

The Courts

Magistrates Court in Akko		A 003926/96	
Before:	The Honorable Judge Hanna Lapin-Harel	Date:	27/02/2003

In the matter of:

Itzik Ralo

By his representative advocate Barlev

Plaintiff

V.

- 1. Moshe Zehavi**
- 2. Lillian Hirsch Zehavi**

By their representative advocate Haim Darash

Defendants

Judgment**Forward**

This action deals with the desire for quick “enrichment,” relations among members in a multi-level marketing organization and legal validity, if any, to an undertaking made by a “sponsor” in a company and a distributor who was recruited by him for the purpose of

distributing the products. It shall immediately be noted that the action before is dismissed.

“Herbalife” is a company that, according to its claims, distributes nutritional and plant products manufactured in high quality and standard.

The company is an American company that operates distribution networks worldwide including Israel.

The company is structured like a multi-level organization, that is to say, the products are sold by a network of independent distributors directly to the public without the mediation of shops or any other kind of retail marketing.

Distributors are rates according to a rank system. The lowest rank is “distributor” followed by a “supervisor” and then “tabulator.”

Definition of functions and the manner of obtaining them is described as follows:

1. Distributor – “you can become a distributor by ordering a distributor kit. In the first stage you will work according to a structure of 25% retail profit and you can sponsor other persons and add them as distributors so that you can advance.”
2. Supervisor – a distributor who met the supervisor qualification requirements. A supervisor can earn royalty overrides (R.O.) and works according to 50% retail profit structure.

Team member, tabulator – successful supervisors can climb the marketing structure of Herbalife. Meeting qualification requirements will entitle a supervisor with the status of tabulator.

There are 3 levels at this stage too –

1. GET – Global Expansion Team
2. Millionaire Team
3. President Team

The last three are irrelevant to the case under discussion.

The foregoing was taken from **N/11** – Herbalife Distributor Guide

The Guide also specifies the products supplied by the company, and guidelines as to how to become a distributor, rights and duties, ordering process and more.

This Guide contains additional numerous terms from which we may learn about the company's method of work, organizational structure, subordination structure, royalties and more. (concerning the case under discussion, in addition to the aforesaid terms, the terms 'sponsor' definition and duties, and 'fully qualified supervisor' are important), specification of supervisors' profit rates, different types of advice as to location of new distributors to establish a business, national and international rules of advertisement, and additional information.

The Guide contains an example of a form for a prospective distributor. The form contains two parts: the first part contains details of the candidate-applicant, details of the distributor-supervisor and sponsor details.

The second part is a "distribution agreement" which the candidate signs as a party and includes Mr. Mark Hughes, President of Herbalife, as the other party. My Hughes is founder of the company, its president and he is probably signed on all of Herbalife distribution agreements.

Plaintiff's claims

The Plaintiff was recruited by the Defendants to serve a distributor. The Defendants are supervisors and members of the international team. The Plaintiff requested to become a "supervisor distributor" and purchased from the company products in the value of \$4,000 for that purpose. The order was prepared with the help of the Defendants on 27.6.1995. A purchase in such amount entitles a candidate to become a supervisor immediately upon the start of contracting period, since it entitles the buyer with more than 4000 points required for that purpose. The advantage of being a supervisor lies in the high percentage of profit – 50% retail profit from sales.

The Plaintiff received the products yet was unable to sell and distribute them except for one kit of products sold to his girlfriend. After a few months without success the Plaintiff requested to return the products and receive his money. The Defendants refused.

The Plaintiff and the Defendants conducted “negotiations,” conversations, requests and so on as the Plaintiff wished to receive his money back.

This state of affairs lasted for the few months during which some of the products were kept in the house of the Defendants.

Part of the products was sold and their proceeds were given to the Plaintiff while some of the products were returned to the Plaintiff.

The Plaintiff testified that the Defendants were the ones who convinced him to purchase the products for a higher amount already from the start in order to receive the rank of supervisor and increase his profits. The Plaintiff was convinced and purchased products in the amount of \$4,008.

The Plaintiff testified that the Defendants undertook to guide, train, support, teach and assist him in his routine work, and even help him recruit new agents.

According to his claim, the Defendants failed to meet their promises and undertakings. Furthermore, only after signing the agreement he found out that he was on his own, and he was not an employee or a representative or an agent as specified in the ads, but self-employed. The implication of this state of affairs was that he was obligated to report his income to the VAT and income tax authorities.

The Plaintiff testified that the Defendants undertook to give him a 50% discount and instead he received a discount of only 32.25%. Once the Plaintiff, according to his claims, realized that the Defendants misled him, he returned all the stock at his disposal to the Defendants who promised to return the money within two weeks.

The money was not returned. Instead, the Defendant went to Brazil and tried to sell the products without his permission.

Once the Defendant returned after a while he paid him a small fraction of the proceeds.

He received a selection of products as security until the Defendants would supplement the amount they owed him, since this agreement was not executed the Plaintiff wrote to Herbalife that guided him as to the manner of returning the products and cancel the transaction.

The Plaintiff testified that following the intervention by a person by the name of Epstein, he received NIS 1,200 from the Defendants instead of 475 Brazilian Reals on 4.8.1996. In addition he received NIS 500 as rate of exchange differentials.

The Defendants breached their undertakings towards the Plaintiff in two levels. First, they did not guide or help him to succeed in his work. And second, they did not return his money, NIS 8,419. The balance of the original amount after reduction of the products he used himself.

The Defense

Only Defendant no. 1, Moshe Zehavi, testified on behalf of the Defendants, even though the distribution agreement states that Mrs. Lillian Hirsch is the sponsor and supervising distributor of the Plaintiff. Mrs. Lillian did not provide her testimony, regrettably.

In his affidavit Mr. Zehavi testified in his affidavit that both he and his wife (Mrs. Hirsch) were supervisors and members of Herbalife international team. In the framework of his role to recruit agents, following advertisement campaigns, the Plaintiff arrived to him. The Plaintiff arrived to a meeting set up by a number of supervisors in a lecture hall on **27.6.1995**. About 30 people attended the meeting that day and the company's method of work was explained to them.

The Plaintiff was the one who requested to become a supervisor and even though the Defendant advised him to wait a few days, the Plaintiff insisted that he wanted to become a supervisor immediately in order to increase his profits.

The Plaintiff received in this meeting a kit of products for self-consumption, a video tape containing guidance instructions and the Guide (N/11). The Defendant testified that

already in September the Plaintiff informed him that he was unable to market the products.

Consequently the Defendant attempted to help the Plaintiff and arranged a meeting in a conference hall in "Carlton" hotel yet no one showed up for the meeting.

The Defendant stated that at the Plaintiffs' request and out of a desire to help him, he agreed to keep the Plaintiff's products for a limited period of time. According to his claim, the Plaintiff made this request so that the products would not be foreclosed by the execution office. At a later stage, the Plaintiff started to demand from the Defendant to return the money paid for the products.

The Defendant agreed to sell the products for the Plaintiff in Brazil, where he went.

The Defendant returned from Brazil and in April 1996, following his return, he gave the Plaintiff 475 Brazilian Reals, the value of the products he was able to sell. The two agreed that the remaining products, in the amount of NIS 5,000 including VAT, will remain with the Defendant so that he could sell it and under the condition that if the products would not be sold, they would be returned to the Plaintiff. Mr. Zehavi denied the Plaintiff's claims that he did not receive any guidance. The opposite is true, the Plaintiff attended approximately 20 meetings that were held in his home and he made every attempt to help him market the products, yet failed.

Mr. Zehavi testified that he explained to the Plaintiff that there was a way to return the products to the company by filing a suitable application and to the best of his knowledge the Plaintiff acted in this manner.

Two persons were involved in this process of sale of the Plaintiff's products and return of money, and they are Mr. Epstein and Mr. Benny Saar. They were not summoned to testify.

As part of the defense evidence, three notes, **N/4, N/6 and N/7** were presented. When **N/6** was also enclosed that the affidavit on behalf of the Plaintiff.

N/4 is a card containing the Plaintiff's name, address and phone number, on which the following is written:

1. **1.4.96** products in the amount of NIS 5,000 remain to be sold.
 2. **10.7.96** paid on account of check for products sold 500
- Balance NIS 4,500

The signature of the Plaintiff appears on this card and the word "approved."

While giving his testimony the Plaintiff denied that the words "sold products, products instead" and the word "returned" appeared in **N/4** while he signed **it** and therefore he believed that the note was forged.

N/6 is a note dated **4.8.96**, written and signed by Mr. Epstein Arye, who exchanged 475 Brazilian Reals for NIS 1,200 and gave a check with the same amount to the Plaintiff.

Mr. Epstein wrote that 475 Reals were given by the Defendant to the Plaintiff.

N/6 bears the Plaintiff's signature which he approved.

N/7 is a note dated **10.4.96** specifying that the products in the amount of NIS 5,000 + purchase tax remained with the Defendant and the products or equivalent in value would be returned.

During a certain period between November 1995 and April 1996 the Defendant went to Brazil and took with him some of the Plaintiff's products, following the Plaintiff's consent, according to his claim, while the Plaintiff claims that this was done against his consent. The Defendant sold some of the products and gave the proceeds to the Plaintiff.

Even though the Defendant attempted to help the Plaintiff as much as he could, the Plaintiff filed the action. Then the Defendant contacted Herbalife and was physically assaulted by the Plaintiff.

The Plaintiff claimed that he was assaulted too and advocate Darash said that criminal cases were opened against the Parties for these events and were closed afterwards.

Discussion

The Plaintiff's maintains that he was deceived and understood that in order to convince other people to join the marketing network he would have to deceive them as well and therefore wished to discontinue his work. Since the Defendants undertook to return him his money and failed to do so, he filed the action against them.

The Defendants' claim is that there is no opponency between them and the Plaintiff. The agreement was with Herbalife and he could have approached them and ask them to return the products.

They were only trying to guide and assist the Plaintiff even though according to the rules they were prohibited from receiving the products from him. The Defendants feel that the Plaintiff is an ingrate. Mr. Zehavi denied that the Plaintiff prohibited him to take the products to Brazil. He was keeping the products as "a favor" since the Plaintiff was unable to eke out a living.

Mr. Zehavi testified that he retired from distribution of Herbalife products a few years ago since he found the work to be too hard and especially when he had to deliver lectures four times a week with two more evenings that were devoted to training sessions.

A binding relationship was created between the Plaintiff and the Defendants by virtue of the definitions specified in **N/1 + N/11**.

The Defendant was the sponsor, the distributor and the supervisor with relation to the Plaintiff.

The definitions provided in **N/11** were specified hereinabove as well as the duties. In the existence of a hierarchical structure consisting of rights and duties among members, a binding relationship also arises.

It transpires that there is no need of “entry exams.” And no serious professional training is required to receive the title “supervisor.” The key is money = credit points. In return for 4,008 credit points for which the Plaintiff paid after discount NIS 12,071 he became a distributor – supervisor overnight, and could already operate on his own according to the rules specified in **N/11**, become a sponsor and recruit a group of distributors under his responsibility.

It is undisputed that the Plaintiff failed in the distribution of Herbalife products.

Defendant no. 2 whose voice was not heard even though she was the official sponsor breached her undertakings towards the Plaintiff, to guide and assist him in this business. According to the testimony of the Defendant himself, he tried to help the Plaintiff by finding a lecture hall for the Plaintiff to present his products, 3 months after the Plaintiff contacted him.

And what happened during the period of 3 months??

According to **N/11** the Defendants, and especially Defendant no.2, had to assist the Plaintiff from the first moment of work.

The question is whether breach of this personal undertaking caused the Plaintiff to fail in the sale of the products and whether, due to this reason, the Plaintiff is entitled to receive the money he invested in the products.

The answer to this question is in the negative.

I was not presented with any evidence concerning this matter, demonstrating that only lack of guidance and training prevented commercial success from the Plaintiff. It is possible that his skills or lack of skills stood in his way.

The Defendant helped, or attempted to help the Plaintiff, both in storage of the products and their sale.

It transpires that the Defendant was not that successful in selling the products and therefore the method itself might not generate easy and quick profits as the Plaintiff thought.

Did the Defendants try to deceive the Plaintiff?

I do not accept the claim that the entire profit of the Defendants was 5% (unless they act in a different manner than specified in N/11). The profits specified therein can reach up to 50% and in any event any distributor that they recruit expands their organization, adds points and additional profit by definition.

I do not accept the claim that under pressure the Plaintiff ordered products worth \$4,008. The Defendants had a clear interest of increasing their profits in the event of such sale.

As said, only the Plaintiff and Defendant 1 testified before me while Mr. Epstein, Mr. Saar and Defendant 2 did not testify before me.

I am actually presented with one version against the other when none of the Parties supported his version with additional evidence even though this task was not difficult.

According to case law, a party that refrains from presenting additional evidence or summoning another witness, weakens its position and strengthens the opponent' position.

The two Parties did not provide accurate information on different issues. It is clear that the Plaintiff could have contacted the company already in September requesting to cancel the agreement with him. Why did he not do so? The Plaintiff claimed that he indeed made an oral request and requested intervention and following this intervention the Defendant agreed to help him.

The Defendant denied this statement.

No member of the company was summoned to explain the mechanism applied to cancel the agreement, if any, or to certify or reject the Plaintiff's version concerning this matter.

The written request was made by the Plaintiff after the attempt to sell the products failed.

The method of marketing reminds the "pyramid" marketing method. The difference is that in this case there are products involved.

The Honorable Judge Amit wrote about this game (the pyramid) and the fact that it is based upon a scheme involving loss to the majority of its participants. Honorable Judge Amit noted in his Judgment in **Small Claims 2929/00 (Elmakayem Haim v. Alfa Club in Small Court Haifa)** published in Magistrates Court Rulings, Volume 17 215.

The Honorable Judge Amit referred to a warning issued by the American Federal Trade Commission noting that even a marketing method based upon agents recruiting other agents is under suspicion as disguise for forbidden pyramid games, even if a product is sold or a service is rendered.

The warning is enclosed to the Judgment delivered by Judge Amit, providing some characteristics involved in the pyramid game, characteristics that should raise suspicion that a pyramid scheme is involved:

The FTC suggests that you use common sense when evaluating a multilevel marketing opportunity and consider these tips as you make your decision:

1. Avoid any plan that includes commissions for recruiting additional distributors. It may be an illegal pyramid.
2. Beware of plans that ask new distributors to purchase expensive products and marketing. These plans may be pyramids in disguise.
3. Be cautious of plans that claim you will make money through continued growth of your downline, that is, the number of distributors you recruit.
4. Beware of plans that claim to sell miracle products or promise enormous earnings.
8. Remember that no matter how good a product and how solid a multilevel marketing plan may be, you'll need to invest sweat equity as well as dollars for your investment to pay off.

Published in –

The facts concerning the manner of recruitment of the Plaintiff and probably others (for example, Mrs. Smadja) are undisputed, and a review of N/11 raises the suspicion that we are facing a “pyramid” here.

This is stated above and beyond, since the Plaintiff's representative did not raise any claims concerning this matter, not in the statement of claim or his summaries. His claims focus on the breach of the Defendants' undertakings towards the Plaintiff, concerning the sale of the products and return of the money invested.

Yet during his testimony on 19.7.01, the Plaintiff said as follows:

P. 6 line 15:

“I was convinced that method of Herbalife was wrong and I resolved to disconnect all ties with them, return the products and not become an Herbalife agent; I invested my money and saw no profits.”

And in p. 7 lines 7-10:

“...but they cannot take \$4000 from the person and tell him that if he is unable to distribute the products then ‘tough luck’ and not receive the products and give the products to other distributors. One of the reasons I stopped working in this line of business is that I cannot deceive my agents and tell them ‘invest the money’ and then ‘tough luck’ because there are also soldiers involved.”

And in page 8 lines 26-27

“A. I contacted Mr. Zehavi and asked him about it; he convinced me that with time small losses will be replaced by profits.

Q. You were convinced that you intended to become a distributor?

A. Of course. In conferences I attended they presented senior agents of Herbalife, checks and astronomical profits and a very positive economic status and anyone should become a Herbalife agent?”

Page 8, lines 26-27

“A. I refer to section 9 in my affidavit and I read from it...I lost NIS 3,600, I felt that they were dishonest and furthermore I understood that I was supposed to deceive my future agents and then with these two things combined I decided that this meant trouble, and I decided to give back the products and receive my money.”

Page 9, line 15:

“A. This is clear. I request to add these products that are of no value as of today, I did not receive any money for them until this day. I wish to present this as an Exhibit.”

I am of the opinion that if the Defendants would have fulfilled their duties towards the Plaintiff, including assistance in returning the products to the company, the dispute would not have arisen, without stating my opinion concerning the legal status of this marketing scheme being based upon the principles of the “pyramid.”

I do not ignore the testimony of Mrs. Smadja that was accepted without interrogation. Mrs. Smadja succeeded in her work. She was also recruited by the Plaintiff and received support, help and close guidance. It is unclear for how long Mrs. Smadja worked since her affidavit contains no date, and she discontinued her work about half a year before the date of signing the affidavit.

Apparently the Defendants were very successful in their work if they succeeded in become a part of the international team. Nevertheless, it is unclear whether they reached this status due to sale of the products to the public or recruiting agents and distributors like the Plaintiff and the products only to them.

The Defendant testified that he retired owing to hard work that was involved that included lectures and training sessions four times a week. Distributors are recruited in

lectures. To wit, when an actual sale to clients was involved (not agents) even the Defendant was not that successful and wanted to return the products to the Plaintiff. I assume, and this is an assumption only, that the main part of the profits was generated by recruiting agents and selling the products to agents only.

If I was presented with solid evidence that the recruitment of the Plaintiff was conducted in bad faith, there was room to act in accordance with the provisions set forth in Section 12 to the Contracts Law (General Part) 5733-1973 and charge the Defendants with compensation of the Plaintiff.

This is not the case and despite the foregoing, concerning the pyramid game it would be far reaching to assert that the Defendants intended to deceive the Plaintiff.

The Plaintiff is an adult who dealt in trade, signed the agreement out of his own free will, and entered the transaction with his eyes open. Indeed he claimed that since he was too excited he did not examine the documents yet there is no claim that he entered the agreement forcefully or under duress.

The Plaintiff himself said that even though he understood that the business was not “kosher,” he chose to continue and sell the products and not return them to the company. Therefore, his claims concerning deceit and lack of willingness to deceive others should be examined with excessive caution.

As to the alleged undertaking of the Defendant to sell the products and return him his money, I do not believe that the Defendant made such promise to the Plaintiff. Indeed, the notes N/6 and N/7 appear strange, as well as the settling of accounts between the Parties, yet I find it hard to believe that the Defendant made such promise to the Plaintiff especially when there is no hindrance to return the products to the company and receive a refund with a deduction of 10%.

In conclusion, I am not of the opinion that the Plaintiff is entitled to recover his money from the Defendants.

The action is dismissed. Under the circumstances of the matter no order for court costs is issued.

Granted today, 25 Adar A, 5763 (27 February 2003) in the absence of the Parties.

The secretariat will send a copy of the Judgment to the Parties.

Judge Hanna Lapin-Harel 54678313-3926/96

Judge Hanna Lapin-Harel, Judge

Typist: Dalia

This document is subject to wording and editorial changes