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7 UNITED STATES DISTRICT COURT
8 DISTRICT OF NEVADA

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10 FEDERAL TRADE COMMISSION,
11 Plaintiff,

12 v.

13 SEASILVER USA, INC.; AMERICALOE,
14 INC.; BELA BERKES; JASON BERKES;
15 BRETT RADEMACHER, individually, and
16 d/b/a Netmark International and
17 NetmarkPro, and DAVID R. FRIEDMAN,
18 D.C.,

19 Defendants.

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Case No: CV-S-0676 (RLH)(LRL)

INITIAL REPORT OF TEMPORARY RECEIVER

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INITIAL REPORT OF TEMPORARY RECEIVER

I.

Introduction

On June 13, 2003, this Court entered a Temporary Restraining Order (“TRO”) which, among other things, appointed me Temporary Receiver over Seasilver USA, Inc. and Americaloe Inc. (collectively referred to as “Seasilver” in this report). As detailed below, we took control of Seasilver (and a number of related holding companies) on Monday morning, June 16, 2003, when we entered each of Seasilver’s five buildings in Carlsbad, California. We immediately ceased almost all operations. On Thursday, June 19, 2003, it was necessary to lay-off approximately 450 regular employees and to terminate the Company’s arrangements with temporary staffing companies who provided the Company nearly 200 temporary employees per day. We retained only a skeleton staff to maintain minimal operations.

We have had the full cooperation of the Federal Trade Commission (“FTC”). Similarly, we have had the cooperation of defendants Bela and Jason Berkes, and, at the Berkes’ instruction, the cooperation of Seasilver employees.

We have accomplished much during the course of the last week and one-half and have satisfied a number of the assignments set forth in the TRO. Each of the major areas is addressed below.

One of the mandates of the TRO was a requirement that the Temporary Receiver make the good faith determination whether Seasilver could operate lawfully and profitably. As detailed more fully below, I feel that Seasilver can be lawfully operated under the Temporary Receiver. Similarly, it appears that the company can be operated profitably, though this determination is an imperfect prediction based upon our review of the business thus far.

The timing of this report is dictated by our view that to the extent the company will be able to resurrect and reinvent itself as a law abiding company it must do so

1 quickly. This, in turn, is compelled by two facts. First, the company's financial
2 condition, while not precarious, is not particularly powerful given outstanding
3 payables. Even with skeletal operations, it will not take long to burn through
4 remaining cash. Second, there is a substantial risk of losing the company's
5 established multi-level marketing distribution network with the passage of time. (This
6 distribution system is likely to be significantly hampered in any event because two of
7 the major distributors, David Friedman and Brett Rademcher, are defendants in this
8 case.)

9 It would appear that the TRO allows me to restart operations based on a good
10 faith determination of lawfulness and profitability. Nevertheless, in an abundance of
11 caution, and to provide the FTC and defendants an opportunity to weigh in on this
12 decision, we seek the Court's guidance. I stand ready to appear before the court
13 telephonically or in person to further this issue.

14 II.

15 The Seasilver Business

16 Corporate Structure

17 Seasilver USA, Inc. was founded in or about 1994 by defendant Bela W.
18 Berkes, Jr., who formulated the "Seasilver" product. It is a private Nevada
19 corporation, incorporated in October 1995. The stock is owned one hundred percent
20 (100%) by defendant Jason E. Berkes, son of Bela Berkes, who serves as the
21 President and CEO of the company.

22 Product

23 The company markets and makes one product - a liquid dietary supplement
24 designed and advertised as a "Foundational Health" aid. The product is sold under
25 the "Seasilver" name. It is sold in a 32-ounce bottle available in packages of 1, 3 and
26 12 bottles. Retail price per bottle is \$39.95.

1 **Employees**

2 As of June 1, 2003, the company employed approximately 487 people with a
3 monthly gross payroll of approximately \$1.7 million. Approximately 300 of these
4 employees work in the Company's telephone call center. In addition, the Company
5 employed nearly 200 temporary employees each day, primarily in the call center, all
6 of whom were provided by third party staffing companies.

7 The business was informally operated through five departments: marketing,
8 manufacturing, shipping and distribution, finance, and legal/administration. There is
9 a vice president, or equivalent, heading each department. All vice presidents report
10 to the CEO. The Company has historically maintained a generous bonus points
11 system for employees which provided bonuses to employees based on length of
12 service and gross sales.

13 **Facilities**

14 Seasilver is headquartered in Carlsbad, California where it operates from five
15 leased buildings with a total of 310,000 square feet. One of the five buildings is
16 owned by a related company. The total monthly lease obligation is approximately
17 \$350,000.

18 In general, the facilities are first rate and state-of-the-art. The Company
19 recently completed renovations and improvements to the manufacturing facility and
20 equipment totaling approximately \$7 million and another \$1 million in upgrades are
21 scheduled to be completed by December 15, 2003. The call center, which previously
22 operated 24 hours a day seven days a week, has top line telephone and computer
23 equipment to operate the most sophisticated forms of telephone sales, inbound and
24 outbound.

25 The Company also operates nine distribution centers at leased warehouses in
26 nine different states: California, Kansas, New York, Ohio, South Carolina, Texas,
27 Utah, Alaska and Hawaii.

28

1 **Sales and Distribution**

2 The product is distributed exclusively through a variation of the traditional
3 "multi level marketing" model. The company currently has approximately 300,000
4 active Independent Business Associates (IBAs), often referred to as distributors.
5 These distributors sell directly to consumers and place orders with the Company for
6 shipment directly to the consumers. A limited number of distributors (approximately
7 10 percent) purchase product for direct resale to consumers. The product is not
8 available in retail stores.

9 Distributors are incentivized through a complex bonus program which pays
10 bonuses for sales of product and for sales by their "down-line" – i.e., distributors
11 whom they recruit to the business. Seasilver pays a bonus on a distributor's down
12 line sales four levels deep. Bonus payments to IBAs for the month of May 2003, for
13 example, were approximately \$6 million. Not all IBAs qualify for monthly bonus
14 checks.

15 Seasilver has experienced rapid growth in the last two years. Gross sales for
16 the fiscal years ending May 31, 2001, 2002, and 2003 were approximately \$2.5
17 million, \$16 million, and \$97 million, respectively. Sales for the month of May, 2003
18 alone were approximately \$15 million. Gross sales for fiscal years 2002 and 2003
19 increased 527% and 533%, respectively, over the preceding year. This product sales
20 growth has been the direct result, in part, of an increase in the number of distributors
21 across the country.

22 The gross profit margin on the product is high. The business plan incorporates
23 the assumption that the gross margin on the product, inclusive of royalties at 6.25%
24 of net sales, is approximately 70%. After inclusion of distributors' bonuses, the net
25 margin is approximately 30%.

1 **Marketing**

2 The Company is presently organized and operates as a marketing company.
3 Sales growth in the last two years has resulted from increasingly aggressive
4 marketing, particularly marketing by distributors.

5 From its Carlsbad headquarters, the Company maintains a full service website
6 and provides printed brochures and other materials which are sent to end customers
7 and to distributors for their use. The Company also organizes a series of promotional
8 events designed to rally distributors, current and future. The Company does not
9 directly provide or place any media in print, radio or television.

10 The principal marketing is managed and paid for by distributors in the field.
11 They initiate a variety of promotional and marketing activities including print and radio
12 ads and extensive word of mouth selling. The largest distributors have been very
13 aggressive advertisers over the last two years.

14 **Seasilver Compliance Efforts Pre-TRO**

15 At the time I was appointed, Seasilver had an in-house general counsel and
16 had recently added an assistant general counsel. The assistant general counsel
17 purportedly had some legal compliance responsibilities, but frankly confided she had
18 not been able to assimilate the business let alone mandate any serious compliance.

19 As best we have been able to determine, there was minimal pro-active efforts
20 to comply with FTC and FDA laws and regulations. Nor was there any effort to police
21 claims made by distributors of Seasilver or to require them to comply with FTC and
22 FDA regulations.¹ The company made no efforts to monitor health claims being
23 made by distributors on their websites, their printed advertising materials, or their
24 television or radio infomercials. Moreover, up until a week before the appointment of
25 the Temporary Receiver, the company was distributing at least one pamphlet which
26 contained clearly unsupportable health claims.

27 _____
28 ¹ The general counsel did present a couple of examples of the company's efforts to police
matters brought directly to its attention.

1 The company did have Distributor Policies and Procedures, adopted in 2002,
2 which required distributors to clear advertising and marketing with the company.
3 These Policies and Procedures were not enforced, however. Indeed, it appears the
4 principals of the company acted with reckless indifference or willful blindness to the
5 distributors' marketing efforts. For example, the Berkes and the company's general
6 counsel were particularly asked about an infomercial created by David Friedman.
7 Friedman is the largest Seasilver distributor in the country and he served as a
8 member of the company's Medical Advisory Board. Friedman created an infomercial
9 in which numerous unsupported medical claims are made. In addition to personally
10 airing the infomercial, Friedman apparently sold it to other distributors who then aired
11 it extensively throughout the country. The defendants and the general counsel
12 admitted vague anecdotal knowledge of the infomercial but claimed to never have
13 heard it. The only way these explanations can be believed is to conclude these
14 individuals were acting with willful blindness or reckless indifference to what the
15 company's primary distributor, who was also a member of the company's Medical
16 Advisory Board, was doing.

17 In short, legal compliance efforts were non-existent. Perhaps even more
18 troubling, the company's culture seems one in which laws and regulations were
19 generally ignored to the extent they interfered with the company's marketing mission.
20 It appears that the general counsel's few recommendations in this area were largely
21 disregarded. For this company to reinvent itself as a law-abiding company, it must
22 make wholesale changes to its corporate culture. It must also impose on itself, or the
23 Court must impose on it (either internally or through independent monitoring), a
24 functioning compliance system.

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III.**Summary of Temporary Receiver's Actions To Date****Entry into the Seasilver Offices**

The Court appointed the Temporary Receiver on June 13, 2003. After assembling a team, which included professional security agents, investigators, forensic accountants and computer forensic experts, the Temporary Receiver took control of the Company's five buildings in Carlsbad, California, on June 16, 2003. Five FTC attorneys and officers of the Carlsbad Police Department accompanied us in the entry. We felt that this large and diverse team was necessary given the uncertainties we were facing concerning the level of cooperation of the defendants and the employees. Further, the security presence was necessary to ensure the orderly dissemination of information and the dismissal of employees without loss or destruction of Seasilver property.

The investigators were tasked with explaining the Temporary Restraining Order and, to the extent necessary, its effect to the employees through and with the assistance of the Company's department heads. Further, outside security collected the Company property in the employees' possession as they were dismissed. This process went very smoothly and all employees were cooperative. The defendants, Bela and Jason Berkes, cooperated with the Temporary Receiver's instructions and assisted in dealing with the workforce and in obtaining access to all electronic information. The Company had multiple shifts, and, as a second shift arrived, the situation was explained to them and they were dismissed. Once the dismissal was complete and the buildings were secure, much of the outside security was no longer needed, and they were dismissed Wednesday morning.

The FTC attorneys immediately began reviewing the Company records and documents as allowed by the TRO. The defendants facilitated this review. Within hours of our entry, the Company's offices were cleared, and only a skeleton crew of essential employees remained.

1 **Initial Steps Taken Upon Entry**

2 Pursuant to the Order, we immediately took steps to freeze the Company's
3 assets. In fact, members of the receivership team personally served copies of the
4 Order on local bank branches to ensure that all accounts would be frozen
5 immediately prior to entry. As we learned more information concerning the location
6 of financial assets, we took further steps to freeze those accounts as well.

7 Almost immediately after entering Seasilver, computer forensic experts
8 obtained access to the Company's servers and began shutting them down. In order
9 to further safeguard all electronic information, the limited remote access links were
10 also shut down. We were able to utilize limited computer resources to assist in
11 implementing the TRO. The Company's website was immediately shut down.
12 Finally, the computer forensic experts took digital images of the Company's servers
13 and select hard-drives in order to preserve as much information as possible. These
14 digital images will be available to both the FTC and the defendants.

15 The forensic accountant met immediately with the CFO and the accounting
16 staff to obtain a detailed listing of the Company's assets and accounts. The
17 accountant continues to follow up with the CFO to obtain further detail concerning the
18 Company's assets and payables.

19 **Contact with FTC and Defendants**

20 We are cognizant of our role as an agent of the Court and a neutral party. We
21 have attempted to keep both the FTC and the defendants informed of all action taken
22 and the status of Seasilver. Both the FTC attorneys and the defendants were
23 allowed to remain on premises after the receiver entered the premises. FTC
24 attorneys were able to complete their review of Seasilver documents on Tuesday,
25 June 17, 2003. Defendants have been offered access as and when they want to
26 meet, review documents or otherwise come to the Seasilver offices, so long as it
27 does not distract from the receiver's mission.

28

1 Defendants Bela and Jason Berkes have at all times expressed their
2 willingness to cooperate with us. They have also apparently complied with our
3 requests. However, a couple of events have come to light in the last several days
4 which lead me to question whether their cooperation is really true cooperation. First,
5 the defendants attended, without the knowledge of anyone on our staff, a distributor
6 meeting last Saturday. The defendants did not mention the meeting, either before or
7 after their attendance. I learned of the meeting – and a number of troubling claims
8 made by Bela Berkes – only by virtue of a distributor emailing me to determine if the
9 claims were true. When confronted with the fact that we learned that they had
10 attended a distributor event and made statements which were troubling, defendants
11 claimed that the meeting was not arranged by them, occurred on short notice, and
12 they attended only after speaking with their tax counsel. (They apparently did not
13 contact their FTC counsel.)

14 I also learned that the defendants are either participating in (or passing
15 information on to people coordinating) distributor conference calls. Although we had
16 several meetings in the last week and one-half, defendants did not mention that they
17 were involved in such calls. Mentioning and describing this involvement would seem
18 consistent with true cooperation. This failure is particularly troubling because when I
19 asked Jason Berkes about my ability to communicate with distributors via scheduled
20 conference calls, he was very pessimistic about this possibility. Jason told me that
21 the company had intended to begin weekly conference calls, but it had only been
22 done once at the end of May.

23 Seasilver employees have been extremely cooperative, almost without fail.²

24
25 ² The one exception involved the conduct of a Seasilver accounting consultant named Michael
26 Murray. Mr. Murray left with the vast majority of employees on Monday after our entry into Seasilver
27 offices. It later came to our attention that Mr. Murray may have taken some company documents from
28 Seasilver. Mr. Murray was subsequently asked to return to Seasilver and questioned about the
documents. He denied that he had taken any documents. I informed Mr. Murray that I did not believe
him and that I intended to ask the Court to hold him in contempt. I gave him my telephone number,
asked him to contact me if his recollection changed, and asked him to leave the building. The
following day, I received a telephone call from an attorney representing Mr. Murray, who indicated that

1 On behalf of the receivership defendants, I immediately indicated to FTC
2 counsel that I was willing to enter into a settlement with the FTC along the lines
3 reflected in the TRO. I further represented that based upon my conversations with
4 the defendants, I believed they, too, were willing enter into such a settlement and that
5 a settlement could likely be entered quickly. Counsel for the FTC was uncomfortable
6 with my role in settlement talks, because it may result in a conflict inconsistent with
7 my neutral role and because the defendants would ultimately need to enter the
8 agreement. Since time was of the essence, I determined that the attorney who had
9 been assisting the Company in regulatory matters should then be utilized by the
10 defendants, since he was familiar with the company and the defendants.
11 Accordingly, I agreed to waive any conflict on behalf of Seasilver so that this attorney
12 could represent the defendants and engage in meaningful settlement talks with the
13 FTC. I understand that the FTC and defendants are in ongoing talks. I have since
14 retained regulatory counsel to provide me independent counsel.

15 **FDA Product Seizure**

16 On Wednesday, June 18, 2003, representatives of the Food and Drug
17 Administration ("FDA") and the U.S. Marshal's office completed a court-ordered
18 seizure of the Seasilver product located at the Carlsbad facility. The seizure was
19 based on the FDA's claim that the product is mis-branded. No claims are made by
20 the FDA as to the product itself, just as to the labeling. Under terms of the seizure,
21 the Company may not move the seized product. As such, the Company has no
22 current ability to ship its current inventory of finished goods.

23 On Wednesday, June 26, 2003, the FDA completed a similar seizure at the
24 Seasilver distribution center near Cincinnati, Ohio.

25 We have attempted to facilitate the prompt resolution of the FDA claims and
26 encouraged defendants' counsel to do so. In the meantime, defendants Bela and

27
28 Mr. Murray did indeed have some Seasilver documents. The attorney arranged for the documents to
be returned to the company. This was accomplished by the end of the week. I do not intend to seek a

1 Jason Berkes have made a preliminary decision that they will not seek to recondition
2 or re-label the current product, but will permit it to be destroyed. According to the
3 Berkes, such a re-labeling and/or reconditioning of product now located in ten
4 distribution centers around the country would not be cost effective. Instead, our staff
5 has commenced development of a new label and packaging to comply with all
6 applicable FDA regulations. If and when production recommences, this new label
7 and packaging will be utilized.

8 IV.

9 Steps Taken to Comply with TRO

10 We immediately set in motion all steps necessary to comply with the TRO and
11 limitations on marketing activities.

12 Orders

13 All order taking and outbound sales activities from the Carlsbad call center
14 were terminated immediately upon our arrival on the morning of June 16, 2003.

15 Production

16 Production was immediately terminated upon our arrival on the morning of
17 June 16, 2003, except that we have permitted the completion of aloe processing from
18 deliveries of pre-paid plants; otherwise, the plants would spoil. All production of any
19 kind ceased Friday June 19, 2003.

20 Shipping

21 No product has shipped from Carlsbad since our arrival on the morning of
22 June 16, 2003. By 2:15 CT the nine off-site distribution centers in nine states closed.

23 Websites

24 The Company website was taken down entirely as of 11 am on Monday June
25 16, 2003. Approximately, 1,400 Seasilver "replicated" websites were also taken off-
26 line that morning. These websites were operated by Seasilver and had personalized
27 web addresses and contact information for individual distributors who participated in
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1 the program. These replicating websites were designed by Seasilver as smaller
2 versions of the corporate website and were identical except for the distributor's
3 contact information.

4 We then walked through the entire site with the Company's IT personnel and
5 removed all potentially objectionable materials, including: the Home Page graphic
6 box with references that Seasilver "balances, cleanses, purifies, nourishes,
7 oxygenates, protects, and strengthens"; all references to the Medical Advisory Board,
8 their biographies and their testimonials; removal of the bulk of the portion entitled
9 "Seasilver Our Product", including the banner words "safe, effective, affordable;" and
10 the sections entitled "Why Seasilver?", "Benefits of Seasilver's Foundational Health
11 Program", "Research", and "Product FAQs". The only portions remaining of the
12 Product section are: "Nutrient List" and abbreviated versions of "Proprietary
13 Ingredients" (contains only the name of the five ingredients, but no description or
14 benefits) and abbreviated "Product Price Comparison" (with any references to
15 ingredients or benefits removed).

16 The revamped website was activated at 6:30 pm on June 16, 2003, except
17 that all order placement functionality remains disabled. The replicating websites
18 have not been re-activated. The website now includes a banner entitled "FTC Files
19 Complaint" which contained a link to an electronic copy of the TRO.

20 **Recall of Product Brochure**

21 The current Product Brochure has been sequestered and will not be used for
22 any purpose. We have sent e-mail notice to all distributors with e-mail addresses to
23 cease use of that brochure immediately and to return any in inventory.

24 **Notice to Distributors**

25 The Temporary Receiver sent an e-mail notice to distributors with valid e-mail
26 addresses to cease/desist from making any health claims about the product and
27 advising them to read the Temporary Restraining Order which was available on the
28 Company website.

1 **E-mail Notice to all Operators of Independent Websites**

2 In addition to taking all replicating websites offline, the Temporary Receiver
3 emailed those independent resellers, as well as users, with valid email addresses
4 and who put Seasilver material on their own websites and asked that they take that
5 information off-line.

6 **Redesign of Labeling and Packaging**

7 Our staff, Seasilver personnel, and counsel immediately commenced revisions
8 to the Seasilver product label and packaging. The content and graphics of both will
9 be altered to insure compliance with the TRO, FDA regulations and all other
10 applicable regulations.

11 **V.**
12 **Summary of Assets and Financial Condition**

13 **[Filed Under Seal]**

14 Because Seasilver is a privately-held company, we feel that the financial
15 information should be filed under seal. Accordingly, this section is filed separately
16 and under seal.

17 **VI.**
18 **Can the Company Be Operated Lawfully and Profitably?**

19 The Court's Order empowers me to continue and conduct the business of the
20 receivership defendants subject to the receiver's "good faith determination that the
21 business can be lawfully operated at a profit using the assets of the receivership
22 estate."

23 Our preliminary conclusion is: If the FTC and FDA matters can be promptly
24 resolved by way of Consent Decree and/or Stipulated Preliminary Injunction, this
25 business can proceed lawfully. Sales and profitability will clearly be impacted by this
26 business disruption and the removal of the unsubstantiated health claims, but we see
27 no clear evidence that suggests that profitability would necessarily be impossible in
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1 the future. The chances for profitability are, however, directly related to how quickly
2 the regulatory matters can be clearly resolved.

3 Profitability will, however, be a challenge on two specific fronts:

- 4 1. The Product. The business has been built in part on unsubstantiated
5 health benefits of the product. It is unclear how well the product will fare
6 without those claims.
- 7 2. The Distribution Network. A key component of this business is a
8 zealous distribution network which believes in the product and sees
9 personal economic gain from being a distributor. A huge factor in the
10 recent sales growth has been an explosion in the number of distributors
11 who have, in turn, been the loudest disseminators of improper health
12 claims. If distributors are properly reined in, become disillusioned about
13 the product, and grow skeptical about their ability to make money, there
14 is a risk that the distribution network may slowly implode.

15 We see both of these as real challenges as the Company seeks to go forward,
16 but we have no evidence to suggest that the effort is necessarily doomed. The
17 business does possess some powerful weapons to deal with these challenges – a
18 debt-free operation, high-end facilities and infrastructure, an existing national
19 distribution network, and a business model that has, in the past, generated millions of
20 dollars of positive cash flow per month. Even if sales decline, the Company has the
21 ability to downsize facilities, staff and operations and/or diversify product offerings to
22 preserve profitability.

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VII.

Request for Court Guidance Regarding Resumption of Operations

We are taking all steps to facilitate a prompt resolution between receivership defendants and the FTC and FDA such that the Company can again lawfully sell and ship the Seasilver product. We are guardedly optimistic that such a resolution will be reached shortly. If such a resolution is reached, we will be faced with complex business issues as to whether and how to resume operations. We are in the midst of developing operational contingency plans. Before operations can be resumed, however, we need the Court's approval and further guidance. We request that the Court advise us as to how and when we can best approach the Court for that purpose.

Dated: June 26, 2003



THOMAS W. McNAMARA, RECEIVER