 2002 for their systematic illegal sign posting.

6 76. Herbalife and the FG Defendants had a duty to disclose the aforementioned material
7 facts arising from (a) their positions in Herbalife which gave them access to information not
8 available to other distributors or prospective distributors, (b) the partial disclosures made in the FG
9 promotional materials, and (c) the provisions of the California Seller Assisted Marketing Plan law,
10 California Civil Code § 1812.200, et seq.

11 77. Herbalife and the FG Defendants employ disclaimers in their contracts and
12 promotional materials which state that "testimonial" or other representations as to possible
13 earnings are not "guarantees" or "typical." However, these disclaimers are totally inadequate.
14 Defendants knew and intended for prospective distributors and participants in Herbalife and the
15 FG System to rely on these testimonial earnings claims as reasonable projections of possible
16 earnings. Defendants had no reasonable basis for making these earnings claims and knew that it
17 would be difficult or impossible for more than a small fraction of new distributors to achieve
18 similar results. For instance, while President's Team distributors may earn \$20,000 per month or
19 more, there are only a few hundred such distributors, representing less than 0.5% of all Supervisors
20 and a minute percentage of Herbalife's million-plus distributors, and a significant portion of such
21 President's Team distributors' "earnings" often are derived from the sales of promotional materials
22 to downline distributors.

23 78. In short, the FG System is characterized by misrepresentations and omissions of
24 material fact. Information provided in video and audio-cassette tapes and written promotional
25 materials combine to give investors the materially incorrect impression that their investments will
26 be easily recouped, that the promotional campaigns used in the FG System will generate new
27 prospects, that distributors will profit from their initial investment with little or no risk. In fact,
28 only a handful of distributors have achieved the extraordinary levels of income represented by

1 defendants, with most losing their entire initial investment. Persons who attempt to participate in
2 the FG/Herbalife program typically invest from \$4,000 to \$50,000 or more in purchases of
3 Herbalife products and FG promotional materials, lose all or most of their investment, and suffer
4 other damages. Defendants are continuing to promote, approve and/or operate the fraudulent
5 FG/Herbalife endless chain scheme in and from the State of California and throughout the United
6 States. These continuing activities further threaten the investments of the Class and will victimize
7 thousands of additional persons unless defendants are restrained and enjoined. Defendants'
8 activities have inflicted, and will continue to inflict, irreparable harm upon the plaintiff, the Class
9 members, and prospective Herbalife distributors who employ the FG System.

10 79. As a result of and in reliance upon the uniform and standardized representations and
11 omissions of each of the defendants, the plaintiff and other FG/Herbalife distributors at all levels
12 have become unknowing victims of the FG scheme.

13
14 **HERBALIFE'S KNOWLEDGE, APPROVAL AND CONTROL OVER THE FG SYSTEM**

15 80. As alleged above, Herbalife jointly manages the Herbalife network marketing
16 system with its elite group of President's Team distributors. Herbalife conceived of and adopted
17 Lead Generation Systems, developed by its high level distributors, as a crucial part of its business
18 strategy to revitalize sales following the substantial decline in U.S. sales in 1996.

19 81. Many of the representations in the FG promotional materials were attributable to
20 statements made and approved by Herbalife and its founder, Mark Hughes. These include, for
21 example, the advice to spend 80% of one's time recruiting and only 20% retailing. In addition, as
22 alleged above, Herbalife uses deceptive "testimonial" earnings claims in its official corporate
23 promotional materials, and encourages its distributors, including the Individual Defendants, to do
24 the same. The testimonial earnings claims used in the FG System are not materially different than
25 the testimonial earnings claims used by Herbalife in its corporate promotional materials, including
26 the www.herbalife.com web site.

1 91. In fact, VSM is and was a fraudulent scheme designed to exhort Herbalife
2 distributors to instantly achieve “Supervisor” status under the Herbalife compensation structure by
3 making a qualifying purchase of Herbalife products, to focus most of their efforts on recruiting
4 new distributors, and to ignore retailing. The VSM scheme benefits Herbalife because the
5 qualifying purchases of Herbalife products necessary to reach the Supervisor level generate
6 substantial sales for Herbalife. The VSM scheme benefits the Individual Defendants because the
7 qualifying purchases by new Supervisors result in additional royalty and bonus income for them,
8 and it benefits Herbsforlife Marketing and Network Consultants because it realizes additional
9 profits from the sale of substantial amounts of promotional materials and sales leads. The actual
10 operation of VSM in conjunction with the Herbalife Plan is an endless chain sales scheme, where
11 rewards are paid in connection with recruitment of new participants and the purchase of Herbalife
12 products and VSM promotional materials, rather than the sale of Herbalife products to bona fide
13 consumers.

14 92. VSM touts itself as a “sophisticated 21st century training system” and that it is
15 “[t]he newest way of marketing that is taking the world by storm.” VSM uses email solicitations,
16 “flash” presentations and an automated marketing and recruiting web site,
17 www.How2bSuccessful.com, to recruit new Herbalife distributors.

18 93. In its uniform promotional materials provided to prospective recruits, VSM asserts
19 that it provides the “Newest and most effective exclusive marketing in North America” which will
20 enable participants “to help new team members to start at a quick pace,” creates both a “fear of
21 loss” and a “sense of urgency,” is “Very affordable,” and provides “Unlimited support.”

22 94. In its solicitations, VSM claims its “brand new concept” that has created “huge
23 opportunities for individuals like you and me”. It claims that individuals who participate will be
24 able to “leverage” their time and earn “residual income,” i.e., earnings that will continue
25 indefinitely.

26 95. VSM’s solicitations are indeed designed to create a sense of urgency. In fact, VSM
27 emphasizes that it is a “time sensitive program” and that “timing is of the essence.”
28

1 96. The specific means that VSM uses to create the sense of urgency is to present the
2 prospect with a list of other prospects. By email, the prospect is provided with access to a
3 password-protected web site. A web site page labeled “genealogy” includes a lengthy list of other
4 prospects - generally totaling 300 to 400 names. Each name on the list is designated as PE(“Pre-
5 Enrollee”), QA(“Qualified Applicant”), or TM (“Team Member”). The page provides the
6 following explanation:

7 You are currently viewing your current Success Lineage. It is very important that
8 you understand what is being shown to you on this page as it can be vital for your
9 business.

10 First, find your name in the lineage by looking for the name that is highlighted.
11 Once you have located where you are in success lineage you need to look at the
12 people above and below your position.

13 The PE’s below your position are currently evaluating the information you recently
14 viewed and are deciding if they want to take the next step or not. If they take the
15 next step they will then be upgraded to QA, just like you.

16 Next you will notice QA’s above you and there may also be QA’s below you. All of
17 these people are currently talking with their marketing experts and learning more
18 about our business. At any moment they can decide to upgrade to TM and jump
19 above all other QA’s in the lineage, including you.

20 If a QA below you upgrades to TM, you must upgrade to TM by the next decision
21 day or else you will lose the potential to have them in your business, forever.

22 If you upgrade now, you will then have the opportunity to skip above all the other
23 QA’s listed above you and be able to benefit from having them in your business.

24 As you can see it is very important that you contact your marketing expert
25 immediately and talk with them on how you can take the next step.

26 97. Subsequent pages reinforce the sense of urgency by stating, for instance, that “The
27 clock is ticking! 2 People have already upgraded to Team Member! You MUST upgrade to Team
28 Member by next Tuesday AT MIDNIGHT PST or LOSE THOSE PEOPLE FOREVER.”

1 98. VSM's flash presentation states that "Many other people are listening to this
2 message at the same time you are," and that "timing is everything."

3 99. The VSM marketing program emphasizes the importance of recruiting large
4 numbers of other participants. In Session One of the Internet training web site, VSM asserts that:

5 Vertical Skip Marketing is a tool used to build a massive distributor organization in
6 a relatively short period of time - compared to more traditional methods. We
7 employ the leveraged power of the internet, with a unique organization building
8 strategy, to develop large teams quickly.

9 Let's talk about recruiting because this is how you became a Team member and
10 therefore are more familiar with this avenue. We go through thousands of people to
11 find people that are serious about making some changes in their lives. We work
12 with many advertising agencies to get the message out. The message is we are
13 looking for people that can help us with the expansion process we are going
14 through.

15 100. VSM asserts that participants who use its system will "Attract a swarm of qualified
16 prospects." The majority of the VSM program is devoted to detailed instruction in the process of
17 recruiting new participants. While lip service is given to "retailing", VSM asserts that the "big
18 money" is made through recruitment. For instance, in an audio tape accessible through the VSM
19 website, Michaels states that "Your goal is not to set up a retail store with hundreds of customers,
20 but to use the products and have 10-15 customers, and spend the rest of your time building a
21 network where your residual income and financial security lies." Later in the same tape Michaels
22 emphasizes this message by stating "This is about 10 to 15 customers and then a huge network and
23 residual income."

24 101. Throughout its promotional materials, VSM emphasizes the financial rewards that
25 participants are likely to earn, including statements such as the following:

26 A. And the best news is; you are part of this exclusive team that is prospering
27 in record time by following the few basic steps that we have laid out for you;

28 B. VSM will help you build a financially rewarding business with virtually
unlimited potential

C. Billions of dollars of sales/profits for the Distributors to share in;

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

D. More Millionaires produced than any company in history;

E. A unique system of doing business that eliminates the traditional barriers that prevent most people from achieving massive success;

F. The Herbalife Marketing Plan pays out a higher percentage profit to the distributors than any other company in the industry. This means you will earn the most for your efforts with us. The most exciting parts of the plan are the Royalty Overrides and Bonuses Supervisors can earn. Royalty Overrides and Bonuses offer you Residual Income month after month;

G. We have people just like you who started where you are, who are now earning high six figure incomes! You will be rewarded in more ways than you can possibly imagine. You will discover that Herbalife is a more than just a profitable business—it is a totally satisfying way of life, limited only by your imagination and energy.

102. VSM’s flash presentation states that “Our team members have earned \$700 million in bonuses and commissions in the past 12 months.” Other promotional materials represent that following the VSM program will produce “absolutely staggering” income within 12 to 18 months.

103. VSM’s promotional materials represent, expressly and by implication, that Herbalife has approved the VSM marketing program. For instance, in a January 31, 2005 email advertising a VSM/Herbalife Convention in Los Angeles taking place in February of 2005, Michaels and Zukerbrod stated that “Herbalife has reviewed [the VSM] system and is totally aware of what we are doing and the success we are having.” Herbalife is referred to as VSM’s “Parent Company.”

104. VSM’s promotional materials emphasize the importance of immediately qualifying at the rank of “Supervisor” in the Herbalife compensation plan, using representations such as the following:

A. The Supervisor position offers you the best opportunity to earn the most money for your efforts. Thousands of people become Supervisors every month with our company. You will become a Supervisor too as you follow our step by step plan to build your business;

B. The absolute best starting level in Herbalife is Supervisor;

1 C. Successful people make upfront decisions. They commit first and figure out
2 the details later. That's why they are called the 'decision makers.' To copy their
3 results, you must simply copy their actions of qualifying as a Supervisor quickly.

4 105. Accordingly, VSM operates as an endless chain scheme, in which retailing is
5 secondary to recruitment.

6 106. Defendants' representations as to the probabilities of success and their income
7 projections were and are false. Despite defendants' claims, there is in fact little chance that most
8 individuals who purchase the VSM System distributorships will even recoup their initial
9 investment.

10 107. In connection with the VSM System, defendants have uniformly failed to disclose
11 the following material facts:

12 a. That investments of money and time in the Herbalife Plan and the VSM
13 System are exceedingly risky because the Herbalife Plan, including the VSM System as employed
14 in connection with the Herbalife Plan, constitutes an endless chain sales scheme, that such schemes
15 inevitably collapse after a period of explosive growth, and most people in endless chain schemes
16 lose money;

17 b. That the rate of attrition among Herbalife distributors is over 90% a year,
18 and the rate of attrition among Herbalife Supervisors is approximately 60% a year;

19 c. That the Federal Trade Commission found the practice – employed by
20 Herbalife and the VSM Defendants - of representing by implication, the use of hypothetical
21 examples, or otherwise that distributors in multi-level marketing programs earn or achieve any
22 stated amounts of profits, earnings or sales in excess of the average profits, earnings, or sales of all
23 distributors, to be an "unfair or deceptive act or practice" in violation of law, unless the average
24 profits, earnings or sales or the percent of all distributors who actually achieved such stated profits,
25 earnings or sales is clearly and conspicuously disclosed;

26 d. That in order for plaintiff and members of the Class to effectively evaluate
27 the Herbalife Supervisor positions as business opportunities, each of the defendants should have
28 disclosed the following information but failed to do so:

(1) The actual bases for the earnings claims made in the VSM promotional materials;

(2) The number and percentages of Supervisors who actually achieved the earnings or ranges of earnings represented by the defendants, as well as the total number of distributors who acquired interests in each rank of the Herbalife Plan on an annual basis and by geographical area;

(3) The number and percentages of distributors who reached each rank in the Herbalife Plan as compared to the total number of distributors who acquired interests in the Herbalife Plan on an annual basis and by geographical area;

(4) The average income actually earned by distributors at each rank of the Herbalife Plan on an annual basis and by geographical area;

(5) The average payments and expenses actually made and incurred by distributors at each rank of the Herbalife Plan on an annual basis and by geographical area;

(6) The number and percentages of distributors at each level of the Herbalife Plan who voluntarily terminated or failed to renew their positions, who were terminated or refused renewal by Herbalife for any reason, who ceased to be "active", or who otherwise abandoned their positions in the Herbalife Plan on an annual basis and by geographical area; and

(7) all other material information which could affect the decision of a reasonable businessperson; and

e. That those VSM distributors who have achieved the levels of incomes represented by defendants did so in large part because of the enormous revenues generated from the sales of VSM promotional materials, revenues which are not generally available to victims of the VSM promotional scheme, and by "discretionary" payments by Herbalife to high level distributors such as Michaels and Zuckerbrod.

108. Herbalife and the VSM Defendants had a duty to disclose the aforementioned material facts arising from (a) their positions in Herbalife which gave them access to information not available to other distributors or prospective distributors, (b) the partial disclosures made in the

1 VSM promotional materials, and (c) the provisions of the California Seller Assisted Marketing
2 Plan law, California Civil Code § 1812.200, et seq.

3 109. Herbalife and the other defendants employ disclaimers in their contracts and
4 promotional materials, as well as the contracts and promotional materials of VSM, which state that
5 “testimonial” or other representations as to possible earnings are not “guarantees” or “typical.”
6 However, these disclaimers are totally inadequate. Defendants knew and intended for prospective
7 distributors and participants in Herbalife and the VSM System to rely on these testimonial earnings
8 claims as reasonable projections of possible earnings. Defendants had no reasonable basis for
9 making these earnings claims and knew that it would be difficult or impossible for more than a
10 small fraction of new distributors to achieve similar results. For instance, while President’s Team
11 distributors may earn \$20,000 per month or more, there are only a few hundred such distributors,
12 representing less than 0.5% of all Supervisors and a minute percentage of Herbalife’s million-plus
13 distributors. In addition, a significant but undisclosed portion of President’s Team distributors’
14 “earnings” often are derived from the sales of promotional materials to downline distributors, and
15 from discretionary payments by Herbalife to high level Supervisors who appear at Herbalife
16 conventions.

17 110. In short, the VSM System is characterized by misrepresentations and omissions of
18 material fact. Information provided in flash video and audio presentations and the website
19 combine to give investors the materially incorrect impression that their investments will be easily
20 recouped, that the promotional campaigns used in the VSM System will generate new prospects,
21 and that distributors will profit from their initial investment with little or no risk. In fact, only a
22 handful of distributors have achieved the extraordinary levels of income represented by
23 defendants, with most losing their entire initial investment. Persons who attempt to participate in
24 the VSM/Herbalife program typically invest from \$4,000 to \$50,000 or more in purchases of
25 Herbalife products and VSM promotional materials and sales leads, lose all or most of their
26 investment, and suffer other damages. Defendants are continuing to promote, approve and/or
27 operate the fraudulent and illegal VSM/Herbalife endless chain scheme in the State of California
28 and throughout the United States. These continuing activities further threaten the investments of

1 the Class and will victimize thousands of additional persons unless defendants are restrained and
2 enjoined. Defendants' activities have inflicted, and will continue to inflict, irreparable harm upon
3 the plaintiff, the Class members, and prospective Herbalife distributors who employ the VSM
4 System.

5 111. As a result of and in reliance upon the uniform and standardized representations and
6 omissions of each of the defendants, the plaintiff and other VSM/Herbalife distributors at all levels
7 have become unknowing victims of the VSM scheme.

8
9 **HERBALIFE'S KNOWLEDGE, APPROVAL AND**
10 **CONTROL OVER THE VSM SYSTEM**

11 112. As alleged above, Herbalife jointly manages the Herbalife network marketing
12 system with its elite group of President's Club distributors. Herbalife conceived of and adopted
13 Lead Generation Systems, developed by its high level distributors, as a crucial part of its business
14 strategy to revitalize sales following the substantial decline in U.S. sales in 1996.

15 113. Many of the representations in the VSM promotional materials were attributable to
16 statements made and approved by Herbalife and its founder, Mark Hughes. These include, for
17 example, the advice to spend most of one's time recruiting instead of retailing. In addition, as
18 alleged above, Herbalife uses deceptive "testimonial" earnings claims in its official corporate
19 promotional materials, and encourages its distributors, including the Individual Defendants, to do
20 the same. The testimonial earnings claims used in the VSM are not materially different than the
21 testimonial earnings claims used by Herbalife in its corporate promotional materials, including the
22 www.herbalife.com web site.

23 114. As alleged above, VSM was developed and operated by high level Herbalife
24 distributors Michaels and Zuckerbrod.

25 **FACTS REGARDING PLAINTIFF ADAMS**

26 115. Relying on the fraudulent misrepresentations and omissions in the VSM
27 promotional materials described above, plaintiff Rebecca Adams was induced to become an
28 Herbalife distributor and a participant in VSM on or about July 28, 2004 and continuing thereafter.

1 Adams responded to an email questionnaire believed to be sent by Network Consultants LLC and
2 received a phone call pursuant to her questionnaire response from a VSM participant and Herbalife
3 Supervisor. During that conversation, the VSM participant followed a scripted presentation and
4 played a prerecorded message from defendant Michaels and persuaded plaintiff to purchase a \$99
5 introductory package over the telephone. During that conversation, she received a password to
6 gain access to restricted areas of the VSM website. Over the following week, plaintiff Adams was
7 exposed to the messages and representations detailed above in paragraphs 92-103. In a subsequent
8 telephone conversation on or about August 2, 2004, plaintiff's upline VSM participant, known as a
9 "Coach" in VSM parlance, persuaded plaintiff to purchase Herbalife Supervisor status as a "tag-
10 on." A "tag-on," plaintiff was told, could become a Supervisor by purchasing only \$1,000 worth
11 of Herbalife products and tagging their order on to another new Supervisor who had purchased the
12 usual \$4,000 order required to become a Herbalife Supervisor. Plaintiff's VSM Coach filled out
13 the proper forms for plaintiff's "tag-on" Supervisor status, while plaintiff placed her \$1,000 order
14 directly with Herbalife. Plaintiff purchased a web-site and prepaid for six months web hosting
15 services through the VSM website on or about August 4, 2004. On August 5, 2004, plaintiff
16 purchased her first set of purportedly "qualified leads" from VSM for \$900.00. None of these
17 materials cured the fraudulent omissions described above in Paragraph 107. Over the course of the
18 next four months, in reliance on these fraudulent omissions, Adams purchased \$6,000 worth of
19 "qualified leads" from Network Consultants LLC through the VSM website at the suggestion of
20 her Coach and in accordance with the VSM System.

21 116. Plaintiff Adams committed herself on a full time basis to VSM, regularly working
22 60 hour weeks following the VSM System. She purchased significant quantities of Herbalife
23 products and VSM promotional materials at various times throughout the Class Period, including
24 \$6,000 worth of sales leads, and paid to attend a VSM training seminar in Las Vegas, Nevada on
25 or about November 4, 2004. Plaintiff continued her efforts to learn to follow the VSM System by
26 listening to numerous conference calls where defendant Michaels regularly spoke.

1 VSM Defendants, because the FG and VSM downlines account for such a large portion of
2 Herbalife's sales that Herbalife cannot take the risk of losing them. Injunctive relief is essential in
3 order to prevent further injury to the Class.

4
5 **CLASS ACTION ALLEGATIONS**

6 122. Plaintiffs bring this Class Action on behalf of themselves, and on behalf of all other
7 persons similarly situated. Plaintiffs request that this Court certify the following two Plaintiff
8 Classes, or appropriate subclasses thereof, initially defined as:

9 **The FG Class**

10 All residents of the United States who, at any time from February 1, 1999 to the
11 date the Class is certified in this action (the "Class Period"):

- 12 (a) were Herbalife distributors; and
13
14 (b) purchased FG promotional materials for use with their
15 Herbalife distributorship; and
16 (c) incurred net economic loss as a result.

17 The defendants, any entity in which any of them has a controlling interest, and their
18 legal representatives, heirs, and successors, are expressly excluded from
19 membership in the FG Class and any subclasses thereof.

20 **The VSM Class**

21 All residents of the United States who, at any time from February 1, 1999 to the
22 date the Class is certified in this action (the "Class Period"):

- 23 (a) were Herbalife distributors; and
24
25 (b) purchased VSM promotional materials for use with their
26 Herbalife distributorship; and
27 (c) incurred net economic loss as a result.
28

1 The defendants, any entity in which any of them has a controlling interest, and their
2 legal representatives, heirs, and successors, are expressly excluded from
3 membership in the VSM Class and any subclasses thereof.

4
5 123. This action has been brought and may properly be maintained, pursuant to the
6 provisions of California Code of Civil Procedure § 382 and California Civil Code § 1781, and
7 satisfies the numerosity, commonality, typicality, adequacy, impairment and superiority
8 requirements thereof, because:

9 (a) The members of both the FG and VSM Classes are so numerous that their
10 individual joinder herein is impractical. Each Class is believed to number at least 5,000 members.
11 Individual and Representative plaintiff Dawn Minton invested and lost more than \$60,000 in
12 connection with Herbalife and FG, and suffered other financial losses. Individual and
13 Representative plaintiff Rebecca Adams invested and lost more than \$4500 in connection with
14 Herbalife and VSM. The remaining aggregate out-of-pocket losses of both Classes are estimated to
15 exceed \$50 million. If the Court determines notice to be necessary or appropriate, Class members
16 may be notified of the pendency of this action by mail, supplemented or substituted by published
17 notice.

18 (b) Common questions of law and fact exist as to all members of the Class.
19 These questions predominate over any questions which affect only the individual members of the
20 Class. These common legal and factual questions include:

- 21 (1) Whether the omissions identified in paragraphs 75 and 107 above
22 were fraudulent and material and whether plaintiffs' and class
23 members' reliance on them was reasonable, and whether defendants
24 acted with the requisite degree of scienter;
- 25 (2) Whether the operation of the FG System in conjunction with the
26 Herbalife Plan constitutes an Endless Chain Scheme in violation of
27 California Penal Code Section 327;

- 1 (3) Whether the operation of the VSM System in conjunction with the
2 Herbalife Plan constitutes and Endless Chain Scheme in violation of
3 California Penal Code Section 327;
4 (4) Whether the operation of the FG System in conjunction with the
5 Herbalife Plan constitutes a Seller Assisted Marketing Plan pursuant
6 to California Civil Code § 1812.201;
7 (5) Whether the operation of the VSM System in conjunction with the
8 Herbalife Plan constitutes a Seller Assisted Marketing Plan pursuant
9 to California Civil Code § 1812.201;
10 (6) Whether the defendants' fraudulent omissions and operation of
11 endless chain schemes violate California Business and Professions
12 Code Section 17200.

13 (c) Each Plaintiff's claims are typical of those of their respective Classes, since
14 each plaintiff and the other Class members were induced to pay money to Herbalife and the FG
15 Defendants, the VSM Defendants and others. Furthermore, plaintiffs and all members of both
16 proposed Classes have sustained monetary damages arising out of defendants' violations of
17 California law as alleged herein.

18 (d) Plaintiffs will fairly and adequately protect the interests of the members of
19 the FG Class and the VSM Class.

20 (i) Plaintiff Minton is a member of the FG Class. She has no interests
21 which are adverse to the interests of the FG Class members. Plaintiff Minton lost
22 money and suffered other financial losses as a result of defendants' illegal conduct.
23 These losses provide her with a substantial stake in this action and the incentive to
24 prosecute it vigorously for herself and for the FG Class. Plaintiff Minton has
25 retained counsel competent and experienced in class actions, franchising and
26 distribution law, consumer protection law and complex litigation, and intend to
27 pursue this action vigorously.
28

1 (ii) Plaintiff Adams is a member of the VSM Class. She has no interests
2 which are adverse to the interests of the VSM Class members. Plaintiff Adams lost
3 money and suffered other financial losses as a result of defendants' illegal conduct.
4 These losses provide her with a substantial stake in this action and the incentive to
5 prosecute it vigorously for herself and for the VSM Class. Plaintiff Adams has
6 retained counsel competent and experienced in class actions, franchising and
7 distribution law, consumer protection law and complex litigation, and intend to
8 pursue this action vigorously.

9 (e) A class action is superior to other available methods for the fair and efficient
10 adjudication of the litigation since individual joinder of all Class members is impracticable.
11 Although the damages suffered by each individual Class member may total thousands or even tens
12 of thousands of dollars, damages of such magnitude are nonetheless relatively small given the
13 expense and burden of individual prosecution of the complex and extensive litigation necessitated
14 by the fraudulent promotion of a business opportunity or illegal endless chain scheme. Thus, it
15 would be virtually impossible for the Class members to individually redress the wrongs done to
16 them. Even if the Class members themselves could afford such individual litigation, such
17 individual prosecution would constitute a highly avoidable inefficiency in the administration of
18 justice by the courts. Further, individualized litigation presents the potential for inconsistent or
19 contradictory judgments. Individualized litigation magnifies the delay and expense to all parties,
20 and to the court system, presented by the complex legal and factual issues of the case. By contrast,
21 a class action presents far fewer management difficulties, and provides the benefits of unitary
22 adjudication, economy of scale, and comprehensive supervision by a single court.

23 (f) The foregoing allegations demonstrate satisfaction of the basic certification
24 criteria and the requirements for voluntary, or opt-out certification under the statutes referred to in
25 Paragraph 123. The circumstances of this litigation may likewise justify the certification of the
26 proposed Class on a mandatory (non-opt out) basis under the relevant provisions of California
27 Code of Civil Procedure § 382, California Civil Code § 1781, because the prosecution of separate
28 actions by the members of the proposed Class would create a risk of (A) inconsistent or varying

1 adjudication with respect to individual members of the Class which would establish incompatible
2 standards of conduct for the party opposing the Classes; or (B) adjudication with respect to
3 individual members of the Class which would as a practical matter be dispositive of the interests of
4 the other members not party to the adjudications, or substantially impair or impede their ability to
5 protect their interests.

6 (g) In conducting the unlawful endless chain scheme alleged herein and by
7 omitting and concealing material facts regarding the scheme from prospective distributors,
8 defendants have acted or refused to act on grounds generally applicable to the Class, thereby
9 making appropriate final injunctive relief or corresponding declaratory relief with respect to the
10 Class as a whole, and making appropriate class certification under California Code of Civil
11 Procedure § 382, California Civil Code § 1781 and any other relevant provisions of other statutes
12 alleged herein.

13
14 **CLAIMS FOR RELIEF**

15
16 **FIRST CAUSE OF ACTION**
17 **(FRAUD AND DECEIT -- AGAINST HERBALIFE AND FG DEFENDANTS BY**
18 **PLAINTIFF MINTON ON BEHALF OF FG CLASS**

19 124. Plaintiff Minton repeats each allegation contained in the preceding paragraphs, as if
20 fully set forth herein. This cause of action is asserted against the Herbalife Defendants and the FG
21 Defendants, on behalf of Plaintiff Minton and all members of the FG Class.

22 125. The FG Defendants, acting on their own behalf and as agents of the Herbalife
23 Defendants, made the fraudulent omissions identified in Paragraph 75 above, to the Plaintiff
24 Minton and the members of the FG Class.

25 126. The FG Defendants had the express and implied authority of the Herbalife
26 Defendants to make the aforementioned fraudulent representations and omissions based on their
27 role in the Herbalife Plan, as described in Paragraphs 28-31 above and their development of a
28 Herbalife's LGS as described in Paragraphs 45-62 above.

1 127. The FG Defendants and the Herbalife Defendants had a duty to disclose the true
2 facts concerning their fraudulent omissions for the reasons set forth in Paragraph 75 above.

3 128. The fraudulent representations and omissions, or substantially similar or identical
4 representations and omissions, were made by the FG Defendants acting as agents of the Herbalife
5 Defendants continuously throughout the Class Period.

6 129. Each of the misrepresentations and omissions complained of above, have been
7 engaged in by the FG Defendants and the Herbalife Defendants with malice and with specific and
8 deliberate intent to oppress, defraud and deceive plaintiff Minton and the FG Class.

9 130. The FG Defendants and the Herbalife Defendants, and each of them, knew and
10 know that they were and are engaged in the fraudulent conduct as aforesaid, and that said conduct
11 constitutes a breach of their duties to the plaintiff Minton and the FG Class and a fraud. In the
12 alternative, said defendants and each of them, have engaged in the conduct as hereinbefore
13 described which rendered and continues to render substantial assistance to, aided and abetted, and
14 concealed the fraudulent FG System.

15 131. As a proximate result of the conduct of defendants and each of them, Plaintiff
16 Minton and the FG Class have invested time and money in their Herbalife distributorships and the
17 FG System in actual and justifiable reliance thereon, and have been injured as a proximate result
18 thereof.

19 132. As a result, and because the FG Defendants and the Herbalife Defendants have
20 acted and continue to act maliciously and oppressively, despicably, and in callous disregard of the
21 rights and interests of plaintiffs. Plaintiff Minton and the FG Class are not only entitled to the
22 damages set forth above, but also to punitive damages, in a sum not presently known, for the sake
23 of example and by way of punishing defendants.

24

25

26

27

28

1 139. The operation of the Herbalife Plan in conjunction with the FG System constitutes a
2 Seller Assisted Marketing Plan within the meaning of California Civil Code § 1812.201(a) which
3 is not within the scope of any of the exclusions set forth in California Civil Code § 1812.201(b), in
4 that:

5 a. The FG System calls for Herbalife distributors to make a total initial
6 payment exceeding \$500 within six months after commencement of operations for products,
7 equipment, supplies or services, including but not limited to the purchase of multiple copies of the
8 “First Package” and “Second Package” for use in soliciting new distributors, as well as sufficient
9 Herbalife products to qualify as a Supervisor;

10 b. Defendants have advertised or solicited the purchase of the Herbalife Plan
11 and the FG System; and

12 c. Defendants have represented that purchasers will earn, are likely to earn and
13 can earn an amount in excess of the initial payment.

14 140. Defendants have sold, or represented that they have sold, five or more hybrid
15 Herbalife/FG distributorships within the 24 months preceding the solicitations of Plaintiff Minton
16 and the FG Class, or have represented that they intend to sell five or more hybrid Herbalife/FG
17 distributorships within the 12 months following the solicitations of the Plaintiff Minton and the FG
18 Class.

19 141. The sales or offers to sell hybrid Herbalife/FG distributorships occurred within or
20 originated from the State of California in that the Herbalife Defendants have their principal places
21 of business in California, that the Herbalife LGS Strategy was conceived and controlled from
22 Herbalife’s California headquarters, and the purchase of a hybrid Herbalife/FG distributorship
23 necessarily involves the execution of an Herbalife distributorship agreement.

24 142. Defendants have violated the California Seller Assisted Marketing Plans law,
25 California Civil Code § 1812.200, et seq., by:

26 a. Making earnings claims concerning the Herbalife Plan and the FG System
27 without the substantiating data or disclosures required by California Civil Code § 1812.204(d); and
28

1 155. Each of the misrepresentations and omissions complained of above, have been
2 engaged in by the VSM Defendants and the Herbalife Defendants with malice and with specific
3 and deliberate intent to oppress, defraud and deceive plaintiff Adams and the VSM Class.

4 156. The VSM Defendants and the Herbalife Defendants, and each of them, knew and
5 know that they were and are engaged in the fraudulent conduct as aforesaid, and that said conduct
6 constitutes a breach of their duties to the plaintiff Adams and the VSM Class and a fraud. In the
7 alternative, said defendants and each of them, have engaged in the conduct as hereinbefore
8 described which rendered and continues to render substantial assistance to, aided and abetted, and
9 concealed the fraudulent VSM System.

10 157. As a proximate result of the conduct of defendants and each of them, Plaintiff
11 Adams and the VSM Class have invested time and money in their Herbalife distributorships and
12 the VSM System in actual and justifiable reliance thereon, and have been injured as a proximate
13 result thereof.

14 158. As a result, and because the VSM Defendants and the Herbalife Defendants have
15 acted and continue to act maliciously and oppressively, despicably, and in callous disregard of the
16 rights and interests of plaintiffs. Plaintiff Adams and the VSM Class are not only entitled to the
17 damages set forth above, but also to punitive damages, in a sum not presently known, for the sake
18 of example and by way of punishing defendants.

19

20

21

22

SIXTH CAUSE OF ACTION
(ENDLESS CHAIN SCHEME IN VIOLATION OF
CALIFORNIA PENAL CODE §327 AND CIVIL CODE §1689.2 -- AGAINST HERBALIFE
AND VSM DEFENDANTS BY PLAINTIFF ADAMS ON BEHALF OF VSM CLASS)

23

24

25

26

27

28

159. Plaintiff Adams repeats each allegation contained in the preceding paragraphs, as if
fully set forth herein. This cause of action is asserted against the Herbalife Defendants and the
VSM Defendants, on behalf of the Plaintiff Adams and all members of the VSM Class.

160. The operation of the Herbalife Plan in conjunction with the VSM System for the
promotion of Herbalife distributorships constitutes an Endless Chain scheme within the meaning of
California Penal Code § 327, because participants pay consideration (including the purchase of

1 sufficient Herbalife products to qualify as a Supervisor, as well as VSM promotional materials) for
2 the chance to receive compensation (Herbalife bonuses and commissions) when a person recruited
3 by the participant recruits a new participant and also purchases sufficient Herbalife products to
4 qualify as a Supervisor.

5 161. The VSM Defendants contrived, prepared, set up, proposed and operated the VSM
6 System, and operated the Herbalife Plan in conjunction with the VSM System, and thereby
7 operated an Endless Chain Scheme within the meaning of California Penal Code § 327.

8 162. The Herbalife Defendants contrived, prepared, set up, proposed and operated the
9 Herbalife Plan, and operated the VSM System in conjunction with the Herbalife Plan, and thereby
10 operated an Endless Chain Scheme within the meaning of California Penal Code § 327.

11 163. Plaintiff Adams and the VSM Class are entitled to rescission of the VSM and
12 Herbalife contracts and return of all consideration paid pursuant to defendants' Endless Chain
13 Scheme, less any compensation received, pursuant to California Civil Code § 1689.2.

14
15 **SEVENTH CAUSE OF ACTION**
16 **(VIOLATION OF CALIFORNIA SELLER ASSISTED**
17 **MARKETING PLANS LAW -- AGAINST HERBALIFE AND VSM DEFENDANTS BY**
18 **PLAINTIFF ADAMS ON BEHALF OF VSM CLASS)**

19 164. Plaintiff Adams repeats each allegation contained in the preceding paragraphs, as if
20 fully set forth herein. This cause of action is asserted against the Herbalife Defendants and the
21 VSM Defendants, on behalf of Plaintiff Adams and all members of the VSM Class.

22 165. The operation of the Herbalife Plan in conjunction with the VSM System
23 constitutes a Seller Assisted Marketing Plan within the meaning of California Civil Code §
24 1812.201(a) which is not within the scope of any of the exclusions set forth in California Civil
25 Code § 1812.201(b), in that:

26 a. The VSM System calls for Herbalife distributors to make a total initial
27 payment exceeding \$500 within six months after commencement of operations for products,
28 equipment, supplies or services, including but not limited to the purchase of VSM promotional
materials for use in soliciting new distributors, as well as sufficient Herbalife products to qualify as
a Supervisor;

1 ;

2 b. Defendants have advertised or solicited the purchase of the Herbalife Plan
3 and the VSM System; and

4 c. Defendants have represented that purchasers will earn, are likely to earn and
5 can earn an amount in excess of the initial payment.

6 166. Defendants have sold, or represented that they have sold, five or more hybrid
7 Herbalife/VSM distributorships within the 24 months preceding the solicitations of Plaintiff
8 Adams and the VSM Class, or have represented that they intend to sell five or more hybrid
9 Herbalife/VSM distributorships within the 12 months following the solicitations of the Plaintiff
10 Adams and the VSM Class.

11 167. The sales or offers to sell hybrid Herbalife/VSM distributorships occurred within or
12 originated from the State of California in that the Herbalife Defendants have their principal places
13 of business in California, that the Herbalife LGS Strategy was conceived and controlled from
14 Herbalife's California headquarters, and the purchase of a hybrid Herbalife/VSM distributorship
15 necessarily involves the execution of an Herbalife distributorship agreement.

16 168. Defendants have violated the California Seller Assisted Marketing Plans law,
17 California Civil Code § 1812.200, *et seq.*, by:

18 a. Making earnings claims concerning the Herbalife Plan and the VSM System
19 without the substantiating data or disclosures required by California Civil Code § 1812.204(d); and

20 b. Failing to provide prospective purchasers of the Herbalife Plan and the VSM
21 System with the disclosure statement required by California Civil Code § 1812.205 or the
22 information sheet required by California Civil Code § 1812.206.

23 169. Plaintiff Adams and members of the VSM Class have been injured by defendants'
24 violations of the California Seller Assisted Marketing Plans law and are therefore entitled to actual
25 damages, damages in the nature of rescission and punitive damages pursuant to California Civil
26 Code § 1812.218.

27

28

EIGHTH CAUSE OF ACTION
(UNLAWFUL, UNFAIR OR DECEPTIVE BUSINESS PRACTICES
IN VIOLATION OF CALIFORNIA BUSINESS AND PROFESSIONS

1 **CODE SECTION 17200 ET SEQ. -- AGAINST HERBALIFE AND VSM DEFENDANTS**
2 **BY PLAINTIFF ADAMS ON BEHALF OF VSM CLASS)**

3 170. Plaintiff Adams repeats each allegation contained in the preceding paragraphs, as if
4 fully set forth herein. This cause of action is asserted against the Herbalife Defendants and the
5 VSM Defendants , on behalf of Plaintiff Adams and the VSM Class.

6 171. By promoting and selling the Herbalife Plan and the VSM System in connection
7 with Herbalife distributorships as alleged herein, defendants have engaged in unlawful or
8 deceptive business practices and unfair competition within the meaning of California Business and
9 Professions Code § 17200, by contriving, preparing, setting up, proposing or operating an endless
10 chain in violation of California Penal Code § 327.

11 172. In addition, defendants engaged in deceptive and/or unfair business practices, as
12 well as unfair, deceptive, or untrue advertising and acts prohibited by Business & Professions Code
13 § 17500, et seq., by marketing the Herbalife Plan and the VSM System as described above, by
14 reason of material fraudulent omissions as set forth in Paragraph 107 above.

15 173. The above-described unlawful, unfair and deceptive business practices conducted
16 by defendants present a threat and likelihood of deception to members of the VSM Class and the
17 general public, in that defendants have systematically perpetrated and continue to perpetrate
18 deceptive, unlawful and unfair acts upon members of the public by knowingly marketing the
19 Herbalife Plan and the VSM System deceptively as described above.

20 174. Pursuant to Business & Professions Code §§ 17200 and 17203, Plaintiff Adams, on
21 behalf of herself and members of the VSM Class, seek an order awarding plaintiff and members of
22 the VSM Class restitution of all monies wrongfully acquired by defendants by means of such
23 wrongful acts and practices, as permitted under California law, so as to restore any and all monies
24 to Plaintiff Adams and members of the VSM Class which are still retained by defendants, plus
25 interest, attorneys' fees and costs pursuant to, inter alia, Code of Civil Procedure § 1021.5.

26 175. Defendants' unfair competition presents a continuing threat and likelihood of
27 causing further harm to Plaintiff Adams and members of the VSM Class, such that injunctive relief
28

1 would be appropriate, in the form of an order enjoining defendants from selling, promoting or
2 condoning the sale of the Herbalife Plan or the VSM System and promotional materials.

3
4
5 **PRAYER FOR RELIEF**

6 WHEREFORE, plaintiffs request of this Court the following relief, on behalf of the
7 plaintiffs themselves and the FG Class and the VSM Class:

8 A. For an order certifying the proposed FG Class and VSM Class under California
9 Code of Civil Procedure § 382 and California Civil Code § 1781 and certifying any necessary or
10 appropriate subclasses under other relevant provisions of California Code of Civil Procedure §
11 382;

12 B. For rescission of Class members' contracts with Herbalife, FG and VSM and
13 recovery of the consideration paid by them to defendants and other amounts expended in
14 connection therewith, plus interest thereon at the contract or legal rate from the date of each said
15 purchase;

16 C. For compensatory damages for their economic losses, together with interest thereon
17 at the contract or legal rate, plus additional general and incidental damages, according to proof;

18 D. For exemplary and punitive damages for defendants' fraud, in an amount
19 commensurate with each defendant's ability to pay, which will be shown at trial;

20 E. Except as to the claims under California Business and Professions Code § 17200,
21 for disgorgement by defendants, and restitution to the plaintiff and the proposed Class, of all
22 earnings, profits, compensation and benefits obtained by defendants as a result of their deceptive
23 business practices;

24 F. For injunctive relief, as requested above, and the cessation of the Herbalife Plan and
25 the FG System in violation of applicable state law;

26 G. For costs incurred herein, including attorneys' fees to the extent allowable by law;

27 and

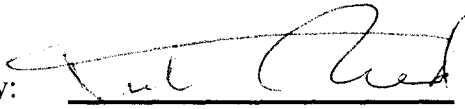
28 H. For such other and further legal and equitable relief as this Court may deem proper.

DEMAND FOR JURY TRIAL

Plaintiffs demand a trial by jury as to all issues so triable.

DATED: January 17, 2006

SCHUBERT & REED LLP

By: 

Juden Justice Reed

ROBERT C. SCHUBERT S.B.N. 62684
JUDEN JUSTICE REED S.B.N. 153748
AARON H. DARSKY S.B.N. 212229
SCHUBERT & REED LLP
Three Embarcadero Center, Suite 1650
San Francisco, California 94111
Telephone: (415) 788-4220

DOUGLAS M. BROOKS
GILMAN & PASTOR, LLP
60 State Street, 37th Floor
Boston, MA 02109
Telephone: (617) 742-9700

EDWARD L. MANCHUR
200 Broadway, Suite 304
Lynnfield, MA 01940
Telephone (781) 599-4000

Attorneys for Individual and
Representative Plaintiff Dawn Minton

SCHUBERT & REED LLP
Three Embarcadero Center, Suite 1650
San Francisco, CA 94111
(415) 788-4220

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

1 PROOF OF SERVICE BY LEXISNEXIS FILE & SERVE AND BY ELECTRONIC MAIL

2 I, the undersigned, state that I am a citizen of the United States and am employed in the City
3 and County of San Francisco, State of California; that I am over the age of eighteen (18) years and
4 not a party to the within action; and that I am employed at Schubert & Reed LLP, Three
5 Embarcadero Center, Suite 1650, San Francisco, California 94111. Pursuant to Judge Carl J. West's
6 Order Authorizing Electronic Service dated December 6, 2005, on the date set out below I served a
7 true copy of the attached **PLAINTIFF'S FIRST AMENDED AND CONSOLIDATED CLASS**
8 **ACTION COMPLAINT FOR DAMAGES AND INJUNCTIVE RELIEF** on all counsel of
9 record in this action by transmitting the document to LexisNexis File & Serve pursuant to the terms
10 of the aforementioned Order. I further state that on the date set out below I transmitted a true copy
11 of the attached document via electronic mail to all counsel of record at the email addresses given
12 below:

13 Kenneth G. Gilman, Esq.
14 Doug Brooks, Esq.
15 Gilman and Pastor, LLP
16 <kgilman@Gilmanpastor.com>
17 <dmbrooks@gilmanpastor.com>

18 Edward L. Manchur, Esq.
19 Whittenberg Knudsen, LLP
20 <elm@wealthdesign.com>

21 **Plaintiffs' Counsel**

22 Jeffrey K. Riffer, Esq.
23 Jeffer Mangels Butler & Marmaro LLP
24 <jriffer@jmbm.com>

25 **Counsel for the Freedom Lifestyles Entities and the O'Connell Defendants**

26 William Bollard, Esq.
27 Julander, Brown & Bollard, LLP
28 <william@jbblaw.us>

**Counsel for Defendants Paul Michaels, Mark
 Zuckerbrod, and Network Consultants LLC**

SCHUBERT & REED LLP
Three Embarcadero Center, Suite 1650
San Francisco, CA 94111
(415) 788-4220

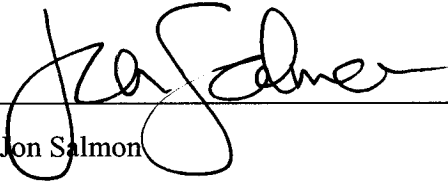
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Charles E. Patterson, Esq.
Morrison & Foerster LLP
<cpatterson@mof.com>

Counsel for the Herbalife Defendants

I declare under the penalty of perjury that the foregoing is true and correct.

Executed this 17th day of January, 2006 in San Francisco, California.



Jon Salmon