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UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

DOCKET NO. 9329

IN THE MATTER OF
DANIEL CHAPTER ONE, a corporation

and

JAMES FEIJO, individually and as an officer of Daniel Chapter One

ANSWERING BRIEF OF COUNSEL SUPPORTING THE COMPLAINT

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INTRODUCTION

Judge Chappell got it right. He made 425 detailed findings of fact and then applied well-established precedent to those findings. Based on those findings and conclusions, Judge Chappell issued a cease and desist Order consistent with Federal Trade Commission ("FTC") practice and precedent.

Regarding jurisdiction, Judge Chappell correctly found that Respondent Daniel Chapter One ("DCO") operates a multi-million dollar commercial enterprise, and that Respondent James Feijo ("Feijo") treats DCO's funds as his own. The ALJ correctly found that the FTC has jurisdiction over both Respondents.

Regarding the advertisements, Judge Chappell correctly found that a facial analysis of Daniel Chapter One's advertisements for Bio*Shark, 7 Herb Formula, GDU, and BioMixx (the "Challenged Products") demonstrates that Respondents made claims that their products could treat, cure, or prevent cancer, inhibit tumors, or ameliorate the adverse effects of radiation and chemotherapy. They told consumers **"How to fight cancer is your choice!"** and that the Challenged Products were "Daniel Chapter One's Cancer solution" which would "stop tumor growth" and "battle cancer." The record in this case reveals that Respondents lacked any reasonable substantiation for those claims, making those claims deceptive.

In their appeal, Respondents make no effort to demonstrate that the ALJ's Findings of Fact were not supported by the evidence. Indeed, in this advertising case, the Respondents discuss everything but the advertisements at issue. Respondents' decision to ignore their advertisements is not surprising, because the advertisements at issue make the claims alleged in the Complaint.

Similarly, Respondents make no serious effort to distinguish the legal authority relied

upon by Judge Chappell. Rather, Respondents spout rhetoric invoking Due Process and the First Amendment but ignore the long string of well-established precedents on which Judge Chappell relied and based his decision.

Respondents build their argument on a flawed foundation. Respondents premise their rhetoric on the notion that absent extrinsic evidence they can only be found liable for the exact words used in their advertisements. Respondents assert that because the claims alleged in the Complaint go beyond the exact words of their advertisements and Complaint Counsel offered no extrinsic evidence, the ALJ erred in finding that the claims alleged in the Complaint were made. Respondents ignore and fail to distinguish the well-recognized body of law (upon which the ALJ relied) finding that a court and the Commission can conduct a facial analysis of the advertisements to determine what claims were made. Indeed, rather than addressing the detailed findings of fact made by the ALJ concerning the claims made by the advertisements, Respondents simply ignore them and then complain that the ALJ adjudicated by presumption. Respondents' decision to ignore the claims conveyed by their advertisements does not make those advertisements disappear.

Respondents build upon this error in discussing substantiation. Respondents at trial proffered "experts" who were not even medical doctors, who could not and did not opine on whether DCO possessed substantiation for the claims alleged in the Complaint. Rather, DCO's experts limited their opinions to selected excerpts from some of the advertisements. The ALJ correctly noted this error, but the Respondents continue to argue in this fashion on appeal. Respondents ignore that a facial analysis of the advertisements reveals that the Respondents tout the Challenged Products as effective cancer and tumor treatments and then chastize the ALJ for relying on a world-recognized oncologist to find the claims made unsubstantiated. Respondents

ignore that the advertisements tout the Challenged Products as effective cancer and tumor treatments and argue that because no cancer treatment claims were made they need not offer the level of substantiation necessary to support such claims.

Respondents' First Amendment argument, the penthouse in this house of cards, rests on the same shaky foundation. The ALJ correctly found that because the advertisements were deceptive they were entitled to no First Amendment protection. Based on the same flawed arguments, Respondents assert that the advertisements have not been adequately shown to be false and, therefore, First Amendment protection applies.

The ALJ's Initial Decision contains detailed findings of fact well supported by the evidence and applies straight-forward and well-established law to those facts. Nothing in the Respondents' rhetoric changes that. The Initial Decision should be affirmed.[1]

STATEMENT OF FACTS

A. History of the Proceedings

On September 16, 2008, the FTC issued the Complaint in this matter. The Court held a hearing on jurisdiction on April 21, 2009. On April 22, 2009, the ALJ issued a ruling from the bench that Complaint Counsel had demonstrated, by a preponderance of the evidence, that jurisdiction exists in the case. The trial commenced on April 23, 2009 and the testimonial portion concluded on April 27, 2009. Closing arguments were heard on July 9, 2009. A total of eleven witnesses testified at the hearing on jurisdiction and at trial. In an initial decision filed on

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[1] On appeal, the Commission may make its own legal determinations and *de novo* factual findings from the hearing record. *See* 5 U.S.C. 557(b) ("On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision except as it may limit the issues on notice or by rule."); *see also* Federal Register, Vol. 74, No. 8 (16 CFR Parts 3 and 4 Rules of Practice; Final Rule) (January 13, 2009).

August 5, 2009 (the "Decision"), the ALJ found that the FTC has jurisdiction over Respondents, held that Respondents are liable under Sections 5(a) and 12 of the FTC Act, and issued a cease and desist Order.

B. Summary of the Relevant Facts

1. DCO Operated as a For-Profit Enterprise to Funnel Money to the Feijos.

DCO opened as a health food store in 1986. F. 12.[2] From 1990 to 1997, DCO was a for-profit Rhode Island corporation that was organized "[t]o engage in the sale, retail, wholesale and distribution of health products, including but not limited to health foods and supplements, namely those with special nutritive qualities and values." F. 22-27. In 2002, DCO was organized as a corporation sole under Washington state laws. F 28. James Feijo serves as DCO's overseer and trustee for all DCO assets. F. 5-6. Patricia Feijo is Respondent James Feijo's wife and DCO's Secretary. F. 7.

DCO is a multi-million dollar commercial operation run by James Feijo, who treats DCO's assets as his own to completely support himself and his family. DCO pays all of the Feijos' living expenses. F. 58. James Feijo does not have his own individual bank account. F. 76. Sometime in the mid-1990s, James Feijo stopped paying personal income taxes. F. 78, Transcript of Hearing on Jurisdiction at p. 78. Respondents do not maintain any records of how much DCO money is spent on the Feijos' living expenses. F. 59. However, it is undisputed that Mr. and Mrs. Feijo use DCO's funds so that they can (i) live in and make use of two houses, one in Florida on country club land with a pool in the back; and (ii) drive two Cadillacs. Moreover, Complaint Counsel obtained banking records showing that James Feijo has frequently used an

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[2] "F. _" refers to the ALJ's Findings of Fact set forth in the Decision at pp. 6-66.

American Express Business Gold Card, in the names of Daniel Chapter One and Patricia Feijo, to which Mr. Feijo is also a signatory, to eat at restaurants, play golf on a regular basis, purchase golf club memberships, and purchase cigars and other retail items. F. 64-66. Approximately $9,936 was charged for golf expenses on DCO's American Express Business Gold Card from December 2005 through March 2009, F. 67; approximately $14,024 was charged for restaurant expenses, F. 68; approximately $28,582 was charged for automobile expenses, F. 69; and approximately $1,077 was charged to buy cigars. F. 70. The Feijos incurred expenses eating at restaurants such as PF Changs and the Cheesecake Factory despite the fact that the Feijos claim that the name for DCO comes from the Book of Daniel in the Old Testament of the Bible in which Daniel and his men were held in captivity and were expected to eat the king's very rich diet of meats and wine, but instead ate and drank only pulse and water. F. 17, Complaint Counsel's Exhibit ("CX") 48.

The Feijos' lifestyle is funded by the 150-200 products DCO sells to consumers, including the Challenged Products. F. 8. Over one thousand consumers have purchased DCO's products. F. 81. DCO has generated approximately $2 million in annual sales for 2006, 2007, and 2008. F. 9, 80. Respondents' sales of the Challenged Products constitute 20 or 30 percent of these annual sales. F. 80. The DCO products are expensive. An FTC investigator, Michael Marino, purchased one bottle of each of the Challenged Products which together cost $175.75. F. 147-57. Nothing on the DCO Website indicated to the FTC's investigator that a consumer would have to be part of any religious community in order to purchase the Challenged Products, or that they could be obtained in exchange for a "donation," purchased at a reduced price, or received for free. F. 149-50.

2. Respondents Advertised That The Challenged Products Could Prevent, Treat, or Cure Cancer and/or Tumors Without Any Scientific Substantiation for Such Claims.

Respondents disseminate information about the Challenged Products to the public through a variety of media, including the Internet, written publications, and a radio show. F. 158. Any consumer can be directed to the DCO Website by entering the term "cancer" in a Google search. F. 162. Respondents prey upon desperate, sick consumers suffering from cancer.

Respondents represent in their advertisements and promotional materials that the Challenged Products are effective in preventing, treating, or curing cancer or tumors. Respondents encourage consumers who "suffer from any type of cancer" "**to buy the products**" they describe as **"Daniel Chapter One's Cancer solutions,"** assuring consumers that **"How to fight cancer is your choice!"** F. 180 (bold in original). They tout the Challenged Products as products that "stop tumor growth," "fight[] tumor formation," "battle[] cancer," and "eliminate[] pre-cancerous growth." F. 180, 182, 184, 221-23, 226, 229, 234, 238-41, 253, 266, 283. Their "Cancer News webpage" refers to specific cures and products – "Dad's throat cancer cured – 7 Herb and more," "Nancy – Cured Breast Cancer in 3 months – 7 Herb and GDU," and "Robert – Prostate cured from DC1 products." F. 187.

Indeed, Respondents initially admitted in their answer that they made the following health and disease claims about the Challenged Products:

a. Bio*Shark inhibits tumor growth;

b. Bio*Shark is effective in the treatment of cancer;

c. 7 Herb Formula is effective in the treatment or cure of cancer;

d. 7 Herb Formula inhibits tumor formation;

e. GDU eliminates tumors;

f. GDU is effective in the treatment of cancer;

g. BioMixx is effective in the treatment of cancer; and

h. Bio Mixx heals the destructive effects of radiation and chemotherapy.

Respondents' Answer at ¶ 14.

Respondents did not conduct or direct others to conduct any scientific testing of the effects of the Challenged Products, and offered no evidence of any such testing having been performed by others. F. 308. Instead of relying upon scientific testing to substantiate their advertising claims, Respondents claimed that they relied on personal observations, customer testimonials, and a variety of books, magazines, and articles about how certain substances in the Challenged Products could be utilized. F. 316-18. Their proffered experts were not medical doctors and had no specialized training or experience regarding cancer or cancer treatment. F. 335-337. Even Respondents' purported experts admitted, however, that because the Challenged Products have not been tested, their effectiveness in the prevention, treatment, or cure of cancer is not known. F. 364.

ARGUMENT

I. THE ALJ CORRECTLY CONCLUDED THAT THE FTC HAS JURISDICTION OVER RESPONDENTS.

In determining whether an allegedly nonprofit corporation is within the jurisdiction of Section 4 of the FTC Act, the FTC essentially looks to (i) whether the corporation is "organized for and actually engaged in business for only charitable purposes" and (ii) whether the corporation derives any profit for itself or its members. Respondents argue that "[i]n its organization and operation, DCO is a not for profit religious organization and as such is not

subject to the jurisdiction of the Federal Trade Commission." Respondents' Appeal Brief at 31 ("Resp't Br."). However, the undisputed facts here demonstrate that DCO is a business organized to sell its expensive products to the public that uses the profits it makes from such sales to fund the Feijos' personal living and entertainment expenses. This "profit" to the Feijos puts Respondents squarely within the FTC's jurisdiction.

A. The FTC Has Jurisdiction Over Corporations Engaged in Business for Their Own or Their Members' Profit.

Section 5(a)(1)-(2) of the FTC Act grants the FTC the authority to "prevent unfair or deceptive acts or practices in or affecting commerce" by "persons, partnerships, or corporations." 15 U.S.C. § 45(a)(1)-(2) *cited in* Decision at 69. Section 4 of the FTC Act defines "corporation" in part as "any company, trust, so-called Massachusetts trust, or association, incorporated or unincorporated, ...without shares of capital or capital stock or certificates of interest, except partnerships, which is organized to carry on business for its own profit or that of its members." 15 U.S.C. § 44 *cited in* Decision at 69. Courts and the Commission have consistently held that any entity organized as a nonprofit is within the jurisdiction of the FTC if the entity in fact engages in business for its own profit or that of its members. Decision at 69 *citing Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 766-67 (1999); *Cmty. Blood Bank v. FTC*, 405 F.2d 1011, 1017 (8th Cir. 1969). In *Community Blood Bank*, the seminal case concerning jurisdiction under the FTC Act, the Court of Appeals explained that "under § 4 the Commission lacks jurisdiction over nonprofit corporations without shares of capital, which are organized for and actually engaged in business for only charitable purposes, and do not derive any 'profit' for themselves or their members within the meaning of the word 'profit' as attributed to corporations having shares of capital." 405 F.2d at 1022 *quoted in* Decision at 69.

Commenting on *Community Blood Bank*, the Commission stated: "The court thus established a two-pronged test looking both to the source of the [entity's] income, *i.e.*, to whether the corporation is 'organized for and actually engaged in business for only charitable purposes,' and to the destination of the income, *i.e.*, to whether either the corporation or its members derive profit." Decision at 69 *quoting In re Coll. Football Ass'n*, 117 F.T.C. 971, 994 (1990). Under *College Football Association*, either prong of the test provides a basis for establishing jurisdiction. *See* 117 F.T.C. at 993 ("[w]hile we agree that the distribution of funds to private persons or for-profit companies as opposed to their use for 'recognized public purposes' is one basis for finding an entity to be organized to carry on business for . . . profit,' we conclude that the source of the income provides another basis for such a finding . . .").

As correctly found by the ALJ based on a preponderance of the evidence, (i) DCO is not a business organized or engaged in only charitable purposes and (ii) DCO engages in business for its own profit or that of its members.

B. DCO Operates as a Commercial Enterprise and is Not a Business Organized or Engaged in Business For Only Charitable Purposes.

1. Respondents Operate a Commercial Enterprise, Not a Charitable Organization.

While Respondents continue to assert that DCO is a not-for-profit religious organization, Resp't Br. at 31, the evidence demonstrates that DCO operates as a commercial enterprise. DCO was incorporated as a *for-profit* corporation from 1990 to 1997 and sold the Challenged Products during the 1990s. F.12-13, 22-23, 27. Indeed, DCO's Articles of Incorporation during this period stated that DCO was organized as a for-profit corporation: "To engage in the sale, retail, wholesale and distribution of health products, including but not limited to health foods and supplements, namely those with special nutritive qualities and values." Decision at 70 *citing* F.

23. In 2002, DCO changed its corporate form to a corporation sole and continued to sell the Challenged Products. Decision at 70 *citing* F. 8-9, 28. However, this change in form did not alter DCO's commercial nature.

Indeed, as noted by the ALJ, Respondents have generated approximately $2 million in annual sales for the years 2006, 2007, and 2008 for DCO's nearly 200 products. Decision at 70 *citing* F. 9. Respondents' sales of the Challenged Products constitute twenty or thirty percent of these annual sales. *Id. citing* F. 80. While Respondents claim that they "maintain a charitable program that allows anyone to obtain products for free," they failed to provide any documents to indicate whether and how much of DCO's products they have given away. Resp't Br. at 30; Decision at 73 *citing* F. 54. Instead, the ALJ found that Respondents charge consumers three to ten times what it costs DCO to purchase the Challenged Products from manufacturers. Decision at 70 *citing* F. 83, 127-29, 140-42, 144-46. DCO has a toll-free phone number and a call center and operates websites through which consumers may purchase DCO products. *Id. citing* F. 84, 99, 103-04. DCO also sells its products through stores in several states and through various distributors, including chiropractic centers. *Id. citing* F. 116-19. The DCO Website invites consumers to shop at DCO's "On-Line Store" and the "About Us" section on the website describes the company as a "health food store" or "health food supplement store." *Id. citing* F. 32, 105. Michael Marino, an FTC undercover investigator, purchased the Challenged Products from the DCO Website for $175.75. F. 147, 157. Nothing on the DCO Website indicated that the Challenged Products could be obtained in exchange for a donation, purchased at a reduced price, or received for free. F. 149. After purchasing the products, Marino received an email thanking him for his purchase and offering a ten percent discount on a subsequent purchase. F. 152. In their Websites and brochures, Respondents compare their products to those of their

competitors. (DCO Website stating: "Daniel Chapter One is the first and only company to add Siberian ginseng to the formula"). Decision at 70 *citing* F. 137-38.

Finally, Respondents' unsupported assertion that DCO operates at a breakeven point or less does not allow them to evade jurisdiction. Resp't Br. at 35. First, as the ALJ found, DCO's revenues apparently exceeded its expenses, since DCO was able to completely support two individuals and their homes (see *infra* pp.15-16) and to maintain surpluses of hundreds of thousands of dollars for extended periods of time in various accounts.[3] Decision at 70-71 *citing* F. 42-45. Second, a showing that DCO was successful in running its business is not required for jurisdiction to exist. *See Cal. Dental*, 526 U.S. at 768 n.6 ("It should go without saying that the FTC Act does not require for Commission jurisdiction that members of an entity turn a profit on their membership, but only that the entity be organized to carry on business for members' profit"); *In re Ohio Christian (of Calvary Grace Christian Churches of Faith, Inc.)* 80 F.T.C. 815, 849-50 (1972) (stating that the fact that respondents "were apparently not very successful in their enterprise was of 'little consequence'").

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[3] Respondents destroyed documents and failed to comply fully with discovery requests regarding their finances, even after being ordered to do so. Accordingly, Complaint Counsel asked for an adverse inference that the information sought from Respondents in discovery would have defeated Respondents' nonprofit argument. The ALJ concluded, that "[a]lthough an adverse inference in this case may have been appropriate, it is not necessary here, because the facts are sufficient to demonstrate that DCO operated as a business for its own profit or that of its members." Decision at 71 n.2. The ALJ found that (i) James Feijo did not change DCO's policy of not maintaining records after learning that the FTC had brought a proceeding against him and DCO; (ii) DCO did not change its document retention policies after receiving the Court's first and second orders to produce certain documents to Complaint Counsel; (iii) James Feijo had the authority to change DCO's document retention policies after being ordered to produce responsive documents to Complaint Counsel; and (iv) DCO continued to discard documents, even after the ALJ ordered Respondents to produce certain documents to Complaint Counsel. F. 50-53.

2. DCO is Not a Business Organized for Only Charitable Purposes.

In arguing that the FTC lacks jurisdiction, Respondents rely heavily on DCO's organization as a corporation sole under the laws of the State of Washington.[4] Decision at 71. However, courts and the Commission look to the substance, rather than the form, of incorporation in determining jurisdiction under the FTC Act. *See* Decision at 71, *citing Cmty. Blood Bank*, 405 F.2d at 1019 ("mere form of incorporation does not put [an entity] outside the jurisdiction of the Commission"). As the ALJ properly found, "[r]egardless of DCO's form of incorporation, the evidence shows that DCO bears none of the substantive indicia of a corporation that is truly organized only for charitable purposes." Decision at 71.

DCO's Articles of Incorporation do not declare that DCO was organized exclusively for charitable or other clearly nonprofit purposes, but instead include provisions permitting "other worthwhile projects for the common good of Daniel Chapter One at large." Decision at 73 *citing* F. 29-30. DCO's Articles of Incorporation, unlike those in *Community Blood Bank*, also do not provide for distribution of its assets upon dissolution solely to other nonprofit entities or prohibit distribution of its earnings to the benefit of any individual or for-profit corporation. Decision at

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[4] According to an IRS Revenue Ruling, "[a] 'corporation sole' is a corporate form authorized under certain state laws to enable *bona fide* religious leaders to hold property and conduct business for the benefit of the religious entity." Rev. Rul. 2004-27, I.R.B. 2004-12 (March 22, 2004), *available at* http://www.irs.gov/irb/2004-12_IRB/ar11.html. A proper corporation sole may own property and enter into contracts, but only for the purposes of that religious entity and not for the incorporator's personal benefit. *Id.* A corporation sole does not receive special status under the federal tax laws unless it qualifies as a § 501(c)(3) entity with the IRS. *See id.* The IRS has warned that corporations sole are often not used for their intended purpose and have instead become vehicles for tax evasion. *See e.g.,* IRS Rev. Rul. 2004-27. Earlier this year, Washington State passed a bill that banned the formation of corporations sole after August 1, 2009, and requires existing corporations sole registered with the state to file annual reports. The Washington Secretary of State explained that "[t]he entity has been reserved for churches and religious societies but has seen a significant amount of abuse over the years by individuals using the corporation sole designation for tax evasion purposes." http://www/secstate.wa.gov/corps/CorporationSoleLegislativeChanges.aspx.

73 *citing* F. 30.[5]

In addition, DCO is not registered with the Internal Revenue Service as a tax-exempt organization under Section 501(c)(3) or any other section of the IRS Code. Decision at 71 *citing* F. 31.[6] Respondents contend that it is immaterial for jurisdictional purposes that DCO does not have a Section 501(c)(3) tax exemption because they claim that churches do not need to obtain such an exemption, pursuant to Section 508(c)(1)(A) of the IRS Code. *See* Decision at 72. However, as explained by the ALJ, "[c]ontrary to Respondents' argument, Section 508(c)(1)(A) exempts churches from certain notice requirements applicable to other entities seeking to obtain a Section 501(c)(3) tax exemption, and has no bearing on the issue of FTC jurisdiction." Decision at 72. The ALJ further explained that because DCO distributes funds for the use of both James and Patricia Feijo, private individuals and DCO's corporate officers (discussed below), DCO would not qualify as a tax-exempt nonprofit corporation under either the Internal Revenue Code or laws of the State of Washington. Decision at 73 *citing* 26 U.S.C. § 501(c)(3) and Rev. Code Wash. § 24.03.005.

In their brief, Respondents, for the first time in this action, point to several additional sections of IRS Code for the proposition that certain church-related income is exempt from federal income taxes. Resp't Br. at 38-40. Respondents also raise for the first time an IRS Code

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[5] Article 8 of DCO's Articles of Incorporation evidences that DCO somehow believes it is sovereign from the United States of America. *See* CX 31 (DCO's Articles of Incorporation). This belief manifests itself in DCO's and Feijo's failure to pay taxes and apparent belief that they may disregard the laws of this country with impunity.

[6] In evaluating the FTC's jurisdiction, "[t]he Commission has long recognized that while the terms employed in other statutes and interpretation adopted by other agencies are not controlling, the treatment of exemptions for nonprofit corporations by other branches of the Federal Government is helpful." *See* Decision at 72 *quoting In re College Football Ass'n*, 117 F.T.C. at 994 (citations omitted).

section and a Treasury Regulation relating to the Minister's Parsonage Allowance[7] arguing that, pursuant to this allowance, "DCO funds used for James Feijo's home and other incidentals are not income to him," and "as a matter of law, those funds do not inure to his benefit and thus under no circumstances could be considered profit." *Id.* at 40. Respondents also state that, "[v]ery clearly, the ALJ did not consider these provisions to any extent whatsoever." *Id.*

First, the ALJ is not required to raise and consider *sua sponte* any provisions in the tax code that apply to churches and ministers for the purposes of determining Respondents' jurisdiction. Second, Respondents have not in any way established that these IRS Code sections or Treasury Regulations apply to them, let alone that they would change the ALJ's ultimate ruling that the FTC has jurisdiction in this case. Third, while undoubtedly there are certain circumstances under which legitimate church-related income and the rental value of parsonages are excluded from gross income, nothing suggests that the provisions cited to by Respondents were intended to exempt Florida vacation homes, Cadillacs, golf club memberships, tennis lessons, cigars, and expensive restaurant meals from the tax laws. The ALJ expressly found that "[t]his contribution of funds to the Feijos defeats Respondents' claim that DCO is operated exclusively for charitable purposes." Decision at 73.

C. DCO Engages in Business for its Own Profit or That of its Members.

As explained by the ALJ, "whether Respondent DCO is a ministry is not dispositive in determining the FTC's jurisdiction over Respondent's activities. Instead, the pivotal inquiry is whether Respondent DCO engaged in business for its own profit or that of its members." *See*

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[7] Section 107 of the Internal Revenue Code and Treasury Regulation § 1.107-1 relate to the exclusion from gross income of the rental value of parsonages (the home furnished to a minister as part of his compensation).