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CLERK, U.S. DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA

1 LAZARE POTTER & GIACOVAS LLP  
ROBERT A. GIACOVAS, ESQ. (*Pro Hac Vice* Application Pending)  
2 LAINIE E. COHEN, ESQ. (CSB# 216726)  
950 Third Avenue, 15<sup>th</sup> Floor  
3 New York, New York 10022  
Telephone: (212) 758-9300  
4 Facsimile: (212) 888-0919

BY: *MTB* DEPUTY

5 NEIL, DYMOTT, FRANK, McFALL & TREXLER APLC  
MICHAEL I. NEIL, ESQ. (CSB# 40057)  
6 HUGH A. McCABE, ESQ. (CSB# 131828)  
DAVID P. HALL, ESQ. (CSB# 196891)  
7 1010 Second Avenue, Suite 2500  
San Diego, California 92101  
8 Telephone: (619) 238-1712  
Facsimile: (619) 238-1562

9 Attorneys for Plaintiffs, MEDIFAST, INC.,  
10 and BRADLEY MacDONALD

11  
12 UNITED STATES DISTRICT COURT  
13 SOUTHERN DISTRICT OF CALIFORNIA  
14

15 MEDIFAST, INC., a Delaware Corporation,  
and BRADLEY MacDONALD, an individual,

CASE NO. 10 CV 0382

JLS WMC

16 Plaintiffs,

COMPLAINT FOR:

17 v.

(1) DEFAMATION;

18 BARRY MINKOW, an individual; FRAUD  
19 DISCOVERY INSTITUTE, INC., a California  
corporation; ROBERT L. FITZPATRICK, an  
20 individual; TRACY COENEN, an individual;  
SEQUENCE, INC., a Wisconsin service  
21 corporation; WILLIAM LOBDELL, an  
individual; iBUSINESS REPORTING, a  
22 California business organization of unknown  
form; and 'ZEEYOURSELF', an individual,

(2) VIOLATIONS OF CALIFORNIA  
CORPORATIONS CODE  
SECTIONS 25400, et seq.;

(3) UNFAIR BUSINESS PRACTICES  
(CAL. BUS & PROF. CODE  
SECTIONS 17200, et seq.)

DEMAND FOR JURY TRIAL

23 Defendants.  
24

25 INTRODUCTION

26 Plaintiffs, Medifast, Inc., and Bradley MacDonald (hereinafter "Plaintiffs"), for their  
27 Complaint against Defendants Barry Minkow (hereinafter "Minkow"), Fraud Discovery Institute,  
28 Inc. (hereinafter "FDI"), Robert L. FitzPatrick (hereinafter "FitzPatrick"), Tracy Coenen

CR

1 (hereinafter "Coenen"), Sequence, Inc. (hereinafter "Sequence"), William Lobdell (hereinafter  
2 "Lobdell"), iBusiness Reporting (hereinafter "iBiz") and 'zeeyourself' (hereinafter "Zee")  
3 (collectively "Defendants"), alleges as follows:

4 **NATURE OF THE ACTION**

5 1. This action arises out of the defamatory statements made, repeated and perpetuated  
6 by Defendants through their respective websites and blog postings – frauddiscovery.net;  
7 medifraud.net; sequence-inc.com/fraudfiles; ibizreporting.com; and the Yahoo! Finance message  
8 board – that began on February 17, 2009, with the posting by Minkow and FDI of the false and  
9 defamatory 'Expert Report on Take Shape for Life, a Division of Medifast, Inc.,' (hereinafter the  
10 "Report" a copy of which is attached hereto as Exhibit 1, and incorporated by reference as if fully  
11 set forth herein) drafted by FitzPatrick, at the direction of Minkow and FDI, as their retained  
12 'expert.'

13 2. In his Report, which on information and belief was completed on September 15,  
14 2008, but first published on February 17, 2009, on the FDI website, FitzPatrick falsely, and without  
15 any basis in fact, accused Plaintiffs of running a Ponzi scheme, and a pyramid scheme; has likened  
16 Plaintiffs to Bernie Madoff; and accused Plaintiffs of violating California Penal Code, Chapter 9, §  
17 327, the "Endless Chain" statute.

18 3. Defendants, and each of them have perpetuated the false and defamatory statements  
19 and opinions of FitzPatrick, and adopted them as their own, by republishing his alleged findings on  
20 their own websites, and through their own postings containing similarly defamatory statements, on  
21 various message boards within the internet community, in a scheme to drive down the stock price of  
22 Medifast, in order that Defendants may make huge profits by short-selling Medifast stock in the  
23 wake of their defamatory attacks on Plaintiffs' otherwise stellar reputations.

24 4. As a result of these baseless and defamatory attacks, which have continued to grow  
25 over the past year, and continue relentlessly on a daily basis, Plaintiffs have suffered and will  
26 continue to suffer damages to their professional and personal reputations.

27 ///

28 ///

**THE PARTIES**

1  
2           5.       Plaintiff, Medifast, Inc. is a Delaware corporation with its principal place of business  
3 at 11445 Cronhill Drive, Owings Mills, Maryland, 21117. Medifast stock trades on the New York  
4 Stock Exchange (“NYSE”) under the symbol “MED.”

5           6.       Plaintiff, Colonel Bradley T. MacDonald (Ret.) is an individual domiciled in the  
6 state of Florida, and residing at 3800 N. Ocean Drive, #1250, Singer Island, Florida 33404.  
7 MacDonald is the the Executive Chairman of the Board of Medifast, a Medifast shareholder, and  
8 was the co-founder of Take Shape For Life, Inc. (“TSFL”), Medifast’s direct sales division, and the  
9 subject of the defamatory statements made by Defendants. His name and professional reputation  
10 are intricately linked with Medifast and TSFL.

11           7.       Defendant, Barry Minkow is an individual domiciled in the state of California, and  
12 on information and belief, residing at 181 Calla Avenue, Imperial Beach, California, 91932.

13           8.       Defendant, Fraud Discovery Institute, Inc. is a California corporation with its  
14 principal place of business at 9747 Business Park Avenue, #218, San Diego, California, 92131.

15           9.       Defendant, Robert L. FitzPatrick is an individual domiciled in the state of North  
16 Carolina, and on information and belief, residing at 2808 Park Road, Charlotte, North Carolina,  
17 28209. FitzPatrick was directly retained by Minkow and FDI to prepare the Report and was paid  
18 for his services.

19           10.      Defendant, Tracy Coenen is an individual domiciled in the state of Wisconsin, and  
20 on information and belief, residing at 316 Milwaukee Street, # 416, Milwaukee, Wisconsin, 53202.

21           11.      Defendant, Sequence, Inc. is a Wisconsin service corporation with its principal place  
22 of business at 111 E. Wisconsin Avenue, #1230, Milwaukee, Wisconsin, 53202. On information  
23 and belief, Coenen and her company, Sequence, Inc. have been retained by Minkow and FDI on  
24 several occasions to aid in the targeted investigations of publicly-traded companies for alleged  
25 fraud, thus directly targeting their services to a California domiciliary for their own profit.

26           12.      Defendant, William Lobdell is an individual domiciled in the state of California, and  
27 on information and belief, residing at 476 Broadway, Costa Mesa, California.

28



1 product line with the support of health coaches and certified health advisors, TSFL is a simple,  
2 convenient means for people to lose weight and maintain a healthy lifestyle.

3 21. TSFL works on a philosophy called the Trilogy of Optimal Health. As stated on the  
4 TSFL website, Optimal Health can be broken down into three critical areas of life:

5 Healthy Body - physical health is the foundation of a happy and fulfilling life. Achieving a  
6 healthy body requires two things: 1) reaching a healthy weight using Medifast Meals, and 2)  
7 adopting the BeSlim philosophy which incorporates six core behaviors to help attain and  
8 maintain Optimal Health.

9 Healthy Mind - how we feel about ourselves also affects long term Optimal Health. Through  
10 personal development, learning ways to release stress, and creating time for ourselves, we  
11 take control of our lives. That sense of freedom breeds happiness - another key to Optimal  
12 Health.

13 Healthy Finances - debt causes stress - and stress can take a severe toll on both your  
14 physical and mental health. By managing and eliminating debt, learning ways to budget, and  
15 or seizing financial opportunities, you further yourself on the road to Optimal Health.

16 22. Anyone can purchase Medifast products without the use of a health coach, by going  
17 to the Medifast website and placing an order.

18 23. If a Medifast customer is interested in obtaining the additional benefits of having a  
19 personal health coach to provide counseling, mentoring and support, he/she can do so by contacting  
20 a health coach through the Medifast website, at which point he/she will become a TSFL client, and  
21 be entitled to all of the benefits of the program, inclusive of the same access to Medifast's products.

22 24. However, many TSFL clients began with the TSFL program upon the  
23 recommendation of a friend or loved-one – someone who had tried TSFL and found success with  
24 the program, and decided to help others obtain similar success by either becoming a health coach,  
25 or by simply recommending the TSFL program.

26 25. As the Optimal Health philosophy indicates, beyond a weight-loss program, TSFL  
27 also offers its clients an opportunity to increase their income if they choose to become a TSFL  
28 health coach. A TSFL client can become a health coach by executing a Health Advisor Application  
and Agreement, and by purchasing either the Application Pak or Career Builder Pak for a one-time  
cost of \$199.

29 26. As stated in Medifast's Form 10-Qs filed with the Securities and Exchange  
Commission ("SEC") and on the TSFL website, becoming a health coach is a business opportunity

1 that has a low cost of start-up and requires no holding of inventory, as all orders are shipped to the  
2 end consumer directly from the company. No TSFL health coach is ever required to purchase  
3 Medifast product up front with his or her own funds.

4 27. Health coaches receive training in how to counsel and support their clients, and must  
5 pass a test in order to begin coaching clients. Training and support are continually available  
6 throughout a health coach's career with TSFL.

7 28. Once certified, health coaches can sell Medifast products to others, and can also, if  
8 they choose to, recruit other health coaches to join their team. Health coaches are not only sales  
9 people, but provide all of their clients with personal counseling, mentoring and support as long as  
10 they are on the Medifast program, a vital component of TSFL's success as a weight-loss program,  
11 and what differentiates TSFL from other weight-loss programs.

12 29. The average 28-day supply of Medifast dietary supplements, sold in bundled paks,  
13 currently retails for \$299.50. Each pak contains approximately 143 meals, for a total cost of \$2.09  
14 per meal. At five meals a day on the Medifast system, that totals \$10.35 per day in cost to the  
15 consumer. The counseling, mentoring and support of the TSFL health coach are included free.

16 30. A detailed description of the TSFL business model and explanation of the basis for  
17 its continuing success is incorporated into Medifast's Form 10-Q reports filed with the SEC, and are  
18 publicly available.

19 31. Health coaches receive commissions based upon the amount of Medifast food  
20 products they sell to either non-health-coach clients, or to other health coaches. They do not  
21 receive compensation as a result of their recruitment of other new health coaches. The only benefit  
22 that health coaches receive from recruiting additional health coaches is a residual commission on  
23 sales of Medifast products by the recruited health coaches.

24 32. In other words, all commissions earned are based on actual sales of actual Medifast  
25 products to actual consumers.

26 33. Only approximately 1% of TSFL's total revenue is derived from sales of the health  
27 coach application packages. The remainder is derived from product sales. In other words,  
28

1 Medifast's revenue as reported to the SEC reflects actual sales of actual products to actual  
2 customers.

3 34. As reported in Medifast's 10-Qs to the SEC, at the end of the second quarter 2009,  
4 there were approximately 4,650 active health coaches; by the end of the third quarter 2009, that  
5 number had increased to approximately 5,800.

6 35. As the 10-Qs state, growth in TSFL revenues was driven by increased customer  
7 product sales as a result of an increase in more experienced, active health coaches – bigger sales  
8 force = higher sales.

9 36. According the the Center for Disease Control ("CDC"), over one-third of American  
10 adults – more than 72 million people – are obese; sixteen percent of American children are obese.

11 37. According to the CDC, as of 2007 (the most recent year for which data is available),  
12 23.6 million Americans suffer from diabetes; 1.6 million new cases of diabetes are diagnosed each  
13 year; in 2007, 57 million Americans were considered to have "pre-diabetes."

14 38. Medifast and TSFL are specifically targeted to combat these negative trends in  
15 American society and help America get healthy and stay healthy.

16 **Minkow's Get-Rich Scheme:**

17 39. Defendant, Barry Minkow is an ex-felon who was convicted on 57 counts of  
18 securities fraud, and sentenced to 25 years in federal prison, of which he served seven. On  
19 information and belief, Minkow is still paying off a restitutionary judgment of more than \$9 million  
20 to the victims of his crimes.

21 40. Minkow founded FDI approximately five years ago. FDI purports to be a fraud  
22 investigation company, but as the FDI website and Minkow's public statements make clear, the  
23 prominent purpose of FDI is to make money by taking short positions in target companies' stocks.

24 41. FDI targets a publicly traded company and alleges to conduct a private investigation  
25 of that company, seeking evidence of alleged fraud. While investigating, Minkow and his  
26 associates take a short position in the target company's stock.

27 42. A short position is defined as when a person "borrows" stock from a third party, and  
28 warrants to the stock lender that the loan will be covered at a later date. A person "borrows" stock

1 from a lender when the price is high, sells the “borrowed” stock high, and then gambles that the  
2 price will drop before the loan is due, in order to re-purchase the “borrowed” shares at a lower  
3 price, thus making a profit in the deal.

4 43. By taking a short position, and then releasing the negative results of his investigation  
5 on the FDI website, posting video clips on YouTube, creating websites dedicated to bashing a target  
6 company (such as www.medifraud.net), getting his associates such as Coenen and Lobdell (among  
7 others) to repeat his false allegations of fraud on their websites, Minkow, FDI and their associates  
8 are able to reap huge profits when the target company’s stock plummets as a direct result of their  
9 false and defamatory, and very public attacks.

10 **The First Attack:**

11 44. On February 17, 2009, Minkow, FDI and FitzPatrick first published FitzPatrick’s  
12 Report on the FDI website – www.frauddiscovery.net – and launched their new website –  
13 www.medifraud.net (Exhibit 2 attached hereto and incorporated by reference as if fully set forth  
14 herein). Posted on the medifraud website, were four other defamatory documents including a  
15 memo entitled “Points of Similarity Between Madoff and Medifast” (Exhibit 3 attached hereto and  
16 incorporated by reference as if fully set forth herein); an FDI Press Release (Exhibit 4 attached  
17 hereto and incorporated by reference as if fully set forth herein); Lab reports from Bodycote Testing  
18 Group, purporting to find lead in certain of Medifast’s products and a letter from attorney  
19 Christopher E. Grell regarding the alleged lead content (Exhibit 5 attached hereto and incorporated  
20 by reference as if fully set forth herein).

21 45. Minkow also posted a video of himself on YouTube, making all of the same false  
22 and defamatory statements that are asserted in the above-listed exhibits, and provided the link to the  
23 video on the FDI and medifraud websites. That video is still available to viewers at  
24 <http://www.youtube.com/watch?v=iGOpzCvUcxg>.

25 46. The Report purports to be the expert opinion of FitzPatrick, a self-claimed expert in  
26 pyramid schemes, thus giving a false legitimacy to the blatantly false and defamatory allegations  
27 contained therein.

28 ///



1 47. By way of example only, the Report falsely declares:

- 2 A. that TSFL operates as an endless chain or pyramid scheme;
- 3 B. that TSFL's business model violates California Penal Code Chapter 9 § 327;
- 4 C. that like Bernie Madoff's Ponzi scheme, TSFL's unprecedented and
- 5 inexplicable growth should be looked upon with suspicion;
- 6 D. that TSFL's growth is unsustainable and therefore Medifast's reporting to its
- 7 shareholders is false and misleading;
- 8 E. that TSFL's income promise is based on success at endless chain recruiting,
- 9 not retail selling;
- 10 F. that Medifast doesn't offer a viable income opportunity, but the illusion of
- 11 one;
- 12 G. that it is the bogus income opportunity of Medifast, not its weight loss
- 13 products, that account for its singular revenue growth and stock rise; and
- 14 H. TSFL's marketing lure is not legitimate.

15 48. By way of example only, the press release dated February 17, 2009, (Exhibit 3)

16 falsely declares:

- 17 A. that the income lure – that requires paying fees and buying TSFL products –
- 18 is an endless chain scheme;
- 19 B. that Medifast is similar to Bernie Madoff's massive Ponzi scheme;
- 20 C. that Medifast utilizes a similar money transfer game as Madoff by delegating
- 21 the recruitment aspect of the scheme to its "coaches" through the promise of
- 22 outrageous returns;
- 23 D. that Madoff and Medifast both rely upon the transfer of money between
- 24 investors within the scheme as opposed to money from retail sales generated
- 25 outside the scheme;
- 26 E. that the lab reports and analysis by Christopher Grell (Exhibit 5) establish
- 27 that the tested products were in clear violation of California's Proposition
- 28 65, without revealing that California's Proposition 65 does not apply to the

1 products tested; and without revealing that the levels of lead found in the  
2 food are levels potentially harmful to a fetus *in utero*, not an adult; and that  
3 there is already a warning on all Medifast products that pregnant women  
4 should not use the products;

5 F. that Medifast's disclosures to new recruits and Wall Street are hopelessly  
6 inadequate, implying that these alleged inadequacies are somehow in  
7 violation of the law.

8 49. Following the first attack, Medifast issued a press release refuting all of Minkow,  
9 FDI and FitzPatrick's false allegations. In response, FDI issued a second press release on February  
10 18, 2009 (Exhibit 6 attached hereto and incorporated by reference as if fully set forth herein), in  
11 which Minkow, FDI and FitzPatrick completely ignored the truth, and continued to perpetuate the  
12 same lies and falsehoods regarding the TSFL business model in order to force the stock price to fall  
13 further and allow them to reap higher profits in their short-selling scheme.

14 50. In that press release, Minkow, who admitted holding a short position in Medifast  
15 stock, further makes false accusations regarding Medifast's choice of auditing firms, comparing this  
16 choice to Madoff and his Ponzi scheme, without any basis in fact.

17 51. Following this first attack, Medifast's stock price fell almost thirty percent.

18 **The Second Attack:**

19 52. On May 21, 2009, Minkow and FDI launched a second attack on Plaintiffs by  
20 posting on FDI's website and on the medifraud.net website, the following: a press release (Exhibit  
21 7, attached hereto and incorporated by reference as if fully set forth herein); a letter to the Federal  
22 Trade Commission Chairman and California Attorney General (Exhibit 8, hereto and incorporated  
23 by reference as if fully set forth herein); a document entitled "Eleven Key Distinctions Between  
24 Medifast and Avon" (Exhibit 9, hereto and incorporated by reference as if fully set forth herein); a  
25 document entitled "5 Points of Similarity Between Medifast and YTB (YourTravelBiz.com)"  
26 (Exhibit 10, hereto and incorporated by reference as if fully set forth herein); and a second Q-1'09  
27 Updated "Expert Report" from FitzPatrick (Exhibit 11, hereto and incorporated by reference as if  
28 fully set forth herein).

1           53.     Again, these documents contain the same false and defamatory allegations, and  
2 continue to perpetuate the already refuted falsity that Medifast is a Ponzi scheme and a pyramid  
3 scheme and is in violation of the laws of California *and* New York, as well as Federal securities  
4 laws.

5           54.     The same day, Coenen posted the FDI press release (Exhibit 12, attached hereto and  
6 incorporated by reference as if fully set forth herein) and the “5 Points of Similarity Between  
7 Medifast and YTB” (Exhibit 13, attached hereto and incorporated by reference as if fully set forth  
8 herein) on her website, Sequence Inc. Fraud Files, with her own by-line, thus adopting all of the  
9 contents of those two statements as her own.

10          55.     None of these statements were true when made, nor are they true now, and Minkow,  
11 FDI, FitzPatrick and Coenen knew the statements were not true when they posted them. But  
12 Medifast’s stock had bounced back following the release of its Q’1 2009 earnings and that result  
13 was not profitable for Minkow and his associates. As such, it was necessary to ramp-up the attack.

14          56.     The following day, on May 22, 2009, Minkow and FDI issued another press release,  
15 (Exhibit 14, attached hereto and incorporated by reference as if fully set forth herein) which  
16 perpetuated the same false and defamatory statements made previously, and asserted that FDI  
17 would soon be rolling out YouTube videos of past Medifast “coaches” who enrolled in TSFL only  
18 to conclude it was an endless chain, in order to “level the playing field for the potential Medifast  
19 recruit.”

20          57.     As of this filing, FDI has yet to post a single video of this kind.

21     **The Third Attack:**

22          58.     When the second attack failed to have the same drastic effect on the price of  
23 Medifast stock as the first, Minkow, FDI, FitzPatrick and Coenen tried again, beginning on June 9,  
24 2009 with the posting of another press release from Minkow and FDI (Exhibit 15, attached hereto  
25 and incorporated by reference as if fully set forth herein), along with a document entitled  
26 “Summary Explanation of BJI Oddities” (Exhibit 16, attached hereto and incorporated by reference  
27 as if fully set forth herein). This time, Minkow directly attacked the independence of Medifast’s  
28 outside auditors, Bagell, Josephs, Levine & Company, LLC, falsely asserting that Minkow and FDI

1 had conducted an undercover investigation of the firm that revealed that Medifast's auditor was  
2 "moonlighting as the company's stock promoter to investor clients."

3 59. No such conclusion could be reached, as the allegations are absolutely false.

4 60. On June 9, 2009, Medifast's stock price dropped over four and a half percent.

5 61. On June 24, 2009, Coenen posted an entry on her Sequence Inc. Fraud Files blog  
6 entitled "Conflict of interest for Medifast auditors?" (Exhibit 17, attached hereto and incorporated  
7 by reference as if fully set forth herein) once again falsely asserting that BJL Wealth Management,  
8 an investment firm with the same address as the audit firm, recommended the purchase of Medifast  
9 stock to an FDI operative, and further asserting that this would certainly be a conflict of interest for  
10 Medifast and its auditor, Bagell, Josephs, Levine & Company.

11 62. Coenen and Sequence continued the attack on September 14, 2009, by posting an  
12 entry on the Fraud Files blog entitled "Medifast and Take Shape For Life: Weight loss pyramid  
13 scheme?" (Exhibit 18, attached hereto and incorporated by reference as if fully set forth herein).  
14 Again, this entry makes false statements that health coaches are required to put up their own money;  
15 that TSFL is a pyramid scheme; and Medifast is not complying with some unknown and  
16 undisclosed legally mandated reporting requirements, among others.

17 **The Fourth Attack:**

18 63. On January 8, 2010, with Medifast stock prices at an all-time high over the past  
19 several weeks, Minkow and FitzPatrick ramped up their attacks yet again. FitzPatrick released yet  
20 another updated "expert report" this time falsely likening Medifast and TSFL to the housing bubble  
21 and sub-prime mortgage crisis (Exhibit 19, attached hereto and incorporated by reference as if fully  
22 set forth herein), along with another press release touting their investigation and false and  
23 defamatory results (Exhibit 20, attached hereto and incorporated by reference as if fully set forth  
24 herein).

25 64. This updated report contains even more false and defamatory statements, which  
26 again, Defendants cloak in the alleged legitimacy of "expert opinion" in order to avoid culpability.

27 ///

28 ///

1           65. By way of example only, this updated report falsely states:

- 2           A. that Medifast's true competitors are Amway and Pre-Paid Legal Services, among  
3           other such pyramid schemes;
- 4           B. that the evolution of a Medifast consumer pyramid scheme on Main Street to an  
5           inflated stock scheme on Wall Street has an obvious and unavoidable analogy –  
6           the sub-prime mortgage crisis;
- 7           C. that getting a position on the TSFL pyramid pay plan requires a payment of  
8           between \$100 and \$300 and each coach would also be required to purchase  
9           inventory and marketing materials;
- 10          D. that Medifast is merely a pump-and-dump scheme, creating a deception on Wall  
11          Street and misleading shareholders;
- 12          E. that more than \$6 million worth of shares were dumped by insiders in the two  
13          months prior to the report – a statement that is directly contradicted by publicly  
14          available SEC filings;
- 15          F. that the stock price is inflated out of all proportion to revenue because the future  
16          expansion is presented as “unlimited”, just like the coaches’ mythical prospects  
17          for earnings;
- 18          G. and again falsely comparing Medifast to Bernie Madoff.

19          66. Medifast immediately issued a press release refuting these false and defamatory  
20          allegations, and informing the public that an independent investigation and review confirmed that  
21          the TSFL model and Medifast's disclosures were in no way violative of any law.

22          67. Minkow immediately fired back the same day, with another defamatory press release  
23          (Exhibit 21, attached hereto and incorporated by reference as if fully set forth herein), and on  
24          January 12, 2010, with an “Open Letter” to MacDonald directly (Exhibit 22, attached hereto and  
25          incorporated by reference as if fully set forth herein), ignoring the truth and once again attacking  
26          Plaintiffs with false and defamatory allegations.

27          68. Once again, Coenen joined the attack with her postings on January 12, 2010 (Exhibit  
28

1 23, attached hereto and incorporated by reference as if fully set forth herein) and two postings on  
2 January 13, 2010 (Exhibit 24 and 25 respectively, attached hereto and incorporated by reference as  
3 if fully set forth herein), further adopting and disseminating the same false and defamatory  
4 allegations that Medifast is misleading its shareholders, adding fuel to the fire and further driving  
5 down the price of Medifast's stock.

6 69. By the close of the market on January 13, 2010, Medifast stock had dropped from  
7 \$31.77 per share at the open on January 8, before this round of attacks, to \$27.00 per share.

8 70. On January 13, 2010, at 6:41 p.m., the plaintiff-side securities class action law firm  
9 of Barrack Rodos & Bacine issued a press release further disseminating the false and defamatory  
10 allegations of Defendants by announcing it was investigating Medifast for securities violations and  
11 urging any potential plaintiffs to contact the firm immediately. The press release confirms that the  
12 latest Minkow/FDI/FitzPatrick/Coenen attack successfully drove down Medifast's stock price by 14  
13 percent (Exhibit 26, attached hereto and incorporated by reference as if fully set forth herein).

14 71. By the open of the market on January 14, 2010, Medifast stock had dropped to  
15 \$24.86 per share.

16 72. On February 3, 2010, Minkow and FDI announced a new business venture and new  
17 avenue for dissemination of their false and defamatory attacks on publicly-traded companies for the  
18 sole purpose of make large profits by short-selling stock. Minkow and FDI joined forces with ex-  
19 Los Angeles Times reporter, Lobdell and posted a new website – ibizreporting.com. It would be  
20 the business of Lobdell and iBiz to further disseminate the false allegations of fraud in order to  
21 make a profit in the stock market, as iBiz was admittedly funded directly by FDI's profits in short-  
22 selling the stock of targeted companies. Their first attack was on Medifast (Exhibit 27, attached  
23 hereto and incorporated by reference as if fully set forth herein).

24 73. Lobdell's "report" on Medifast includes the same false allegations against Medifast,  
25 including the very specific and false statement that more than \$6 million worth of shares were  
26 dumped by Medifast insiders in the two months prior to his report – a statement that is directly  
27 contradicted by publicly available SEC filings, sources that should have been checked by an ex-  
28 reporter such as Lobdell.

1           74. As a direct result of the Defendants' attacks on Medifast, anonymous posters on the  
2 Yahoo! Finance message board devoted to Medifast have further perpetuated these attacks, and  
3 have specifically targeted MacDonald personally. These attacks have become so far out of control,  
4 that one anonymous poster, 'medisdead' has defamed MacDonald by referring to him as "Pimp-  
5 Daddy Brad." Medisdead has shamefully attacked MacDonald's honorable military service to this  
6 country and implied that MacDonald is a pedophile. (Examples of just some of these attacks on  
7 MacDonald personally are attached hereto as Exhibit 28 and incorporated by reference as if fully set  
8 forth herein).

9           75. Defendant, Zee is another one of these anonymous posters. Zee's postings contain  
10 numerous false and defamatory statements, and perpetuate those contained in Minkow, FDI, and  
11 Coenen's postings as well as those posted by medisdead. Some of Zee's defamatory statements  
12 include:

- 13           A. Medifast is in violation of Federal Trade Commission regulations;
- 14           B. Medifast falsely advertises on its website;
- 15           C. Medifast executives are guilty of insider trading;
- 16           D. Medifast engages in deceptive sales and marketing practices;
- 17           E. Medifast management are hypocrites and unethical;

18 (Exhibit 29, attached hereto and incorporated by reference as if fully set forth herein). (Exhibits 1  
19 through 29 will hereinafter be referred to as the "Defamatory Postings.")

20           76. Medifast stock closed the week of February 12, 2010 at a low of \$19.04 per share, a  
21 drop of over 45 percent since its high of \$35.79 per share, prior to this latest round of attacks.

22           77. Central to FitzPatrick's 'expert opinion' is his false assertion that health coaches are  
23 required to spend money out of their own pockets to purchase Medifast products, at retail prices,  
24 and to re-sell those products to their clients, at retail prices; pay other illusory monthly fees to the  
25 company; and incur the illusory cost and expense of marketing and selling the Medifast products.  
26 This false assertion was adopted and repeated by Minkow, FDI, Coenen, Sequence, Inc., Lobdell  
27 iBiz and Zee, and re-published by each of them in the Defamatory Postings.

28           78. Also central to this 'expert opinion' and to all of the assertions made by Defendants

1 in the Defamatory Postings is their collective false assertion that the only way health coaches make  
2 money is by recruiting more health coaches, not by generating product sales.

3 79. This 'expert opinion' and all of the collective false assertions made by Defendants in  
4 the Defamatory Postings rest on the false premise that TSFL does not sell a product, but sells a  
5 business opportunity, an assertion that is directly contradicted by the TSFL website; Medifast's  
6 website; and Medifast's SEC filings among other public sources.

7 80. This 'expert opinion' and all of the collective false assertions made by Defendants in  
8 the Defamatory Postings rest on the false assertion that Medifast promises success to all of its  
9 potential coaches and that Medifast promises a continuing and never-ending growth in profits to its  
10 shareholders. But Medifast's SEC filings and the TSFL website clearly make no such assertions.

11 81. These are only an exemplary recitation of the false and defamatory statements  
12 contained in the Defamatory Postings and the reasons for their falsity.

13 82. As of February 16, 2010, after the damage has been done, Minkow, FDI, Lobdell  
14 and iBiz have taken down access to their Defamatory Postings and issued a statement indicating  
15 that the investigation of Medifast has ended. The statement makes absolutely no mention of any  
16 results, one way or the other. Coenen's postings on her Sequence, Inc. Fraud Files blog remain  
17 available to readers. Thus, Defendants' allegations against Plaintiffs remain unretracted.

18 83. The use by Defendants of terms such as "Bernie Madoff" "Ponzi scheme" and  
19 comparisons to the very recent sub-prime mortgage melt-down, the use of terms and concepts  
20 bantered about in the media and used by politicians such as Main Street vs. Wall Street and "the  
21 Great Recession" among others are very strategically chosen by Defendants and are specifically  
22 intended to inflame the fears of investors and cause the depression of Medifast's stock.

23 84. These highly inflammatory, negatively-charged terms were carefully chosen by  
24 Defendants to intentionally and maliciously defame Plaintiffs and to cause a panic among investors,  
25 and did in fact have such an effect.

26 85. At all times, true and accurate information refuting Defendants' false assertions and  
27 'expert opinions' was publicly available to them, but Defendants chose to ignore those sources and  
28



1 instead intentionally mislead their audience by asserting that no such true and accurate information  
2 existed, and to continue their attacks for their own pecuniary gain.

3 **FIRST CAUSE OF ACTION**

4 ***Libel Per Se***

5 **(Against all Defendants)**

6 86. Plaintiffs incorporate by reference each and every allegation set forth in paragraphs 1  
7 through 85, above, as if fully set forth herein.

8 87. A cause of action for libel under California law accrued in California because  
9 Defendants' libelous statements were published in California.

10 88. Plaintiffs have for many years enjoyed good reputations generally and in their  
11 occupations and business. Plaintiffs have further enjoyed good relations with the public and  
12 Medifast's shareholders to whom Defendants directed their false and defamatory statements.

13 89. By publishing the Defamatory Postings, Defendants intended to communicate to  
14 others the false statements contained therein, which include but are not limited to those statements  
15 outlined in the paragraphs above.

16 90. The statements in the Defamatory Postings are false because Plaintiffs did not  
17 commit any of the acts alleged – Medifast is not a Ponzi or pyramid scheme; Medifast's products  
18 are not unsafe for human consumption; and there is no conflict of interest between Medifast and its  
19 auditor. Defendants knew or should have known that the statements were false when made, or did  
20 not exercise reasonable care in verifying the truth or falsity of such statements before transmitting  
21 and publishing these statements, or recklessly disregarded the truth or falsity of the statements.

22 91. By publishing the Defamatory Postings, Defendants intended to injure Medifast's  
23 business reputation and to disparage its business. Defendants further intended to injure  
24 MacDonald's personal and professional reputation.

25 92. The statements contained in the Defamatory Postings are libelous *per se* because: (1)  
26 the statements are in printed form and are thus libel; (2) the statements ascribe characteristics that  
27 have a tendency to injure and have in fact injured Plaintiffs in their business and occupation; and (3)  
28 the statements claim Plaintiffs engaged in criminal conduct and other violations of law.



1 98. Defendants' market manipulation was directly intended to depress the price of  
2 Medifast stock.

3 99. As a proximate result of Defendants' acts and/or omissions occurring in California  
4 with regard to Medifast, as alleged, Medifast's stock price was manipulated downward, and  
5 Plaintiffs were injured by such downward manipulation.

6 100. Pursuant to the provisions of California Corporations Code Section 25500, Plaintiffs  
7 are entitled to, and should be awarded, damages against Defendants for unlawful manipulation of  
8 the price of Medifast stock.

9 **THIRD CAUSE OF ACTION**  
10 **(California Business & Professions Code §§ 17200 *et seq.*)**  
11 **(By Plaintiff, Medifast Only Against all Defendants)**

12 101. Plaintiffs incorporate by reference each and every allegation set forth in paragraphs 1  
13 through 100, above, as if fully set forth herein.

14 102. Defendants' illegal stock market manipulation constituted unlawful, unfair, and/or  
15 fraudulent business acts or practices by the Defendants, and each of them, all in violation of  
16 California Business & Professions Code §§ 17200, *et seq.*

17 103. By publishing false and defamatory statements about Medifast and short-selling  
18 Medifast's stock, Defendants engaged in fraudulent, wrongful and unlawful conduct, the purpose of  
19 which was to unfairly damage Medifast's business for Defendants' economic benefit.

20 104. As a result of Defendants' unlawful scheme of attacking Medifast's reputation  
21 through the publishing of libelous statements over the internet, thus scaring the investing public into  
22 selling Medifast stock, and driving the stock price down in order that Defendants could reap huge  
23 profits, Defendants have been unjustly enriched and Defendants should be required to disgorge all  
24 profits made by way of their unfair business practices.

25 105. Defendants unfair business practices have caused substantial harm to Medifast,  
26 through (but not limited to) decreased market capitalization and the diminished value to its common  
27 shares; through loss in recruitment of new health coaches and correlating sales of Medifast product,  
28 loss of other growth opportunities and loss of potential revenue as a result of the defamatory  
statements directly asserted against Medifast's products; and the costs incurred in attempting to

1 deflect and overcome the damage inflicted by Defendants' Defamatory Postings, for which  
2 Medifast is entitled to restitution in an amount to be proven at trial.

3 106. Medifast is further entitled to preliminary and permanent injunctive relief restraining  
4 the Defendants, individually and collectively, each and all of them from committing further unfair  
5 trade practices.

6 **PRAYER FOR RELIEF**

7 WHEREFORE, Plaintiffs hereby pray for judgment against Defendants in their favor on  
8 each claim for relief set forth above and award them relief including, but not limited to:

- 9 1. For general damages in an amount according to proof at trial, but of approximately
- 10 \$270,000,000.00, well in excess of the jurisdictional minimum of this Court;
- 11 2. For special damages in an amount according to proof at trial, in an amount in excess
- 12 of the jurisdictional minimum of this Court;
- 13 3. For restitutionary damages according to proof at trial;
- 14 4. For disgorgement of Defendants' profits;
- 15 5. For punitive damages;
- 16 6. For prejudgment interest;
- 17 7. For costs;
- 18 8. For other applicable remedies as provided in the Civil Code, Corporations Code and
- 19 Business and Professions Code;
- 20 9. For injunctive relief; and
- 21 10. For such and further relief as the Court may deem appropriate.

22 Dated: February 16, 2010

LAZARE POTTER & GIACOVAS LLP

23  
24 By: 

Robert A. Giacovas  
Lainie E. Cohen  
Attorneys for Plaintiffs  
MEDIFAST, INC., and BRADLEY  
MacDONALD

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**JURY DEMAND**

Pursuant to Federal Rule of Civil Procedure 38, Plaintiffs hereby request a trial by jury.

Dated: February 16, 2010

LAZARE POTTER & GIACOVAS LLP

By: 

Robert A. Giacovas  
Lainie E. Cohen  
Attorneys for Plaintiffs  
MEDIFAST, INC., and BRADLEY  
MacDONALD



**Expert Report on  
*Take Shape for Life*, a Division  
of Medifast, Inc. (NYSE: MED)**

Robert L. FitzPatrick

**Submitted to:** Fraud Discovery Institute

**Re:** Analysis of Business Models and Practices of  
Medifast and *Take Shape for Life*; Potential  
Violation of California's "Endless Chain" Statute;  
Implications for Medifast Shareholders

Robert L. FitzPatrick  
1800 Camden Rd. Ste. 107, #101  
Charlotte, NC 28203  
Tel. (704) 334-2047  
Fax (704) 334-0220  
Email: RFitzPatrick@FalseProfits.com

Submitted: \_\_\_\_\_

Robert L. FitzPatrick  
February 16, 2009

## Update – February 16, 2009

In September, 2008, I submitted to Fraud Discovery Institute an analysis of the business model, marketing tactics, and distributor pay plan of Medifast Inc. (MED:NYSE). The report focused on *Take Shape for Life* (TSFL), a division of Medifast Inc. that utilizes the controversial “multi-level marketing” model.<sup>1</sup>

This February update incorporates data from the 3<sup>rd</sup> quarter of 2008. It more closely compares Medifast to its competitors in the meal replacement field and the explanations Medifast has offered for its sudden rise in revenue and stock price, unique in the meal replacement industry during the economic Recession.

I examined implications of the *Take Shape for Life* for Medifast shareholders. In recent years, Medifast’s stock performance has shown sharp spikes and dips in share price, sometimes associated with controversial claims and questionable promotions about its *products*. In early 2007, Medifast’s stock took a sudden dip when CEO, Bradley T. MacDonald, quickly resigned his position. *Barron’s Magazine* had disclosed that he had placed postings on Yahoo financial boards under a pseudonym. (*Barron’s*, Jan. 8, 2007).

Perhaps due to these publicized controversies over its products and the promotional tactics of the CEO, little in-depth or focused analysis has been given to Medifast’s multi-level marketing *business model*. More recently, Medifast stock has shown a spike, related to dramatic revenue growth in the *Take Shape for Life* sector, which accounts for nearly all of Medifast’s growth and is rapidly increasing as a proportion of total revenue,

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<sup>1</sup> The MLM model is under worldwide scrutiny as a disguise for business opportunity scams. Some have charged that the business has devolved into a form of Nigerian scam, originating mostly in the United States and Canada.

- The MLM business model and distributor payment plan, used by *Take Shape for Life* is currently banned in China, which treats it as an inherent fraud, as of 2005.
- The largest of all MLMs, Amway, was recently prosecuted for fraud in England, which sought to shut down Amway in that country. The UK Dept. of Trade and Industry revealed that 99% of the thousands of English consumers who invested as distributors in Amway UK, year after year, failed to earn a profit while the company promoted itself to British consumers as the “greatest income opportunity in the world.”
- Leaders of the MLM, GoldQuest, were prosecuted in Sri Lanka, Iran and other countries and recently arrested for pyramid fraud in India.
- One of the largest and fastest growing MLMs in the USA, YTB, was prosecuted for pyramid fraud in California.
- A large class action lawsuit is pending against Amway, charging that it is a massive pyramid scheme. The suit is led by the firms of Willie Gary and Boies, Schiller, Flexner.
- A fast growing MLM in Canada, Business in Motion, was recently the subject of a news exposé on the CBC news show, *Marketplace*, questioning whether it was a disguised pyramid scheme.
- The FTC in 2008 enacted a new rule to regulate Business Opportunity schemes. In a controversial ruling, the FTC accepted a staff recommendation to exempt MLMs as a separate and distinct form of business.
- MLMs are among the largest financial contributors to the Republican party. The founders of Amway are considered at the pinnacle of political influence and power.



## **Tipping Point into MLM**

In the 3<sup>rd</sup> quarter of 2008, that trend at Medifast reached the tipping point in which *Take Shape for Life* accounted for 50% of the company's revenue. Medifast must now be *categorized* as a multi-level marketing (MLM) company, in the same league with Amway, Pre-Paid Legal and others. Its "business opportunity" offering is now treated as a separate and distinct business type by the Federal Trade Commission (FTC), under Section 5 of the FTC Act, which draws the line between legitimate direct selling and the operation of a pyramid scheme engaged in the sale of a bogus "business opportunity."

This business category includes one prominent MLM, Your Travel Biz.com (YTB), that was recently prosecuted by the California Attorney General for operating a "gigantic pyramid scheme" in violation of California Penal Code Chapter 9. § 327.<sup>2</sup> Both Medifast and YTB are members of the Direct Selling Association, the majority of whose members employ the MLM model.

My report examines and offers an opinion whether *Take Shape for Life* operates as an "endless chain" sales scheme, as defined in the California Penal Code, under which Your Travel Biz.com is being prosecuted. I conclude that Medifast is employing a marketing system that meets the definition of an "endless chain" outlawed in California and that the business model and practices in fact parallel those of Your Travel Biz.com.

## **Reasonable Causes for Suspicion**

In the post Madoff era, which includes the Enron/Arthur Andersen scandals, extraordinary and singular growth by a company must now be viewed as a cause for scrutiny rather than an automatic assumption of market success. A sudden or extraordinary revenue growth that is not explicable by technology superiority, overall industry growth or any other verifiable market factor, should now be reasonably questioned as a possible signal of pyramid fraud. This is the same charge that was leveled at YTB, which had also shown rocket-like revenue growth.<sup>3</sup>

An accompanying sign of possible fraud is a company's explanation for its growth or profitability that is unfounded, erroneous, unintelligible, or based on secrecy. Enron, famously described as the "smartest guys in the room," claimed to have a unique – and incomprehensible – business model which it said facilitated its spectacular growth and profits. This proved to be little more than accounting fraud and pyramid money transfers.

<sup>2</sup> § 327. "Endless chain" schemes

Every person who contrives, prepares, sets up, proposes, or operates any endless chain is guilty of a public offense, and is punishable by imprisonment in the county jail not exceeding one year or in state prison for 16 months, two, or three years.

As used in this section, an "endless chain" means any scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant. Compensation, as used in this section, does not mean or include payment based upon sales made to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme.

<sup>3</sup> In only several years time, YTB enrolled a "sales force" of over 340,000 US consumer/investors and drew nearly 20,000 participants to its annual meeting in St. Louis. In the last year, the number of YTB "agents" grew 67%.

Bernard Madoff similarly claimed to have a trading system, which only he understood, that produced consistent, above-average returns regardless of market trends. His investor reports were described by clients as indecipherable. He has now confessed that his profits were only Ponzi money transfers.

Medifast has enjoyed what can only be described as astonishing growth in comparison to other companies engaged in the same business during this time and in a business field that is declining. In the last year, the *Take Shape for Life* sector grew 99% while sales volume in its industry declined. It accomplished this during one of the worst economic downturns in the American history. In a similar anomalous manner, the Medifast stock has shown extraordinary growth, rising nearly 60% while the Dow Jones Industrial average sank nearly 40%. All of Medifast's competitors have shown steep stock value declines, in accord with the overall stock market.

This report attributes Medifast's extraordinary and singular revenue and stock value increases to its use of the deceptive "endless chain" incentives offered to consumers. Medifast is marketing a misleading business opportunity in which its weight management products are bundled. The promotion of the bogus "business opportunity" drives product sales.

To account for this amazing performance, Medifast has made the logic-defying claim that that consumers become more "health and appearance" conscious during a Recession, leading them to buy meal replacement products! This is not supported by any evidence and is contradicted by academics and by past experience that links Recessions with poorer health and nutrition.

Further, Medifast attributes its growth to a claim that consumers "can substantially supplement their personal cash flow, in a difficult economic period, through direct sales in our *Take Shape for Life* program." This is also not substantiated. Medifast does not divulge actual incomes, costs, dropout rates or distribution of commission payments among the multiple levels of its sales force. Contradicting the claim is data analysis in this report that shows that only a tiny few who joined Medifast could possibly earn even the equivalent of wages of a part time minimum wage job.

The report on Medifast prepared in September 2008 used data through Q-2 '08. It showed that Medifast's revenue growth was driven almost entirely by increases in the *Take Shape for Life* sector, which offered consumers not only a diet program but a MLM "business opportunity." Indeed, the diet plan itself was inextricably bound to the MLM "business opportunity" offering. The offer of an "income opportunity" – based on endless chain recruiting – is woven into every sales pitch.

For example, TSFL Website description of its diet program states that it includes three key components:

- *Healthy Body* - physical health is the foundation of a happy and fulfilling life.
- *Healthy Mind* - how we feel about ourselves also affects long term Optimal Health.
- *Healthy Finances* - debt causes stress - and stress can take a severe toll on both your physical and mental health. By managing and eliminating debt, learning ways to budget, and or *seizing financial opportunities*, you further yourself on the road to Optimal Health. (italics added)

No other meal replacement company ventures into a customer's personal financial life as an integral part of its diet regimen. But *Take Shape for Life* boldly makes "finances" and "seizing financial opportunities" the third of just three critical aspects to its program and philosophy.<sup>4</sup>

Its prescription for how to achieve "healthy finances" is specific. It means signing up as a *Take Shape for Life* "coach", an unpaid, independent distributor, authorized to recruit other coaches in an endless chain pay incentive plan. The meal replacement products and the income potential as a coach are inseparable.

### **Inexplicable Spikes**

The *Take Shape for Life* sector accounted for 50% of Medifast revenue in the 3<sup>rd</sup> quarter of 2008, the last period in which the company supplied data to the SEC. Excluding the *Take Shape for Life* sector, Medifast actually declined in revenue, comparing 3<sup>rd</sup> quarter of '08 to the same period in '07. This put the rest of the company in line with the trends of other companies in the meal replacement business. However, the *Take Shape for Life* sector increased an amazing 99%, enabling Medifast to report to shareholders that it achieved robust growth during this Recessionary time.

A sudden spike in stock, singular in its industry group and during a Recession, requires a reasonable, market-based explanation. The chart below compares Medifast to other major companies in the same business:

Company	Stock Performance One Year	Stock Performance Year to Date
Medifast	+ 59%	+ 32%
NutriSystem	- 40%	- 6%
eDiets.com	- 48%	- 26%
Weight Watchers	- 58%	- 31%
Jenny Craig	Owned by Nestlé; does not disclose figures	
DJIA	- 36%	- 11%

Medifast's positive stock performance is anomalous and is in sharp contrast to its competitors, several of which are much better known and larger. The stock growth also defies the overall stock market.

The growth in stock value is matched by anomalous positive revenue growth in the midst of a national economic contraction.

<sup>4</sup> In its training literature, the "trilogy" of "body, mind and finances" is consistently presented as the basic marketing message. For all who sell the TSFL meal replacement products, the income offer is integral to the promise of weight loss. For example, "...*financial health has been identified as the final element necessary for long-term optimal health. The ability to help people quickly supplement their income can take the burden off of a struggling family's finances. For those committed to going all out to build this health network, there is practically unlimited financial reward!*" (Training Binder, "Setting Your Business in Motion" ©2006 *Take Shape for Life*.)

[http://www.getyouhealth.com/BizDocs/bl\\_setting\\_your\\_business\\_in\\_motion\\_0806.pdf](http://www.getyouhealth.com/BizDocs/bl_setting_your_business_in_motion_0806.pdf)

Company	Q-3 '07 Revenue (in millions)	Q-3 '08 Revenue (in millions)	Percentage Change
Medifast (total)	\$21.8	\$27.3	+ 25.22%
Medifast (Other Weight Loss Business Sectors)	\$15	\$13.7	- 8.7%
Medifast ( <i>Take Shape for Life</i> Sector)	\$6.8	\$13.6	+ 99%
NutriSystem	\$183.1	\$162.7	- 11.14%
eDiets.com.com Inc.	\$6.8	\$4.8	- 29.4%
Weight Watchers	\$337.5	\$352.6	+ 4.47% <sup>5</sup>
Total	\$549.2	\$547.4	- 0.33%

Every company, including Medifast's other sectors, lost revenue in the 3<sup>rd</sup> quarter of 2008 compared to the same period in 2007 or showed only a modest gain. However, the *Take Shape for Life* Sector, which is 50% of Medifast's current revenue, showed an astonishing growth rate of 99%. Without that sector, Medifast would have followed the industry with an average loss of revenue.

The one other major player in the weight management business that relates to Medifast is Jenny Craig. Recently acquired by Swiss food giant, Nestlé, the breakout data on Jenny Craig revenue trends are not disclosed. However, in a recent sales conference call, Nestlé stated,

"Finally in Nutrition, a word on Jenny Craig. This, together with Performance Nutrition, is the most sensitive of our Nutrition business to economic conditions. We have seen a trending down from the amazing performance that we enjoyed in the first quarter."<sup>6</sup>

This indicates that Jenny Craig is following the industry in a downward trend, due to "economic conditions." Only *Take Shape for Life* defies the national economy and differs from all its peers, and it does so in a spectacular manner – a 99% growth!

### Implausible Explanation

In my view, just as the extraordinary and singular growth of Medifast's *Take Shape for Life* revenue and stock value is cause for scrutiny, its implausible explanation for this growth also fits the criteria for suspicion.

<sup>5</sup> Weight Watchers, by far the best known and *broadly distributed* of meal replacement companies shows a slight revenue growth, however, its sales trends are downward. Q-3'08 revenue growth over the same period in '07) was less than half the growth rate of Q-1'08 over the same period in '07.

<sup>6</sup> 2008 Nine Months Sales Conference Call Transcript, Conference Date: 23 October 2008 ; Chairperson: Mr. Roddy Child-Villiers, Head of Investor Relations , Nestlé S.A.  
<http://www.nestle.com/Resource.axd?Id=C0F14074-84BB-4873-9AB5-98E36BEEB757>

In a December, 16, 2008 press release, announcing Q-3 sales growth, Medifast's board chair, Brad MacDonald stated,

"...during tough economic times, consumers turn their attention to improving their health and appearance."

This is a remarkable explanation that conflicts with the sales trends of all other companies offering the very same products for "improving health and appearance" in the meal replacement field. It also conflicts with overall health trends during periods in which poverty and unemployment rise.

Recessions are accompanied by loss of health insurance, mental depression, and associated increases in obesity, not with increased "attention to health and appearance."<sup>7</sup>

It is an astonishing assertion that during a period of dashed hopes, foreclosures, lost savings and delayed retirement, consumers actually spend more on "meal replacement" programs in order to improve their appearance. *Take Shape for Life* meals cost \$300 per month. At a time when many families can barely pay for groceries at all, would they make a priority of Medifast food products?

Reflecting Medifast's bundling of its food products with its other offering – an MLM income scheme – the Medifast chairman stated,

"In that regard, those who have lost weight on the Medifast program... can substantially supplement their personal cash flow, in a difficult economic period, through direct sales in our "*Take Shape for Life*" program."

## Conclusions

This report directly addresses the claim by Medifast that it offers a viable income opportunity that is fairly represented, a veritable life boat in troubled economic waters. This claim is the crux of its marketing program and the acknowledged source of its growth.

I conclude that Medifast, in fact, offers a misleadingly promoted income scheme that cannot possibly fulfill this promise. The income lure – that requires paying fees and buying *Take Shape for Life* products – is an endless chain scheme.

The vast majority of all consumers that Medifast enrolls in its "business opportunity" and who serve as the engines of its growth are doomed to fail. Those that "succeed" will do so on the investments and labor of those lured by the misleading promise. The income promise is based on success at endless chain recruiting, not retail selling. The environment for retail sales of meal replacement products is shrinking, as the sales of all other competitors and the overall market performance show.

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<sup>7</sup> See Jan. 9, 2009 Reuters news story, "Will Americans put on 'recession pounds'?" that quotes the director of the Nutrition Sciences Program at the University of Washington in Seattle, "People ... are going to economize and as they save money on food they will be eating more empty calories or foods high in sugar, saturated fats and refined grains, which are cheaper." The article directly contradicts the Medifast claim that "during tough economic times, consumers turn their attention to improving their health and appearance." To the contrary, Recessions lead to increases in obesity, poorer health and reduced nutrition, (<http://www.reuters.com/article/healthNews/idUSTRE50805W20090109>)

The market for an "income opportunity," however, is exploding. This is the most precious of commodities in a Recession and in the least supply.

An income opportunity based on personally retailing expensive products from a relatively unknown company in a declining market in the midst of a Recession will not "substantially supplement personal cash flow" as Medifast promises.

Medifast does not actually offer a viable income opportunity but the *illusion* of one, as portrayed in the endless chain mirage. As the FTC's expert on pyramid schemes, Dr. Peter Vandernat explained, at all times the bottom ranks (of an endless chain pyramid) will hold the vast majority of investors. When income depends on endless chain expansion, those in the lower ranks, the great majority, are doomed to lose out.

Medifast's website presents charts showing the potential for \$8,000 and \$20,000 incomes *per month*. It makes these representations and offers these lures without disclosing what percentage of the "coaches" could *possibly* earn these incomes or how many ever have. It withholds information from consumers on actual average incomes, the amount of total commissions paid to top levels, the drop out rates, and the expected business costs.

Like Enron's special business model and Madoff's secret trading system, Medifast dazzles its prospects with the classic and indecipherable MLM pay plan, showing the potential of an income with "no cap." Yet, buried in the description are the codes for sending most of the commissions to the top ranks and using "compression" to capitalize on the labors of those faltering and churning at the bottom. The multi-tiered plan stacks ten levels of management upon the newest recruit, with each level geometrically expanding, but never discloses the market potential for any area. The number of coaches and the market for its meal replacement products are *always* treated as "unlimited."

Waving high income figures at consumers in the midst of Recession will indeed attract extraordinary response and can produce greater interest than in those companies that still try to sell weight management products based on quality, price and efficacy. It is the bogus income opportunity of Medifast, not its weight products, that account for its singular revenue growth and stock rise.

The following report lays out the reasons why this marketing lure is not legitimate.

**September, 15, 2008:**

**Expert Report on *Take Shape for Life*, a Division of Medifast, Inc.**

**Overview and Opinion**

This report analyzes the business model and marketing practices of *Take Shape for Life* (TSFL), a division of Medifast Inc. (MED:NYSE) and their implications for Medifast shareholders.<sup>8</sup> Medifast stock has shown a recent spike related to dramatic revenue growth in one sector, *Take Shape for Life*, which utilizes the "multi-level marketing" model. The report examines and offers an opinion whether *Take Shape for Life* operates as an "endless chain" sales scheme, as defined in California Penal Code, Chapter 9. § 327.<sup>9</sup>

My view is that *Take Shape for Life* does operate as an endless chain or pyramid scheme. I conclude that TSFL's business model and reward system – by their design, operation and promotion – meet the definition of an "endless chain" within the meaning of California Penal Code, Chapter 9. § 327.<sup>10</sup>

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<sup>8</sup> In recent years, Medifast's stock performance has shown sharp spikes and dips in share prices, sometimes associated with controversial claims and questionable promotions about its products' efficacy. In early 2007, Medifast's stock took yet another sudden dip when CEO, Bradley T. MacDonald, quickly resigned his position. *Barron's Magazine* had disclosed that he had placed postings on Yahoo financial boards under a pseudonym. (*Barron's*, Jan. 8, 2007).

Perhaps due to these publicized controversies, little in-depth or focused analysis has been given to Medifast's multi-level marketing sector, *Take Shape for Life*, which is largely responsible for the company's recent revenue growth and, once again, a sudden rise in stock value.

<sup>9</sup> § 327. "Endless chain" schemes

Every person who contrives, prepares, sets up, proposes, or operates any endless chain is guilty of a public offense, and is punishable by imprisonment in the county jail not exceeding one year or in state prison for 16 months, two, or three years.

As used in this section, an "endless chain" means any scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant. Compensation, as used in this section, does not mean or include payment based upon sales made to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme.

<sup>10</sup> My view is based on years of research, writing and advocacy work with victims of pyramid schemes and significant experience with litigation involving this California statute. For example, in 2007, I was retained as consultant and expert witness by the Fresno County Counsel on behalf of the Defendant, Fresno County, California and various peace officers employed by the County. The case involved charges brought against a Fresno County Detective and other peace officers by an individual who claimed she was wrongfully charged and harmed in connection with a pyramid scheme prosecution. Fresno County sought to enforce the California state statute on "endless chain" schemes, Penal Code 327, against this person regarding a multi-level marketing company she promoted. I was asked to render an expert opinion as to whether the scheme operated as an unlawful "endless chain" sales scheme, as defined in California Penal Code, Chapter 9. § 327. This work required extensive research into not only the MLM scheme, but the California law and its history, intent and application. (Sharon Saunders, et al, Plaintiffs, vs. Detective Cynthia Knight, et al, Defendants, Case No. CIVF045924, REC LJO, United States District Court, Eastern District of California.)

Despite strong anti-pyramid scheme statutes in some states such as California and Section 5 of FTC Act that treats pyramid schemes as *inherently* "unfair and deceptive trade practices," public understanding of the trickery and harm of endless chains, also called pyramid schemes or money transfers, has markedly *declined*. The internet is currently inundated with endless chain propositions, sometimes called matrix sales, investment clubs, "closed markets", gifting clubs, and a host of multi-level marketing schemes. They purport to sell various items from travel services to gold coins to fruit juice and diet pills. In virtually all cases, investments are garnered from the public with promises of rewards that are dependent upon a continuous recruitment of new investors, i.e., the endless chain. The inherent fraudulence of the endless chain marketing lure was succinctly and eloquently described by the U.S. Federal Trade Commission's (FTC) own expert on pyramid schemes Dr. Peter Vandernat in his May 2001 declaration, on the MLM scheme, SkyBiz.com.

*The proposed rewards set forth in a pyramid scheme are tied primarily to an ongoing ability to recruit others into a stated program and, thereby, a situation is created in which the proposed rewards cannot come true for the vast majority of participants. As recruitment continues, the number of people who are at or near the base of the recruitment structure grows very rapidly, often at an exponential rate for as long as a successful recruitment pattern is maintained. At whatever enrollment level new recruitment ceases, a number of layers of the most recent recruits cannot qualify for the proposed benefits precisely because their own "downlines" are either empty or have insufficient numbers. Moreover, given the nature of the recruitment pattern, these same people (those who are at or near the base of the recruitment structure) comprise the vast majority of participants. The resulting losses are not accidental; they are determined by the structure of a compensation plan that ties most of the proposed rewards to a participant's ability to recruit others into the program.*

*In a pyramid scheme the large scale failure to obtain the proposed rewards is not postponed until market saturation. For as long as a successful recruitment pattern is maintained, the names of the most recent recruits change over time, but the percentage of members constituting the most recent layers of recruits does not appreciably change. At whatever enrollment the program may be considered, whether the total membership be large or small, saturation or not, the rules and implementation of the program ensure that the vast majority of members are not in a position to obtain the proposed rewards. For the promoters of the scheme, this feature always limits the liability for required payouts, while also favoring relatively few participants who are at or near the top of the structure. This description is typically true for all stages of recruitment, including those stages that are still far from market saturation. Also, in a pyramid scheme the number of people who lose money increases exponentially for as long as a successful recruitment pattern is maintained. From the perspective of consumer protection, it is always better that a pyramid scheme fail sooner rather than later.*

In my view, TSFL's income opportunity fits this definition. Its product promotions, inducements, promises, claims and rewards are inextricably tied, though sometimes disguised, to the endless chain recruitment-and-reward model described by Dr. Vandernat.

In structure and pay plan, TSFL is similar to the multi-level marketing scheme, Your Travel Biz.com (YTB), the 26<sup>th</sup> largest travel agency in America. The California Attorney



General is currently prosecuting YTB under California Penal Code, Chapter 9, § 327 and has publicly called it a "gigantic pyramid scheme."<sup>11</sup>

In the YTB scheme, participants pay an initial fee of \$499 and additional monthly charges to gain the status of "agent" which entitles them to sell travel services and to enroll other agents. Each agent can sell travel services directly to the public and can also gain discounts and other benefits from travel service vendors offered to YTB agents. They can also receive rewards when they enroll other "agents" and "overrides" on the travel purchases and sales of those they enroll and those that their recruits enroll in an endless chain of "agents."

TSFL, like YTB, charges consumers a fee to gain special "credentials." It charges between \$99 or \$299 to gain the title of "health coach." Those who pay the higher \$299 investment are rewarded with 33% higher commission rate when they enroll others as coaches or clients.

Upon joining, the scheme immediately offers the new coach a \$100 "client acquisition bonus" for recruiting 5 new participants (participants are other coaches or retail customers, called "clients") within 30 days.

The *client* acquisition bonus appears to reward retail sales. However, a second, related bonus program reveals it to be a pyramid recruitment bonus, part of TSFL's larger endless chain reward program. Those coaches who pay the higher \$299 initial fee are rewarded with another \$100 *every time* one of their recruits achieves the same recruitment goal (five new participants in the first 30 days). This is called an "Assist Bonus."

Since only the "coaches" can recruit, the Assist Bonus, only pays off when one has recruited other coaches, not clients. "Clients" merely buy the meal replacement program for their own personal use. They do not bring in new clients. The Assist Bonus is, therefore, a powerful incentive and a direct reward for recruiting other coaches. Recruiting five clients in 30 days can gain a \$100 bonus. But if five coaches were recruited during the same time period, another \$500 in potential reward becomes available.

Significantly, the recruitment bonus to those who pay the higher sign-up fees also includes a 50% *lower threshold of purchase volume* in order get the \$100 bonus, thereby making it easier to reach the recruitment goal by recruiting participants (referred to as "building structure") rather than producing sales volume, i.e., recruiting more participants rather than selling more products to them.

These bonuses, therefore, induce a higher upfront investment and tilt the overall compensation program, right from the onset, toward recruitment of "coaches" (who also pay retail pricing) over retail selling to "clients" who pay the same pricing as coaches but cannot recruit others to the benefit of the upline recruiters.<sup>12</sup>

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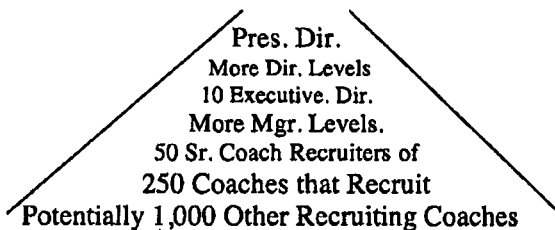
<sup>11</sup> <http://ag.ca.gov/newsalerts/release.php?id=1596>

<sup>12</sup> As in most other multi-level marketing schemes, total personal sales thresholds can also be reached to achieve these levels, that is, the level can be gained by only retail selling. However, the plan does place a fixed requirement that at least five other participants must be enrolled in order to gain "bonuses". The five can be either "coaches" or "clients." All pay the same prices to purchase TSFL products. The formula of the pay plan and the training eventually make clear that the most productive and quickest – and in practice,

The TSFL pay plan is based upon a 10-level pyramid. This heavily-layered hierarchy obviously makes no sense from a management perspective and is contrary to all current business trends of flatter and leaner management structures. However, when seen as a form of *pyramid leveraging* the TSFL plan is elegantly designed. The multiple levels produce an *ever-widening base*. Matched with a pay plan that *siphons most commission dollars to the top*, the seemingly unwieldy and inefficient structure maximizes the seductive lure and power of a pyramid when affixed to a sales program – to reward those at the top and to provide powerful incentives for those at the bottom to try to recruit their way to the top.

At the base of the pyramid and constituting the largest sector in the reward system are the newly recruited “coaches.” They are the *engines* of company revenue through their recruitment work, while also serving as major *sources* for revenue through their own purchases and payments of fees.<sup>13</sup>

After paying as much as \$299 initially and other related charges, each coach is authorized to recruit other coaches. The hierarchy of those who gain rewards when a consumer is enrolled extends upward on a classic “five get five” program (5-25-125-625, etc.).



When an individual coach enrolls five other participants with an aggregate purchase volume, the new coach moves to the level of “Senior Coach.” The TSFL pay plan then begins to offer escalating “bonuses.”

“Manager” level is gained when 2 Senior Coaches are enrolled below,

thereby placing at least 10 other participants into that Manager’s Downline. Higher levels are gained when more participants in increments of five are enrolled under new Senior Coaches. When five Senior Coaches are enrolled, each with five participants below them for a total of 30 (25 participants and 5 Senior Coaches), the rank of Exec. Director is gained. At each level a higher percentage of total payments accrues from the total downline.

The pyramid moves toward its peak with four more levels. Regional Director sits above the Exec. Director. (each Exec. Dire. has 30 participants). The National Director has 3 Exec. Directors for a total of 93 participants below them. Global Directors have five Exec. Directors for a total 155 participants. The top rank of Presidential Director has 10 Exec. Direct.. with 310 participants. As will be explained further and emphasized in the

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the only feasible – means to reach the upper level is to build “structure”, i.e., recruit coaches who recruit other coaches. In this manner, the participant will “construct” a pyramid below and move higher up the chain where far greater rewards are offered. The cultivation of new coaches “leverages” other people’s recruitment incentives to move up the ranks also and gain access to lucrative “bonuses” and “overrides” that are payable only to those in the top ranks. At any time a “client” can be converted to a “coach” and gain the chance to join the “endless chain” and receive “unlimited” rewards from recruitment.

<sup>13</sup> Medifast does not disclose to shareholders how much of *Take Shape for Life’s* revenue comes directly from the payments made by the coaches. If the coaches are also buyers of the products on a monthly basis, they could constitute as much as 20% of company revenue all by themselves. (2,800 coaches purchasing \$300 a month of product for their own use, plus for sales and marketing purposes, plus entry fees, etc.)

rest of the report, the plan overwhelmingly inclines the “coach” to recruit coaches in these positions on the chain (building “structure”).

As the FTC’s Dr. Vandernat explained, the insidious deception of the endless chain is concealed with a promise of rewards that “cannot come true for the vast majority of participants.” TSFL entices consumers to become coaches with a deceptive promise of rewards that are based on the “endless” chain of more coaches. The very same promise is of access to these rewards is offered to all coaches no matter how large the chain grows. In the imaginary world of the endless chain, the market is deceptively portrayed as “limitless.” The deception may also be stated as inducing and rewarding consumers to build an endless line of salespeople in a finite market. *The vast majority are doomed to fail. Those that “succeed” are doing so on the investments and labor of those lured into the money trap.*

As Dr. Vandernat explained, at all times the bottom ranks will hold the vast majority. The above chart illustrates this mathematical design. A Presidential Director may have as many as 300 (or more) coaches in the downline. Over 80% would be in the bottom ranks where they cannot gain “bonuses.” No matter how many Presidential Directors are in TSFL, there will be, correspondingly, hundreds of newly recruited coaches at the bottom. For the 250 at the bottom levels to achieve what the Presidential Director has achieved – by building “structure” – more than 75,000 new coaches would have to be enrolled below them.

### **Medifast and the California “Endless Chain” Statute**

California’s anti-pyramid scheme law was passed in 1968, sponsored by State Senator (and later a famous Mayor of San Francisco) George Moscone and signed into law by then governor of California, Ronald Reagan.

The California law is based upon an *implicit* understanding of the “endless chain” as a classic form of trickery. The language is explicit – and the history of the law’s passage makes clear – that it intended to prevent the endless chain from being used as a marketing device for selling goods or for enticing consumers into an “income opportunity.”

Endless chain schemes typically blend the purchase of a product or service with the promise of income. Some stress the acquisition of a product for free or at a huge discount. Others induce product purchases by offering consumers “unlimited income,” “financial independence” and “freedom of time” through its “unique” income opportunity.

Endless chains, therefore, are both consumer scams, in the same category as “bait and switch” and business opportunity frauds in the same category as stock swindles and investment Ponzi schemes. The continuous recruitment of an ever-expanding base of new buyer/investors is their hallmark.

*Take Shape for Life purports to offer both a steady part time income that offsets the \$300 a month cost of its products and a “full time” job opportunity that it claims can pay tens of thousands per month. Both opportunities are fundamentally based – though disguised – on the enrollment of consumers who enroll other consumers, etc.*

Promoters of pyramid selling schemes often seek to weaken public understanding of the inherent fraudulence of the “endless chain.” A common defense of pyramid selling schemes is to characterize them as less a “business opportunity” than a “discount buying”

program. Most participants, it is often claimed, are not seeking high income (though it is promoted to them) but only join the schemes to get discounted or free products or services after they refer other participants to the scheme.<sup>14</sup>

It is clear that the authors of the California statute intended to outlaw this very type of chain referral marketing scheme in addition to those that blatantly promise the potential of "six figure incomes" to all. In his August 8, 1968 letter to Governor Ronald Reagan asking for his signature on the bill, Senator George Moscone offered a description of the most basic type of endless chain promotion that the law would outlaw and which had only recently appeared in the marketplace:

*"For example, suppose that a buyer was promised a chance to obtain a product free of charge by referring five others and those five were each promised the same opportunity if each referred by more, and so on at the same rate of increase. After ten rounds the cumulative number of persons enrolled would be 12,207,03. Of course, these schemes never approach astronomical proportions. The saturation point is reached at an early stage... It follows that a large segment of the buyers participating in these schemes will suffer financial loss.."*

The law aims at a *fraudulent marketing ploy*, not at products or even pricing. It is the way in which the scheme gains consumer investments or purchases that constitutes the scam. Quoting again the FTC's expert, Dr. Vandernat, the endless chain scheme promises "rewards (that) cannot come true for the vast majority of participants."

- The California law explicitly covers endless chains schemes that *sell products*. ("endless chain" means any scheme for the disposal or distribution of property).

Today, imbedding the pyramid money transfer in the *pricing of a product* or service is the *prevailing* method of disguise for endless chain schemes. Many consumers are misled by claims by pyramid perpetrators that "if a company sells a product, it can't be a pyramid scheme!"

- It *excludes* businesses that straightforwardly pay commissions for sales made to consumers who are not part of the sales scheme, i.e., consumers who are not the coaches, distributors, agents, or IBOs, or whatever participants in the pyramid reward systems may be euphemistically called. (*Compensation, as used in this section, does not mean or include payment based upon sales made to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme.*)

<sup>14</sup> The Direct Selling Association, which represents most major multi-level marketing companies, recently lobbied the Federal Trade Commission to exclude MLMs from a proposed new consumer protection rule to regulate "business opportunity schemes." The DSA has also made public claims that the documented 99% loss rates of consumers that join MLMs is not significant since few of the people who sign up as sales representatives actually try to make sales or to earn an income, DSA maintains. They only wanted products at the "discount" or for free, which is available only to those in the chain pay plan. The high drop out rates of 60-80% a year, according to the DSA, are not indicators of failure but to the *success* of participants in obtaining products at a discount after making a few referrals or having earned a small profit from enrolling others.

- In ensuring that legitimate direct selling is distinguished from pyramid selling, and that pyramid schemes could not be disguised as legitimate direct selling companies, the final law went through a crucial wording change. The last sentence had originally read,

*"Compensation in this section, does not mean or include payment based upon sales made by such persons or participants."*

That wording could have *exempted* rewards that were laundered through product sales, thereby legalizing disguised pyramid schemes and leaving all consumer vulnerable to being recruited into sales businesses that use the endless chain income promise as a sales and purchase incentive.

The California legislature replaced this "loophole" with the wording,

*"Compensation, as used in this section, does not mean or include payment based upon sales made to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme."*

With the final wording, businesses that paid commissions on actual retail sales to real end-users were not included while those that laundered the payments and rewards though product purchases were covered. By shifting the exemption to actual *sales* (sales made to persons who are not participants), rather than to *persons* making sales (sales made by such persons or participants), a fundamental distinction was maintained. True retail sales are not affected but sales driven by pyramid recruitment (*salespeople* selling to *salespeople* who sell to *salespeople*) was recognized for what it is – an endless chain scam.

To end all ambiguity, the final version of the law also deleted the word *primarily* in describing schemes that pay rewards for recruiting new participants and are covered under the law. The final wording made it unequivocal that the law covered *any* business that employed the endless chain as a marketing device.

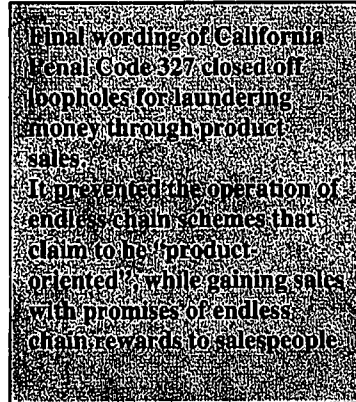
*Earlier draft language of California's "endless chain statute*

1 SECTION 1. Section 327 is added to the Penal Code, to read:  
 2 327. Every person who contrives, prepares, sets up, pro-  
 3 poses, operates, or aids in the operation of or operates any  
 4 endless chain is guilty of a misdemeanor. As used in this section,  
 5 an "endless chain" means any scheme for the disposal or dis-  
 6 tribution of property whereby a participant pays a valuable  
 7 consideration for the chance to receive compensation *primarily*  
 8 for introducing one or more additional persons into participa-  
 9 tion in the scheme or for the chance to receive compensation  
 10 when a person introduced by the participant introduces a new  
 11 participant. *Compensation, as used in this section, does not*  
 12 *mean or include payment based upon sales made by such per-*  
 13 *sons or participants.*

**Current California Law****§ 327. "Endless chain" schemes**

Every person who contrives, prepares, sets up, proposes, or operates any endless chain is guilty of a public offense, and is punishable by imprisonment in the county jail not exceeding one year or in state prison for 16 months, two, or three years.

As used in this section, an "endless chain" means any scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant. Compensation, as used in this section, does not mean or include payment based upon sales made to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme.




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***"Demand created by these schemes is the demand to obtain something for nothing plus a profit too. Accordingly, they detract from the free enterprise system ideal of competition based upon prices, on quality and on need for products and services."***

*--August, 1968 letter sent by State Senator Moscone to Governor Reagan explaining the various problems that the new anti-endless chain law was seeking to address.*

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The final law has the definitive language:

***"an "endless chain" means any scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant."<sup>15</sup>***

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<sup>15</sup> The "loophole," which was removed from the California statute, was strongly promoted – and its removal vigorously protested – by one multi-level marketing company operating in California at that time. The MLM was Holiday Magic. It sold cosmetics and was owned by William Penn Patrick, also the owner of a training programs, Leadership Dynamics and Mind Dynamics. Patrick lobbied legislators to exempt any scheme in which payments and rewards were tied to product purchases.

The law ultimately treated this product-oriented model as merely a disguise for pyramid fraud. The law zeroed in on the endless chain lure that drove the product "sales" as a systematic swindle. The legislators saw that the fraud was in *how products were marketed*, not in the products themselves or the pricing. Tying the pyramid to a "sale" and "purchases" did not change the true nature of the fraudulent enterprise.

### **Take Shape for Life's Pyramid-based Business Model**

To grasp the full significance of the TSFL program of endless chain incentives for coaches, it must be seen in the context of the overall business model of Medifast. Also, since TSFL employs the "multi-level marketing" mode, it is important to see it in the context of the larger MLM "industry."

MLM is not just a business model but a distinct industry with its own Washington, DC lobbying organization, the Direct Selling Association (DSA). *Take Shape for Life* is a DSA member. Every MLM competes with all other MLMs for the sale of the one product they all have in common – *an income opportunity*. Many have strict rules prohibiting participants from joining other MLMs even though the ostensible "products" (soap, fruit juice, herbs, diet pills, etc.) are clearly unrelated. All MLM are more closely related by the "extraordinary" and "unlimited" income opportunity that they market than any of them are to other non-MLM companies that may sell similar "products."<sup>16</sup>

In all MLMs the income opportunity is based on commissions sourced from an "unlimited" and ever-expanding base of recruits. For this reason, the legitimacy of the MLM industry is continuously under question. All publicly traded MLMs must include in their list of "risk factors" the potential of their business model being effectively outlawed.<sup>17</sup>

- The MLM business model is currently banned in China, as of 2005

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Holiday Magic was later shut down and paid millions in restitution. It was prosecuted in the US by the SEC and by regulators in Europe as a pyramid scheme.

Today, exactly the same "loophole" to exempt "product-based" schemes is championed by the Direct Selling Association (DSA) of which Medifast is a member. In these schemes usually 30-40% of the product price (which is often already hyper-inflated) is transferred to upline recruiters – with most of that amount going to the top 1% – as each new participant "buys" the goods upon joining and participating. All new recruits (purchasers) are then urged to build their own "endless chain" of new purchaser/recruits below on whose "purchases" they will gain rewards. *Take Shape for Life* pays even more to its recruiters – 50% of the price of its goods with the great majority of that going to the upper ranks – while authorizing all new "coaches" to "build structure", i.e., recruit more coaches endlessly.

<sup>16</sup> Because all MLMs are actually a singular distinct type of business, regardless of products, some law firms specialize in representing them. The law firm of Grimes & Reese, P.L.L.C. is one of these. It lists *Take Shape for Life* as one its clients. Other MLM clients of Grimes & Reese include Burnlounge, Inc. which is currently being prosecuted by the Federal Trade Commission for operating an illegal pyramid scheme. See <http://www.ftc.gov/opa/2007/06/burnlounge.shtm>

<sup>17</sup> Due to their questionably legal business model, the jeopardy that all MLMs are in – including those traded on stock exchanges and experiencing rapid growth – was highlighted in the recent, traumatic experience of the MLM, Your Travel Biz.com (YTBLA.OB). YTB was ranked as America's 26th largest travel services agency. No action had ever been taken against YTB by the U.S. Federal Trade Commission (FTC) or any other state Attorney General. Like *Take Shape for Life*, YTB is a member of the Direct Selling Association which claims to screen its members to ensure they operate legally and ethically. And, like *Take Shape for Life*, YTB is publicly traded on the stock exchange and must report its financials to the SEC. YTB has a reported "sales force" of over 340,000 and drew nearly 20,000 participants to its annual meeting in St. Louis. In the last year, the number of YTB "agents" grew 67%.

The YTB stock was trading at about \$1.80 on Aug. 3, 2008. The next day, news broke that the California Attorney General was suing YTB for violating California Penal Code, Chapter 9. § 327 – the endless chain statute – and the stock plummeted. A month after the announcement of the prosecution the stock sold for 71 cents, a drop of 61%.

- The largest of all MLMs, Amway, was recently prosecuted for fraud in England. The government of England sought to shut down Amway in the country. It discovered that 99% of all participants in Amway UK, year after year, failed to earn a profit while the company promoted itself to British consumers as the "greatest income opportunity in the world."<sup>18</sup>
- Here in the USA, a large class action lawsuit brought by large and well established law firms in the United States is charging that Amway, the mother of all MLMs is a fraudulent pyramid scheme.<sup>19</sup>
- The MLM company, Your Travel Biz.com, a member of the Direct Selling Association with over 300,000 consumer participants was sued in August, 2008, by the California Attorney General for violating Penal Code 327, the endless chain statute.

Medifast is the only MLM company in the Meal Replacement industry and the only (primarily) Meal Replacement company in the MLM industry.<sup>20</sup> Its uniqueness in MLM has significance. Most MLMs offer products that are cheaper to produce and on which the schemes can make claims of "extraordinary" characteristics – patented, unique, "not sold in stores," etc. Medifast sells *food* which cannot easily be promoted for having miraculous or instantly transformative powers, as "natural herbs" might be.

*Because Medifast does not sell a "sexy" and "amazing" or "unique" product, the role of its income claims becomes even more central to its product sales. The role of its offer of an income is its main means of differentiating itself from the much larger and better known competitors such as NutriSystem or Jenny Craig, among others.*

### **The Role of Take Shape for Life in Medifast**

Though *Take Shape for Life*, which uses the MLM model, is half of the company's total revenue and nearly 90% of its recent growth – and its "income offer" is its chief distinction among competitors – *the MLM model used by Medifast is only minimally disclosed to shareholders in SEC filings.*

Medifast divides its business into four distribution channels:

- |  |     |
|--|-----|
| 1. Website sales driven by advertising (called "direct")         | 48% |
| 2. Sales through medical doctors                                 | 3%  |
| 3. Multi-level Marketing, called " <i>Take Shape for Life</i> ". | 41% |
| 4. Brick-and-mortar Weight Control Centers                       | 7%  |

The MLM sector is the fastest growing sector of Medifast with 72% growth in the first six months of 2008 over the same period in 2007. It grew from 33% of total company

<sup>18</sup> See the 11/24/07 article from the *London Times* at <http://www.pyramidschemealert.org/PSAMain/news/TimesReportonAmwayTrial.html>

<sup>19</sup> Jeff Pokorny and Larry Blenn on behalf of themselves and those similarly situated, Plaintiffs, v. Quixtar, Inc., James Ron Puryear, Georgia Lee Puryear and World Wide Group, L.L.C; Britt Worldwide L.L.C., American Multimedia Inc., Britt Management, Inc. Bill Britt and Peggy Britt, Defendants, Case No. C 07 0201, United State District Court, Northern District of California, Class Action.

<sup>20</sup> Many MLM companies, including Amway, sell some meal replacement products (bars or shakes, for example) but are primarily focused on other products such as soap, vitamins, herbs, etc.



revenue at the end of 2007 to 41% six months later. It accounted for 86% of Medifast's actual growth in the first six months of 2008 over the same period of 2007.

The sector of medical doctor sales declined in revenue. The brick-and-mortar sector grew robustly but is a very small part (7%) of total revenue. Internet sales (called "direct"), which is driven by advertising, is currently Medifast's largest sector (48%) but it grew only 5% year-over-year. *If these growth trends continue, the MLM sector (Take Shape for Life) is clearly slated to be the largest segment of Medifast very soon.*<sup>21</sup>

As noted, Medifast cannot claim a miracle product that prevents illness or is imported from an exotic rain forest and its food products cannot claim to be unique or substantially lower priced. *So, why is the MLM sector growing so rapidly?*

Medifast management answered this question unequivocally.

The Medifast 10Q stated, *"The growth in this segment correlates directly to the increase in health coaches."*

The number of active health coaches grew 87% to 2,800 at the end of the second quarter of 2008 as compared to 1,500 for the same time period in 2007, and up from 2,200 at the end of the first quarter of 2008.

Medifast's current growth is driven by TSFL's growth in "health coaches." Medifast's current growth in stock value, therefore – *over 150% since March 08* – is similarly determined by TSFL's growth in "health coaches."

Despite this extraordinary equation linking growth in the number of coaches and Medifast revenue growth and Medifast stock value growth, Medifast shareholders know almost nothing about these coaches, how they are recruited, or about the factors that determine future growth of coaches.

### **The Limits of Unlimited**

On its "Opportunity" webpage *Take Shape for Life* tells consumers that there "is no cap on your income." Perhaps the coaches can grow their incomes forever, but *Take Shape for Life* surely cannot grow the number of coaches forever.

For example, if the 86% of Medifast's growth that came from *Take Shape for Life* in the first six months of 2008 over the same period of 2007 is based on the 87% increase in the number of coaches, then the number of coaches must continue grow at that rate for the

<sup>21</sup> Medifast reported in its 10-Q for the 2<sup>nd</sup> quarter of '08 that it invested \$400,000 new dollars in ads during the first six months of '08 over the same period last year to drive the internet (direct) sales division. This produced \$1,204,572 additional revenue (5%) in that division over the same period the previous year. *One new dollar in advertising expense produced 3 new dollars (\$3) in revenue.*

In the same time period, the MLM sector, *Take Shape for Life*, increased revenue by \$9,044,790 (72%) while Medifast expended \$4,500,000 new dollars in "commission, and bonuses" to the company's "coaches." *One new dollar in commissions to the coaches produced 2 new dollars (\$2) in revenue.*

Missing from this disclosure, however, is how much was *expended by the coaches* to gain the new business. The dollars spent by Medifast on Commissions are "after-sale-rewards." The true costs of gaining a sale in the *Take Shape for Life* sector must also include the investments made by the coaches who are the actual "direct sellers" and would therefore incur the highest sales and marketing costs. It is precisely these types of costs that California's endless chain law seeks to protect consumers from, in addition protecting them from buying products or services on the false promise of "unlimited" income.

company's *revenue* to continue growing at its current rate. Medifast's rapid stock value rise seems to reflect a belief among some in the securities market that such growth can be sustained. *Can it?*

If growth in coaches were repeated over the next 5 years, at the last reported rate of 87%, there would be 64,000 coaches. In 10 years, there would be 1.5 million coaches! (2,800 x 1.87, compounded at the same rate for 10 years). Factoring the normal high drop out rates, the number of people joining Medifast as coaches would be in the millions! The number of people solicited to successfully enroll these millions would be in the tens of millions! *Whom would the multitude of coaches sell to?*

If Medifast's sustained its current revenue growth rate of 25% over a five-year period it would have total revenue of \$271 million. In ten year annual revenue at the same continued annual growth rate, total revenue would be \$827 million – about the size of NutriSystem Inc., today, one of Medifast's main competitors.

The diet and meal replacement market could conceivably support 25% annual growth for Medifast, compounded over the next 10 years. Such growth would be extraordinary and would clearly involve taking market share from competitors. However, if this growth requires a corresponding rate of growth among the coaches, it clearly is not possible.

Medifast's growth rate is limited under its business model, not because the market could not sustain this rate of market share expansion, but because *the market for coaches* cannot expand at this rate! Legitimate recruitment of coaches requires a viable income opportunity for the coaches, based on market potential. As the number of coaches expands, the available market and the potential income opportunity *diminishes*. This fact is the fundamental reason the California law targeted the "endless chain" as marketing or sales device. It offers what it cannot deliver.

Because Medifast increasingly relies upon an ever-expanding number of "coaches" to sustain growth, the MLM pay plan of *Take Shape for Life* becomes the *de facto* linchpin of the company's stock value.

As noted earlier, in my view, this pay plan meets the definition of an "endless chain" within the meaning of California Penal Code, Chapter 9, § 327. To say this another way, Medifast is hinging its business upon the "endless chain" incentive to induce people to work for it. It is rewarding them on a model that is *unsustainable* and that must *always* prevent large numbers of reaching the promised goals. Indeed it cannot be sustained except by *causing* these dashed expectations. For there to be some winners, there must a correspondingly much larger group of "losers", those at the bottom that cannot be earning the large incomes, due to their position on the chain.

### **Medifast's Cover-up**

To build a business on pre-determined failure by most of salespeople requires extensive *deception*, which Medifast is already engaging in and must intensify to produce higher recruitment rates for coaches. *Take Shape for Life's* MLM business model has inherent limits and liabilities, which are not disclosed Medifast shareholders. Though the company's growth depends on coaches, shareholders do not know from SEC filings about the coaches' productivity or profitability. Nor do they do know about their retention rates.

- Medifast offers no information on its website or in SEC filings about the actual number of coaches recruited in any time frame or their dropout rates. It only offers a count of "active" coaches at the end of a quarter. Therefore, the churn rate, if there is one, is not disclosed.
- The actual number of retail customers per "coach" is also not disclosed. Similarly, the company does not disclose the percentage of incomes of coaches that are based on personal retail sales versus "bonuses and overrides."
- The average income of *all* coaches, active and inactive over and extended time, is not reported to shareholders or to prospective coaches.
- The percentage of annual revenue sourced directly from the coaches (their fees and personal purchases) is not disclosed.
- Perhaps most important, regarding the coaches' profitability, the shareholders do not know how many coaches are in the various levels of the sales hierarchy and the proportions of commission payments made to each of the various levels of coaches.

The last figure about how commissions are apportioned by rank is crucial, since the pay plan offers extraordinary rewards to those in the top ranks only. If the data revealed how much of total commissions went to the various levels, it would reveal the true odds of success for newest recruits, i.e., how much money is left over to pay the latest recruits. Since the company depends on the steady recruitment of more coaches who join the bottom levels, it will always be the revenue produced by the newest recruits – who are always the majority – that sustains annual revenue.

- Currently TSFL recruits coaches without disclosing to the recruits the data on incomes averages, amounts and percentages paid to each level of the "upline", dropout rates or average costs to do the business.<sup>22</sup>

The most basic data related to the recruitment of coaches – what percentage of *Take Shape for Life* revenue is paid out as commissions to the coaches or what the total dollar number is – is not directly disclosed to shareholders.

That basic and crucial piece of financial data is buried within the general line item "Other Selling, General and Administrative Expenses" which accounts for 61% of Medifast Revenue. How much of that went to "commissions"?

Several additional calculations reveal that in the *Take Shape for Life* sector, Medifast pays out 50% of all revenue in commissions to the coaches.

- Medifast's total Revenue for the six months ending June 30 was \$52,706,000. *Take Shape for Life* Revenue is stated as 41% of total Revenue, which is \$21,609,460.
- In the discussion of the "Other Selling, General and Administrative Expenses" in the latest 10Q, Medifast states that "*Take Shape for Life* commission expense, which is completely variable based upon revenue, increased by approximately \$4,500,000 as

<sup>22</sup> Coaches can earn 15% on sales to other coaches or clients. If the average buyer pays about \$300 a month, the per-sale commission is \$45. This is only a gross income before all business overhead and sales and marketing costs expended to get the customer are deducted. By recruiting and selling to a coach, additional payments can accrue without additional labor or costs.

*the Company showed sales growth of 72% as compared to the first six months of 2007.*

- Therefore, if sales grew 72%, commissions would also. The dollar figure of that commission growth is stated as \$4,500,000. Therefore, when \$4,500,000 is divided by 72% growth, it reveals the last period's total commission payments. This equates to \$6,250,000. ( $\$4,500,000 \div .72 = \$6,250,000$ .)
- If last year's commissions were \$6,250,000 and they grew in the same time period by \$4,500,000, then this period's commissions were last year's total plus the growth, which equates to \$10,750,000 ( $\$6,250,000 + \$4,500,000 = \$10,750,000$ .)
- So, in the first six months of this year, the company paid out a total of \$10,750,000 in commissions to the coaches and TSFL's total revenue was \$21,609,460. Commission payout was, therefore, 50% of total revenue ( $\$10,750,000 \div \$21,609,460 = 50\%$ )
- One further verification of this 50% figure is determined by dividing the stated dollar increase in commission by the dollar growth in revenue in the same period. In the first six month of 08, the company said TSFL's revenue was 41% of total revenue and that this sector grew 72% over the same time frame of last year. That number works out to a growth of exactly \$9,044,790. It also reported that during this same time period over previous year, they spent \$4,500,000 in additional dollars for TSFL for commission and bonuses. Dividing the new money Medifast spent on commissions into the new money it gained in revenue, it equals exactly 2, that is, the new commissions were 50% of new revenue.<sup>23</sup>

### **Medifast's Pyramid Pay Plan**

The most important information that shareholders are not provided concerns not just the hard data on income averages, costs and "churn" levels of coaches *but the method by which Medifast pays the coaches*. As in all sales programs, the pay plan is a key to sales force motivation and behavior.

The *Take Shape for Life* pay plan has two key characteristics that not only determine the incomes for the average coach but also directly affect compliance with California's "endless chain" law.

1. The Upline Recruiters of *Take Shape for Life* are paid *more than twice as much as the actual salespeople per sale*. This is a structure completely in reverse from normal direct selling businesses, which pay the largest part of total commissions to the actual sales agent – per sale. It is the salesperson who is primarily responsible for making the sales and who has incurred the highest costs in the sales process (including finding the prospective customers and successfully making the sales) and, therefore, requires the greater financial incentive and deserves the greater financial reward – per sale. *A top-loaded pay plan that transfers most of the commission dollars to the recruiters at the top of the hierarchy – per sale – reveals that the pay plan is oriented to recruiting, not retail selling.*

<sup>23</sup> 50% payout in commissions is quite high in the multi-level marketing field, which supports the fact that *Take Shape for Life* must drive its business with an "income promise". As noted, the product is food, which cannot be said to be "unique", "amazing", and "patented" as so many other MLMs claim their products are.

2. The concentration of rewards to the top levels is exacerbated by the system of "roll-up" and "compression." The published compensation plan describes the system, "*This plan uses roll-up and compression. Roll-up means that if a Coach fails to hit the minimum sales and recruiting requirements (i.e. is Bonus Qualified), his/her volume will "roll-up" and be added to the volume of the next Coach in the line who has met those requirements and is Bonus Qualified. Compression means that if you are Bonus Qualified to earn bonuses on sales volumes in your network (based on your rank), each Bonus Qualified Coach at the specific rank to the depth you are to be paid determines a level or generation as you move down a line. For example, if you are qualified to earn Executive Director bonuses on two generations of Executive Director organizations, your first generation Executive Director will be the first Coach in the line that is currently Bonus Qualified at that rank and your second generation Executive Director will be the next one who is Bonus Qualified at that rank. Unqualified Coaches in between are rendered "invisible" regarding compensation for that pay period and their volume compresses to first qualified Executive Director up the line.*"<sup>24</sup>

The extraordinary significance of this system would likely not be grasped by a consumer that has just signed up as a coach. It is key driver for recruitment and an amazing reward for those in upper levels. Each level of the TSFL pyramid has specific requirements for both volume and structure. If the structure or volume weakens or declines (people buy less or quit the scheme), the rate of pay changes dramatically. And the money that is lost moves up the chain and is transferred to those above who remain "bonus qualified." In this way, recruitment levels are enforced with financial penalties, and the rates of dropouts and losses in status that inevitably occur among those struggling in the lower ranks, directly benefit those above.

The pay plan includes payments to as many as 10 levels of "managers" above the coach that makes a sale. A complex formula is used involving 98% of the retail price, called ARD, for Adjusted Retail Dollar amount), and 50% of the ARD, called CV, for Commissionable Volume. (It is highly unlikely a new coach could decipher the formula and grasp its implications for recruiting and retailing and its relationship to overhead and selling costs.)

At the base of the pyramid is the new coach who makes a sale of *Take Shape for Life's* "meal replacement" products. A month of these products, in round numbers, costs \$300. For making the sale of a month's worth of diet products, the new coach receives 15% of ARD, about \$44, or 14.7% of the retail sale.

14.7% is a remarkably low commission for making retail sales. Avon and other direct sellers offer 50% gross profit margins. Out of that commission amount, the coaches must cover all selling costs and ongoing overhead for their businesses.

Medifast's SEC filings reveal that the company expends 50% of its revenue on commissions to coaches. 14.7% goes to the salesperson making the sale. Where does the other 36.3% go?

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<sup>24</sup> <http://www.tsfl.com/pdfs/comp-overview.pdf>

The pay plan formula offers escalating “bonuses” to those that recruited the coach and those that recruited the coach who recruited the coach, etc.

- *Assist bonuses*: \$100 cash payments when their personally recruited coaches also get five clients or other new coaches in 30 days);
- *Rolling Consistency Bonuses*: based on escalating volumes from other coaches, continued month to month;
- *Growth Bonuses*: paid on Commissionable Volume of orders placed by others in your “organization”;
- *Leadership Bonuses*: paid to Executive Directors and higher on the volume of business ordered through “generations” of Executive Director Teams in the “Health Coach Network”.
- *Generation Bonuses*: paid to Regional, National and Global Director levels, the bonuses are paid on increasing levels level through 5 “generations” of Executive Director Health Coach teams within your “organization.”
- *Elite Leadership Overrides*: paid to National Executive Directors and higher on large portions of a leader’s business (in some instances the entire business) and could mean as much as an additional 3% through more than 5 generations of Executive Director Health Coach teams within an organization.

All of these special bonuses and overrides are reserved to those in the upper levels of the sales chain, but ultimately most of the revenue on which they are based comes from the work of the lowest level coaches. They are the great majority of the sales “organization.”

To grasp the full significance of the incentive reward system offered to those who can rise to higher levels, consider:

- The pay plan overview states that an Executive Director is entitled to a “*Maximum of 30 % of CV on sales in your Health Coach Network starting on Level 1.*” This 30% CV equates to a commission of \$44 on a \$300 sale. That is the same amount that the new Health Coach that actually made the \$300 sale would be paid. The Executive Director is five levels removed from the new coach in management levels!
- The plan also allows the Presidential Director to get a 3% CV cut on the total sales of all level in the “downline.” On the \$300 sale made by the lowliest new coach that is \$4.41 piece of the action, about 10% what the salesperson made who did the work and incurred all sales and marketing costs. The Presidential Director is 10 management levels away from the sale and incurred no costs at all on the sale!

Though practically indecipherable to a new recruit, the *Take Shape for Life* pay plan is a perfect blue print for endless chain recruiting. The most pay – per sale – is transferred in the upper ranks. The higher ranks also gain commissions for a “wider and deeper” levels of the total organization, directing large amounts of total commissions to them. Getting to the upper ranks, where all this money is concentrated *requires a dedicated campaign of recruiting.*

### ***Take Shape for Life's "Other" Product: An Income Opportunity***

The California law is aimed at preventing companies from using an "endless chain" reward plan to induce investments or purchases. Unlike other meal replacement programs, *Take Shape for Life* promotes "income" as an integral part of achieving success in losing weight. *The offer of an "income opportunity" – based on endless chain recruiting – is woven into every sales pitch.*

For example, this is how Jenny Craig, a direct competitor of TSFL, describes the philosophy of its diet program on its website:

- *Food* - A Healthy Relationship With Food
- *Body* - An Active Lifestyle
- *Mind* - A Balanced Approach to Living

Contrast that with TSFL Website description:

- *Healthy Body* - physical health is the foundation of a happy and fulfilling life.
- *Healthy Mind* - how we feel about ourselves also affects long term Optimal Health.
- *Healthy Finances* - debt causes stress - and stress can take a severe toll on both your physical and mental health. By managing and eliminating debt, learning ways to budget, and or *seizing financial opportunities*, you further yourself on the road to Optimal Health. (italics added)

*Healthy finances* as part of a diet program? No other meal replacement program ventures into a customer's personal financial life as an integral part of its diet regimen. But *Take Shape for Life* boldly makes "finances" and "seizing financial opportunities" the third of just three critical aspects to its program and philosophy.<sup>25</sup>

So how does the TSFL program teach you to have "healthy finances"? Reduce credit card use, live more frugally?

No. Its prescription for how to achieve "healthy finances" is quite specific:

#### **Healthy Finances<sup>26</sup>**

- Financial freedom
- Enhanced lifestyle
- No limit to your earnings potential
- Earn rewards commensurate with your efforts

In other words, signing up for TSFL coach work is the means of achieving "healthy finances" and healthy finances are one of the three keys to success in losing weight and reaching "optimal health." The TSFL program involves not just dieting and exercise but also making money as a TSFL coach. The income offer is woven in with the meal

<sup>25</sup> In its training literature, the "trilogy" of "body, mind and finances" is consistently presented as the basic marketing message. For all who sell the TSFL meal replacement products, the income offer is integral to the promise of weight loss. For example, "...*financial health has been identified as the final element necessary for long-term optimal health. The ability to help people quickly supplement their income can take the burden off of a struggling family's finances. For those committed to going all out to build this health network, there is practically unlimited financial reward!*" (Training Binder, "Setting Your Business in Motion" ©2006 *Take Shape for Life*.)

[http://www.getyouhealth.com/BizDocs/b1\\_setting\\_your\\_business\\_in\\_motion\\_0806.pdf](http://www.getyouhealth.com/BizDocs/b1_setting_your_business_in_motion_0806.pdf)

<sup>26</sup> [http://www.tsfl.com/corporate/opportunity\\_whyunique.asp#\\_](http://www.tsfl.com/corporate/opportunity_whyunique.asp#_)

replacements. The two – the meal replacement products and the income potential as a coach – are inextricably bound together.

### **At the Bottom of the Pyramid: The Coach**

According to TSFL's program, signing up as a coach is a way to reach "healthy finances", a key element in its weight control program. Coaching work offers "financial freedom and enhanced lifestyle," it states. It claims also to offer "unlimited earnings potential", determined "only by your own efforts."

Does it?

Medifast does not provide a profile of the financial condition of coaches in SEC filings. The TSFL website offers little detail either. Consumers who are solicited to join TSFL as coaches are not given data on average incomes, turnover rates or business costs. Some closer analysis can shed some light, however.

For example, Medifast reported at the end of the second quarter of 2008 that there were 2,800 "active" coaches (no data is offered on how many are "inactive"). With further calculations explained earlier in this report, it was determined that TSFL paid the coaches \$10.75 million in commission on their own purchases and their sales during the first six months of 2008. This is a mean average of \$148 a week gross income, before all business and marketing and sales costs and taxes – *considerably less than what a part time job at minimum wage job offers.*

But, the real income *for most coaches* must be *much lower* than this. As shown earlier in this report, 65-70% of the total commissions paid out by TSFL goes to the ranks above the basic coaches. So, most commission dollars had to have been paid to the much smaller group at the top, causing a skewed average, weighted to the top. A *median* average income level, showing the point at which half make more and half make less, therefore, would be far lower.

The TSFL website offers a chart illustrating incomes of between \$8,000 and \$20,000 per month. In reality, only a tiny fraction of one percent could possibly earn such incomes (see chart below). A more realistic question is how many TSFL coaches might earn at least more than what a part time person earns at minimum wage? For example, we can test to see how many coaches could earn a modest \$500 per week in *gross* revenue, before expenses are deducted?

The calculations show that the highest possible number of coaches that could earn just \$500 a week is only 829 coaches out of 2,800. If just 829 earn \$500 a week, all 1,971 others would earn zero!<sup>27</sup> So, in reality, *far fewer* than 829 could *possibly* earn even a modest \$500 a week, *before all expenses.*

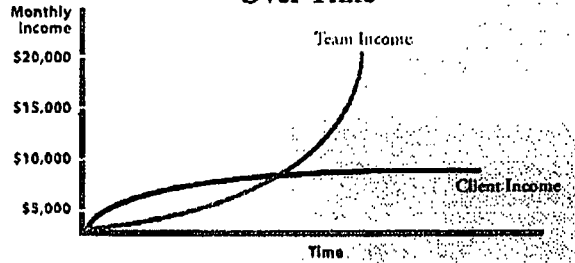
<sup>27</sup> The figure is arrived at by dividing \$500 into the mean average weekly income of \$148 to get .296 which is multiplied by 2,800 to get the number of 829 coaches. To test this number, multiply 829 coaches x \$500 a week x 26 weeks. That figure is equal to the *total* commissions paid during the period: \$10.75 million (rounded). In other words, if 829 coaches earned just \$500 a week, *all the other coaches could earn nothing at all.*

*Note:* the mean average weekly income of \$148 is arrived at by dividing the total commissions of \$10.75 million for six months by the number of coaches during that time – 2,800. That figure is divided by 26 weeks.



The *Take Shape for Life* Website shows scenarios in which coaches earn \$8,000 and \$20,000 per month. The mean average income for coaches is usually \$14,375 a week with the greater mean earning coaches. A simple statistical analysis reveals that the maximum possible percentage of coaches that could earn \$8,000 (the lower figure) is 3%. If they earned that amount, the other 97% would have to earn zero.

**Team Income Will Exceed Client Income Over Time**



**Skills to Learn for Each Strategy**

**Client Focused**  
(\$100 - \$7,500 / month)

**Client & Team Building Focused**  
(\$1,000 - \$25,000+ / month)\*

Illustration of income average using the *Take Shape for Life* binder. See the *Our Business in Motion* ©2009 *Take Shape for Life*.  
**Reality Check:** Mean average monthly income for coaches is \$6,400 with the greater mean earning coaches. Making the midpoint in the illustrations above, \$8,000 for client focus and \$10,000 for team builder, the data shows that the maximum percentage that could earn these incomes is 3% and 5% respectively. If those percentages did earn the illustrated examples, all the other coaches would have to earn zero.

**The Costs of Coaching**

On the other side of the ledger from average incomes are all costs associated with the TSFL coaching business. Under California’s endless chain statute, the costs that a consumer incurs in pursuit of an “endless chain reward” are described as follows:

... a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant.

As noted, Medifast pays the coaching network 50% of its revenue when it makes a sale. SEC filings do not show what percentage of that revenue the coaches – who are independent contractors – expended. The essence of endless chain fraud in a sales scheme involves inducing investment by consumers – which profit the sales company – while offering rewards that it cannot deliver. The *design of endless chain plan* and an *individual’s position on the chain* determines the payment of rewards to most participants, not their individual efforts or talents. Rewards are based on *position* on the chain. Most will, by design, be in the bottom. The only way all who invest could be rewarded is if the chain’s expansion could continue “endlessly”, which it cannot. Hence a law against such reward schemes.

What are those costs? Or, in the language of California’s law, how much “valuable consideration” does a coach pay for the “chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to

receive compensation when a person introduced by the participant introduces a new participant”?

TSFL literature makes no estimates of costs, though it does project potential income. Based on the costs of selling and marketing, the true costs could be substantial, including:

- Entry fees of \$299 or \$99
- Costs for training and certification, if that is chosen
- Inventory expense for sales purposes (a one-month supply of products is about \$300)
- Marketing materials, advertising, business cards, etc.<sup>28</sup>
- All sales costs, i.e., telephone, car expenses, computer, attendance at meetings, including perhaps the annual meeting of TSFL, which has a registration fee of about \$400, not counting hotel and travel and meals.
- As in all self-employment, accounting, office and tax expense.

From a mean average income for the TSFL coaches – which is somewhere far below \$149 a week – *all* these expenses must be *deducted*.

### **Coaching Business Realities**

The economic realities of TSFL coaches call into question the validity and the integrity of Medifast’s solicitation of consumers to financially invest in this work.

The pay plan overwhelmingly rewards building a “structure”, that is, recruiting others in an endless chain. This is achieved by authorizing *all* coaches *forever* to recruit others, thereby compounding the benefit from recruiting a coach over a selling product directly retail client. The very model of endlessly proliferating coaches in any geographic area (who are theoretically all competing with one another for retail “clients”) reveals that the play plan is actually based upon pyramid recruitment, not retailing. The growth of retailers in any market obviously dilutes and diminishes the sales potential in that market for each new coach.

If the plan is based on pyramid recruiting, it similarly dilutes recruiting potential as it expands. And as long as it operates, such a plan must, by design, always place the vast majority in the bottom ranks where recruitment-based rewards are not available.

Using an endless chain lure to solicit consumers places the entire Medifast program in jeopardy of violating California’s and other state’s laws against endless chains, pyramid schemes and deceptive trade practices, in my view.

1. The offer of just 15-20% gross profit to the new coaches to bring in retail business makes sustainable retail sales virtually unfeasible. Only those who build a large “downline” or, in theory, achieve extraordinary individual sales can gain higher rewards for sales work.
2. The average cost of marketing and selling, the churn rate of coaches, and the true amount of time required for sales and marketing are not revealed to the new coaches. Without this basic information, how could they know whether the income offer was valid? Withholding this information from consumers makes the Medifast coach solicitation program a questionable “business opportunity” scheme.

<sup>28</sup> Ads placed by *Take Shape for Life* coaches are frequently placed in local newspapers.

*Take Shape for Life* allocates 50% of its revenue to the entire coaching network when a sale is made. This 50% is taken from the consumer who buys the program from the coach. The coach that actually makes the sales – and who serves as the independent middle man – may earn only 15-20%. How much did it *cost* the coach to get the sale?

In the Medifast “direct” sector which uses advertising to locate prospects and sell them products, the company expends 41% of that sector’s revenue on advertising for it to generate those sales. That indicates a high cost required to actually make a direct sale.<sup>29</sup> Acting as independent contractor, the *Take Shape for Life* coaches face similar costs. They too are making “direct sales.”<sup>30</sup>

Additionally, *Take Shape for Life* coaches face extraordinary competition; they represent one of the smaller players in the meal replacement business with a less known brand; and they enjoy no price advantage over competitors.

These high cost factors indicate that the feasibility of sustaining a retail sales coach business is highly questionable, and at best difficult and costly. The only feasible income path on a sustainable basis is to build a “downline” and seek “bonuses and overrides” derived from *recruitment* activity. *Only a tiny few could be successful, taking that path.*

### **Summary Conclusions:**

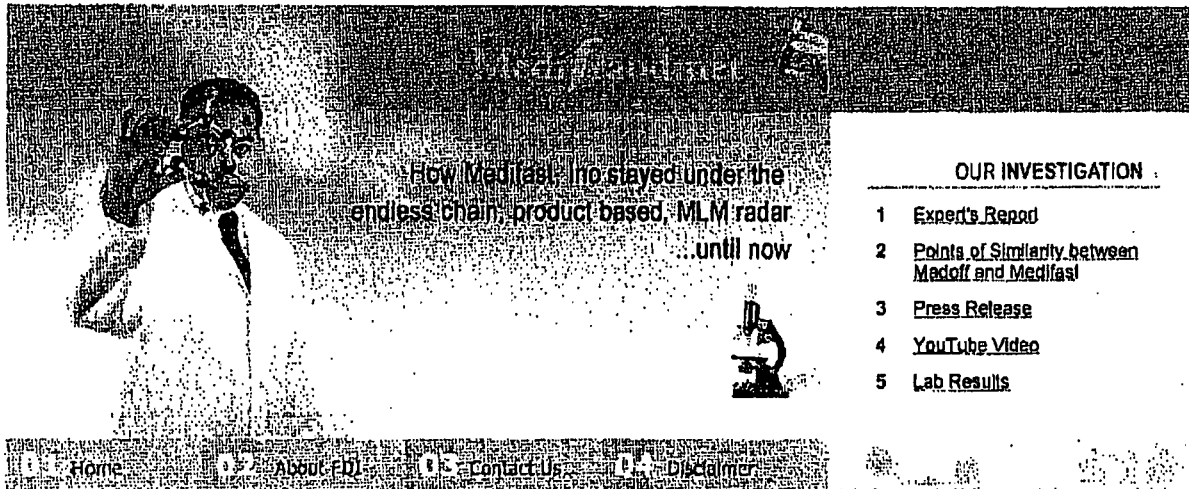
- *Take Shape for Life* has concealed an endless chain marketing scheme within its “coach” sales program. Among the means of concealment, it obscures the distinction between salespeople (coaches) and retail customers (clients) and presents a compensation plan that obscures the requirements for endless chain recruitment.
- In my view, the *Take Shape for Life* income opportunity meets the definition of an endless chain within the meaning of California’s “endless chain” statute.
- *Take Shape for Life* misleadingly recruits consumers into its coach “business opportunity” by withholding key financial information, deceptively portraying income levels, and disguising the plan’s reliance upon promotion of endless chain recruitment.
- Key information about the limits and liabilities of reliance on its coach recruitment program have been withheld from Medifast shareholders. In light of the Medifast’s reliance on the coach sales program, for revenue growth and share performance, the data and facts that shareholders should reasonably have include:
  - ✓ Total amount of revenue sourced directly from the fees and purchases of coaches,
  - ✓ Growth requirements of the number of coaches in order to grow *Take Shape for Life*’s revenue over a 10 year period,
  - ✓ Turnover and retention levels of coaches,
  - ✓ The actual number of coaches vs. clients,

<sup>29</sup> Medifast reported in its Q-2’08 SEC filing that it paid out \$10.4 million in “advertising”. Assuming this is primarily to drive its internet (called direct) sales, and those sales were 48% of total revenue or \$25,298,880, then Medifast spent 41% of that sector’s revenue on advertising for it to generate those sales. That sector grew only 5% in the time period, and ad costs grew 4%.

<sup>30</sup> The high selling costs in the diet field are exacerbated by the short term nature of customer purchasing, requiring continuous marketing for new customers. For example, NutriSystem Inc. reported in its 10K that its customers uses its products on average only for 10-11 weeks.

- √ The average number of retail customers per coach.
- If consumers were given full and factual information about the realities of the TSFL coach "business opportunity," recruitment levels would likely be negatively affected. These facts would include:
  - √ *Median* income averages and the inclusion of *all* coaches per time period, "active" and "inactive."
  - √ Allocation of all commissions by percentage to the various levels on the TSFL sales hierarchy,
  - √ Disclosure of the numbers and percentages of coaches at each level of the TSFL sales hierarchy,
  - √ Actual average costs related to operating a retail sales business for TSFL coaches.
  - √ Historical turnover and retention rates
  - √ The existing number of coaches in any geographic area a coach is solicited in.
- Medifast's solicitations of consumers that claim to offer "*Financial freedom... Enhanced lifestyle... No limit to earnings potential... rewards commensurate with efforts*" are cruelly misleading.
- The endless chain design of the coach recruitment program, the top-loaded and recruitment-oriented pay plan, the low profit rates for initial retail sales, high selling costs, among other factors which the company obscures, result in – and cause – the claims and promises related to a retail-based income opportunity to be unfulfilled for the great majority.





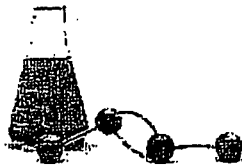
How Medifast, Inc. stayed under the endless chain, product based, MLM radar... until now

OUR INVESTIGATION :

- 1 [Expert's Report](#)
- 2 [Points of Similarity between Madoff and Medifast](#)
- 3 [Press Release](#)
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[Click Here](#) to read the report just released to the Fraud Discovery Institute by expert Robert FitzPatrick of Pyramid Scheme Alert.

In the report, Mr. FitzPatrick shows how the *Take Shape For Life* division of Medifast is nothing more than a Endless Chain Pyramid Scheme.



Watch as Barry Minkow of the Fraud Discovery Institute compares the Endless Chain Pyramid Scheme business model of Medifast's *Take Shape For Life* division to the Ponzi Scheme perpetrated by Madoff. [Click Here](#) for the video

Resources

**MEDIFAST = MADOFF??**

[Click Here](#) to view the Points of Similarity between Madoff and Medifast.

Report details how Ponzi schemes and Endless Chain Pyramid Schemes are very much alike.

**Press Release**

New FDI report reveals Madoff and Medifast, Inc. (NYSE: MED) have too many points of similarity. [Click Here](#) to read.

**Lab Results**

2 FDA approved labs confirm high levels of lead in popular Medifast products. [Click Here](#) to see results.

Primary contact:  
E-mail: [info@frauddiscovery.net](mailto:info@frauddiscovery.net)  
Phone: 888-300-8307

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Info@frauddiscovery.net

Phone & Fax:  
1-888-300-8307

**For Immediate Release**

**Title: New FDI Report Reveals Madoff and Medifast Inc. (NYSE:MED) have too many points of similarity--launch [www.medifraud.net](http://www.medifraud.net) website**

**Sub-title: Consumer group releases results of 6-month undercover investigation of Medifast, Inc (NYSE:MED) including lead testing, 29 page expert's report, product testing, YouTube video and Bernie Madoff comparison.**

San Diego, CA Tuesday February 17th, 2009

The Fraud Discovery Institute, Inc launched [www.medifraud.net](http://www.medifraud.net), a web site containing the results of a 6 month investigation into Medifast, Inc (NYSE:MED), a New York Stock Exchange, publicly traded company.

The site contains a 29 page report by expert, Robert FitzPatrick that concludes: "Medifast, in fact, offers a misleadingly promoted income scheme that cannot possibly fulfill this promise. Medifast does not actually offer a viable income opportunity but the illusion of one, as portrayed in the endless chain mirage. The income lure - that requires paying fees and buying Take Shape for Life products - is an endless chain scheme. The vast majority of all consumers that Medifast enrolls in its "business opportunity" and who serve as the engines of its growth are doomed to fail."

The site also unveils critical points of similarity between the Bernie Madoff massive Ponzi scheme and the recruitment-based multi-level marketing compensation plan of Medifast, Inc. According to the recently released report, just as Bernie Madoff had no real trading profits to distribute to investors and instead relied upon monies paid to investors to come from new investors; in like manner Medifast utilizes the same money transfer game by delegating the recruitment aspect of the scheme to its "coaches" through the promise of outrageous returns (\$8,000 to \$20,000 per month) which is the bait to bring in new recruits whose efforts enrich the upline, not the new distributor/coach. "Both Madoff and Medifast are also closed systems," said Barry Minkow, Co-Founder of the Fraud Discovery Institute, Inc. "They both rely upon the transfer of money between investors within the scheme as opposed to money from retail sales generated outside the scheme."

The [www.medifraud.net](http://www.medifraud.net) web site also contains lab reports from two FDA approved, independent labs that tested some of the popular Medifast, Inc. products and were then analyzed by lawyer and Dietary Supplement Safety Committee Co-Founder Christopher E Grell who summarizes that the tested products were in clear violation of California's Proposition 65 when he states that the: "Medifast Dutch Chocolate contains 1.48 mcg per serving is 296% or 2.96X's more than Prop 65 allows. The second test was 1.46 mcg per serving or 292% or 2.92X's greater."





info@frauddiscovery.net

Phone & Fax:  
1-888-300-8307

But perhaps the most surprising finding in this extensive, 6 month investigation was what was not found. According to Barry Minkow: "Medifast's disclosures to new recruits and Wall Street are hopelessly inadequate and worse than any other product-based MLM that we have ever encountered. They refuse to disclose failure and attrition rates which any potential party interested in the business opportunity ought to be aware of" said Mr. Minkow. "Moreover, while their disclosures about saturation, attrition and total number of coaches both active and inactive are not disclosed, their income opportunity figure of between 8 and 20 per month is not hard to find."



## **Points of Similarity Between Madoff and Medifast**

[Click here for excerpts of the letter sent to SEC and FTC  
arguing Ponzi and Endless Chain Pyramid Schemes are very much alike](#)

### **Recruiting Fresh Money**

**In Madoff's Scheme:** He was responsible for recruiting new people into the scheme, whose money was used to pay earlier investors.

**In Medifast:** The company pushes the responsibility of recruiting new people into the scheme on to their "coaches", with funds from later coaches paying returns to earlier ones.

### **Closed System**

**In Madoff's Scheme:** There were insufficient trading profits coming into the company. So money was transferred from new financial investors to pay off older ones within a closed system.

**In Medifast:** There is insufficient retail sales coming into the company. Investments are gained from "coaches", who must then recruit other coaches into the closed system to recoup their investments.

### **Affinity**

**In Madoff's Scheme:** Financial investors were led to think they were in private and exclusive system with a unique income opportunity that protected them from Recession. Many encouraged their own friends to also invest.

**In Medifast:** Consumer investors are led to believe they are in a Recession proof program, a unique income opportunity with "no cap." Many encourage their own friends to also invest.

### **Unheeded Complaints**

**In Madoff's Scheme:** Complaints about Madoff went unheeded by authorities, despite whistleblowers and evidence of fraud. The scheme appeared viable, and claimed to be a legitimate investment company. Some earlier investors were highly compensated and the others were unaware they were being defrauded; the numbers of participants were growing. By design and operation, the scheme caused the majority to lose. Regulator inaction allowed losses to mount.

**In Medifast and other MLMs:** Complaints about the nature of the MLM industry's false income promises and endless chain scheme go unheeded despite whistle blower reports and evidence of fraud – the constant churning of new recruits and major loss rates among consumer investors. The schemes appear viable and claim to be legitimate direct selling companies. Some early promoters are highly compensated. The others who fail and quit are unaware they were defrauded. By design and operation the schemes cause as many as 99% of consumers to lose money and 60-80% to quit each year. Regulator inaction allows losses to mount.



# Law Offices of Christopher E. Grell

**Attorneys At Law specializing in ephedra litigation, asbestos, dietary supplements, and PPA**  
The Broadlake Plaza, 360 22nd Street, Suite 320, Oakland, California 94612  
Telephone: 510-832-2880 Fax: 510-832-2888

February 16, 2009

Dear Mr. Minkow;

I reviewed your expert's report on Medifast, Inc (including the update), the lab reports from BodyCote and Analytical Labs (both FDA approved labs), the Medifast web site with special focus on suggested frequency of consumption for the products tested and your 'Madoff/Medifast' pyramid and Ponzi comparison. As the Co-Founder of the Dietary Supplement Safety Committee with expertise on Prop 65, I have come to the following conclusions relating to your test results of certain popular Medifast products:

1. Medifast French Vanilla: The first test showed .973 mcg of lead per single serving. This is 109% or 1.09X's more than the .50 mcg of lead per day allowed under Prop 65. If the Attorney General ever decided to apply Prop 65 to this product, a warning label would be required based on just this one serving. If the recommended servings of two or three times a day are included, the number obviously goes up to between 309% or 3.09X's to 584% or 5.84X's higher than what Prop 65 would allow.

The second test of the same French Vanilla type product showed 1.25 mcg per single serving. This is 205% greater or 2.05X's higher than the .50mcg per day set forth in Prop 65. Again, if you added the total servings per day, the exposure would be substantially higher.

2. Medifast Dutch Chocolate: The test showed 1.48 mcg per single serving. This is 296% or 2.96X's more than Prop 65 allows.

The second test showed 1.46 mcg per single serving which is 292% or 2.92X's greater than Prop 65 allows.

In addition to the number of servings per day, these products are typically used with many other products that a person is supposed to take under the Medifast weight management plan. If these products showed similar lead levels, the potential for serious injury increases significantly.

Indeed, in order to sell as much product as possible and because, based on your expert's report, Medifast relies upon a closed system whereby little actual retailing to those outside the scheme or who are not "coaches", the "consumer" aka the

"coaches" are compelled to consume even higher than normal amounts of the product leading to even greater risk.

In short, it would appear, based largely on the company's realization that the best way to move product, when traditional retailing is not an option, is to get the "coaches" to purchase and consume the product in predictable and profitable time tables, leading to excessive consumptions of lead as well as other heavy metals that were detected in the tests that were done, that Medifast is putting profits over safety.

I also have some preliminary concern about Medifast's claim that their products do not appear to be involved with the "peanut" recall. As you may know, Medifast's competitor, Slimfast, made recalls relating to their products that contain peanuts, even though no reports of adverse events were made. Medifast on the other hand, has made no recalls of their nutritional bar products even though Medifast knows that these products are "Manufactured in a facility that uses tree nuts, wheat and peanuts."

In my view, the better part of wisdom would dictate that the company reconsider this apathetic approach to a very serious issue especially when certain competitors have already taken steps to protect the public against possible salmonella poisoning from contaminated products that either contain peanuts or that are "manufactured in a facility" where peanuts are used.

Indeed, in light of the fact that a number of Medifast's clinical studies, which Medifast relies on to promote the safety and efficacy of their products, were "funded" by Medifast, in my opinion, the safety of Medifast's products should be viewed with considerable suspicion.

Respectfully,

Christopher E Grell, Esq.



**TESTING GROUP**  
www.bodycote.com  
www.bodycotetesting.com

September 15, 2008

Fraud Discovery Institute Inc  
9770 Carroll Center Rd  
Ste F  
San Diego, CA 92126

Attn: Christopher Grell, Esq  
Barry Minkow

Re: Bodycote Job Number 108621

Dear Christopher Grell Esq, Barry Minkow

Enclosed is the revised report for Bodycote job number 108621. Per your request, we have changed the ID's as follows:

Originally Reported As:  
Medifast 70 French Vanilla Shake  
FV-52210 48133

Medifast 710 Dutch Chocolate Shake  
DC-70-52110 49805

Now Reported As:  
Medifast 70 French Vanilla Shake  
FV-52210 48133  
29498B2EXP110709OUD  
Medifast 710 Dutch Chocolate Shake  
DC-70-52110 49805  
29848V1EXP010710OUD

We apologize for any inconvenience this may have caused you.

Please return or destroy the original laboratory report previously sent to you.

Sincerely,

Bodycote Testing Group

Eric W. Lindsay  
General Manager  
EWL:lo

Bodycote Testing Group  
9240 Santa Fe Springs Road • Santa Fe Springs • California • 90670 • USA • Tel: +1 (562) 948-2225 • Fax: +1 (562) 948-5850



**TESTING GROUP**  
www.bodycote.com  
www.bodycotetesting.com

September 15, 2008

Fraud Discovery Institute Inc  
9770 Carroll Center Rd  
Ste F  
San Diego, CA 92126

Attn: Christopher Grell, Esq  
Barry Minkow

Job No: 108621R1

LO

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REVISED LABORATORY REPORT

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Samples Received: Two (2) Samples  
Date Received: 09/11/2008  
Original Report Issued: 09/12/2008  
Purchase Order No: CREDIT CARD

The samples were analyzed as follows:

Analysis

Page

Lead for CA Prop 65 by SOP 7130, Rev 5  
Selected Metals by SOP 7040, Rev 9

2  
3 - 4

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Michael Shelton  
Senior Staff Chemist

Herman van Halbeek, Ph.D.  
Senior Staff Chemist

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Bodycote Testing Group  
9240 Santa Fe Springs Road • Santa Fe Springs • California • USA • 90670 • Tel: +1 (562) 948-2225 • Fax: +1 (562) 948-5850





Fraud Discovery Institute Inc  
Job No: 108621R1

Lead for CA Prop 65 by SOP 7130, Rev 5  
Quantitative Analysis Report  
Isotope Dilution Inductively Coupled Plasma-Mass Spectrometry

<u>Sample ID</u>	<u>Lead(ug/g)</u>	<u>Serving Size (g)</u>	<u>Lead (ug/serving)</u>
Medifast 70 Dutch Chocolate Shake DC70-52110 49805 29648V1EXP010710OUD	0.0458	32.4	1.48
Medifast 70 French Vanilla Shake FV70-52210 46133 29498B2EXP110709OUD	0.0312	31.2	0.973
Detection Limit:	0.002		
Date Analyzed: 09-12-08			

Quality Control Summary

Sample: Medifast 70 French Vanilla Shake FV70-52210 46133, 29498B2EXP110709OUD

<u>Analyte</u>	<u>Sample Result</u>	<u>Duplicate Result</u>	<u>Average Result</u>	<u>Sample RPD</u>	<u>Spike Conc</u>	<u>Spike Result</u>	<u>Spike % Rec</u>
Lead	0.0312	0.0352	0.0332	12.0	0.995	0.968	94
Control Limits:				<25			80 - 120

Date Analyzed: 09-12-08

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Page 2 of 4



Fraud Discovery Institute Inc  
Job No: 108621R1

Selected Metals by SOP 7040, Rev 9  
Quantitative Analysis Report  
Inductively Coupled Plasma-Mass Spectrometry

Parts Per Million ( $\mu\text{g/g}$ )

<u>Sample ID</u>	<u>Parts Per Million</u> <u>(<math>\mu\text{g/g}</math>)</u>	<u>Detection</u> <u>Limit (<math>\mu\text{g/g}</math>)</u>	<u>Serving</u> <u>Size (g)</u>	<u>Micrograms</u> <u>Per Serving</u>
Medifast 70 Dutch Chocolate Shake DC70-52110 49805, 29848V1EXP010710OUD				
Arsenic	0.035	0.003	32.4	1.1
Cadmium	0.035	0.003	32.4	1.1
Mercury	ND	0.003	32.4	ND (<0.1)
Detection Limit:	0.003	0.003	0.003	0.003

Date Analyzed: 09-12-08

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Page 3 of 4



Fraud Discovery Institute Inc  
Job No: 108621R1

Selected Metals by SOP 7040, Rev 9  
Quantitative Analysis Report  
Inductively Coupled Plasma-Mass Spectrometry

Sample ID	Parts Per Million (µg/g)	Detection Limit (µg/g)	Serving Size (g)	Micrograms Per Serving
Medifast 70 French Vanilla Shake FV70-52210 46133, 29498B2EXP110709OUD				
Arsenic	0.030	0.003	31.2	0.94
Cadmium	0.018	0.003	31.2	0.56
Mercury	ND	0.003	31.2	ND (<0.09)
Detection Limit:	0.003	0.003	0.003	

Date Analyzed: 09-12-08

Quality Control Summary

Sample: Medifast 70 French Vanilla Shake FV70-52210 46133, 29498B2EXP110709OUD

Analyte	Sample Result	Duplicate Result	Average Result	Sample RPD	Spike Conc	Spike Result	Spike % Rec
Arsenic	0.030	0.034	0.032	NA	2.5	2.88	114
Cadmium	0.018	0.018	0.018	NA	2.5	2.13	84
Mercury	ND	ND	ND	NA	0.25	0.210	84

Date Analyzed: 09-12-08

Sample: Laboratory Fortified Blank (LFB)

Analyte	Blank Result	Spike Conc	Spike Result	Spike % Rec
Arsenic	ND	2.5	2.14	86
Cadmium	ND	2.5	2.12	85
Mercury	ND	0.25	0.247	99

Date Analyzed: 09-12-08

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**TESTING GROUP**  
www.bodycote.com  
www.bodycotetesting.com

September 16, 2008

Fraud Discovery Institute Inc  
9770 Carroll Center Rd  
Ste F  
San Diego, CA 92126

Attn: Christopher Grell, Esq  
Barry Minkow

Job No: 108690

JO

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LABORATORY REPORT

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Samples Received: Two (2) Samples  
Date Received: 09/08/2008  
Date Requested: 09/15/2008  
Purchase Order No: NO CHARGE

The sample was analyzed as follows:

Analysis

Page

Lead for CA Prop 65 by SOP 7130, Rev 5

2

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Michael Shelton  
Senior Staff Chemist

Samina N. Hussain  
Senior Chemist

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Fraud Discovery Institute Inc  
Job No: 108690

Lead for CA Prop 65 by SOP 7130, Rev 5  
Quantitative Analysis Report  
Isotope Dilution Inductively Coupled Plasma-Mass Spectrometry

<u>Sample ID</u>	<u>Lead(µg/g)</u>	<u>Serving Size (g)</u>	<u>Lead (µg/serving)</u>
Medifast 70 French Vanilla Shake Lot 29651B3EXP123109OUD FV-52210 46133	0.040	31.2	1.25
Medifast 70 Dutch Chocolate Shake Lot 29649V1EXP010810OUD DC70-52110 49805	0.045	32.4	1.46

Detection Limit: 0.02

Date Analyzed: 09-16-08

Quality Control Summary

Sample: Medifast 70 Dutch Chocolate Shake DC70-52110 49805 Lot 29649V1EXP010810OUD

<u>Analyte</u>	<u>Sample Result</u>	<u>Duplicate Result</u>	<u>Average Result</u>	<u>Sample RPD</u>	<u>Spike Conc</u>	<u>Spike Result</u>	<u>Spike % Rec</u>
Lead	0.0449	0.0499	0.0474	NA	1.00	0.981	93

Control Limits: <25 80 - 120

Date Analyzed: 09-16-08



**ANALYTICAL LABORATORIES IN ANAHEIM, INC.**

2951 Saturn Street Unit C, Brea, CA 92821 Phone: (714)524-8988 Fax: (714)524-9926  
Website: <http://www.analytical-lab.com>

Fraud Discovery Institute, Inc.

9770 Carroll Center Rd.

San Diego, CA 92126

Tel: (858) 549-7729 Fax: (858) 547-6359

Job #: 27031 Sample: Medifast Dutch Chocolate Shake

Lot #:

Attn: Barry Minkow

Receive Date: 09/15/2008

Report Date: 09/19/2008

Analysis	Claim	Result
<b>Per Serving</b>		
Arsenic		0.914 mcg/32.4g
Lead		0.914 mcg/32.4g
Cadmium		1.04 mcg/32.4g
Mercury		< 0.0324 mcg/32.4g

Method: ICP/MS for Mercury, Cadmium, Lead, Arsenic

Chemist:

*[Handwritten signature]* 09/19/2008

Director, David Ji:

*[Handwritten signature]* 09/22/2008



**ANALYTICAL LABORATORIES IN ANAHEIM, INC.**

2851 Saturn Street Unit C, Brea, CA 92821 Phone: (714)524-9988 Fax: (714)524-9926  
Website: <http://www.analytical-lab.com>

Fraud Discovery Institute, Inc.

9770 Carroll Center Rd.

San Diego, CA 92126

Tel: (858) 549-7729 Fax: (858) 547-6359

Job #: 27030. Sample: Medifast French Vanilla Shake

Lot #:

Attn: Barry Minkow

Receive Date: 09/15/2008

Report Date: 09/19/2008

Analysis	Claim	Result
<b>Per Serving</b>		
Arsenic		1.11 mcg/31.2g
Lead		0.521 mcg/31.2g
Cadmium		0.618 mcg/31.2g
Mercury		0.0462 mcg/31.2g

Method: ICP/MS for Mercury, Cadmium, Lead, Arsenic

Chemist: *[Signature]* 09/19/08 Director, David Ji: *[Signature]* 09/19/2008



**ANALYTICAL LABORATORIES IN ANAHEIM, INC.**  
2951 Saturn Street Unit C, Brea, CA 92821 Phone: (714) 524-9988 Fax: (714) 524-9926  
Website: <http://www.analytical-lab.com>

Fraud Discovery Institute, Inc.  
9770 Carroll Center Rd.  
San Diego, CA 92126  
Tel: (858) 549-7729 Fax: (858) 547-6359  
Job #: 27030 Sample: Medifast French Vanilla Shake  
Lot #:

Attn: Barry Minkow  
Receive Date: 09/15/2008  
Report Date: 09/19/2008

Analysis	Claim	Result
Arsenic		35.7 ppb
Lead		16.7 ppb
Cadmium		19.8 ppb
Mercury		1.48 ppb

Method: ICP/MS for Mercury, Cadmium, Lead, Arsenic

Chemist: [Signature] 09/19/2008 Director, David Ji: [Signature] 09/19/2008





ANALYTICAL LABORATORIES IN ANAHEIM, INC.  
2951 Saturn Street Unit C, Brea, CA 92821 Phone: (714) 524-9988 Fax: (714) 524-9928  
Website: <http://www.analytical-lab.com>

Fraud Discovery Institute, Inc.  
9770 Carroll Center Rd.  
San Diego, CA 92126  
Tel: (858) 549-7729 Fax: (858) 547-6359  
Job #: 27031 Sample: Medifast Dutch Chocolate Shake  
Lot #:

Attn: Barry Minkow  
Receive Date: 09/15/2008  
Report Date: 09/19/2008

Analysis	Claim	Result
Arsenic		28.2 ppb
Lead		28.2 ppb
Cadmium		32.1 ppb
Mercury		< 1 ppb

Method: ICP/MS for Mercury, Cadmium, Lead, Arsenic

Chemist: [Signature] 09/19/2008 Director, David J. [Signature] 09/19/2008





info@frauddiscovery.net

Phone & Fax:  
1-888-300-8307

**For Immediate Release**

**Title: FDI debunks Medifast, Inc. (NYSE:MED) response to report**

**Sub-title: FDI raises new questions about Medifast, Inc's (NYSE:MED) use of a small, one office accounting firm to audit company books; calls it 'Madoff' like.**

San Diego, CA Wednesday, February 18<sup>th</sup>, 2009

The Fraud Discovery Institute, Inc has just released a rebuttal to the Medifast, Inc (NYSE:MED) press release whereby the company claims that less than 1% of their commissions from 2008 is related to recruiting and none of that revenue is paid out to coaches as part of their compensation. But expert Robert FitzPatrick notes that: "This statement is yet another example of Medifast's policy of diversion and concealment concerning its endless chain pay scheme. It appears to refer only to fees for joining the scheme as a recruiter. These fees range from \$100 to \$300 per recruiter with the two fee options offering respectively higher levels of reward. **Medifast's endless chain money transfer is facilitated not in fees** – these are only the tickets of admission – but in product sales, which are gained by misleading income claims and promises, based on the endless chain pay scheme."

He continues: "By referencing only fees, Medifast omits from its denial that approximately 50% of Take Shape for Life's revenue from product purchases is transferred from recruits to Medifast's multi-level recruiters. The great majority of this sum is transferred to those in the upper levels of the recruitment pyramid. The endless chain lure and payment system used by Medifast is a deceptive marketing practice in which consumers are lured to pay fees and make product purchases as coaches and are offered rewards for recruiting other coaches in an endless chain. Income promises and claims are based on 'unlimited expansion' in a limited marketplace. The pay plan is a blue print for endless chain recruiting, offering far more rewards and incentives for recruiting than retailing. This recruitment-based pay plan is being hyped to new levels as a lucrative 'business opportunity' during a Recession."

Moreover, the company claims to be a member of the Direct Sellers Association, which is neither a government agency nor a consumer advocacy group and whose members have included such companies as 'Trek Alliance', which was prosecuted by the FTC for operating as a pyramid scheme and fined for making false income claims and 'Your Travel Biz', currently being sued by the Attorney General of California for violating Penal Code 327-the same claim made by FDI in their recent report about Medifast, Inc (NYSE:MED)

Barry Minkow, the Co-Founder of the Fraud Discovery Institute, Inc states that: "For Medifast Inc. to defend endless chain pyramid allegations by stating their proud affiliation with the Direct Sellers Association would be the moral equivalent of Bernie Madoff saying that he attended the Charles Ponzi School of Investment Advisors."



info@frauddiscovery.net

Phone & Fax:  
1-888-300-8307

Mr. Minkow also questions why a Maryland based, New York Stock Exchange Public company utilizes the services of a small, one location regional accounting firm (recently inspected by the PCAOB [http://www.pcaobus.org/Inspections/Public\\_Reports/2008/Bagell\\_Josephs\\_Levine.pdf](http://www.pcaobus.org/Inspections/Public_Reports/2008/Bagell_Josephs_Levine.pdf)) with a total of six partners in the entire firm and who are located in Marlton, New Jersey to audit its books. "National accounting firms with experience in dealing with product based, multi-level marketing companies know from experience to insist on material disclosures in SEC filings of things like failure and attrition rates, saturation and other relevant data that any new 'coach' recruit would need to evaluate before taking the plunge into the Take Shape for Life business opportunity. The choice of this firm appears to strategically allow the company to get away with making fewer disclosures than any other public company in their industry." Mr. Minkow added "I believe that is yet another point of similarity with the Madoff enterprise."





info@frauddiscovery.net

Phone & Fax:  
1-888-300-8307

**For Immediate release**

**Title:** Fraud Discovery Institute blasts Medifast, Inc (NYSE:MED) says record first quarter sales attributed to well-disguised and cleverly-concealed pyramid scheme

**Sub Title:** In new report, FDI compares points of similarity in Medifast, Inc. with two direct selling companies that share like compensation plans to establish incontrovertible evidence of material misrepresentation to recruits and to Wall Street investors

**Thursday, May 21<sup>st</sup>, 2009**

In a surprise move, the company known for its outspoken criticism of the direct selling industry, the Fraud Discovery Institute, Inc today released a report portraying direct seller Avon Corporation in a positive light ([www.frauddiscovery.net](http://www.frauddiscovery.net)).

To prove that Medifast, Inc (NYSE:MED) is a "scheme pyramid" business opportunity as evidenced by its record breaking first quarter earnings in the middle of a recession, the Fraud Discovery Institute, Inc enlisted the help of nationally recognized expert Robert Fitzpatrick, who issued an 11 point comparison between Medifast and Avon showing Medifast comes up short.

Some of the points that Mr. Fitzpatrick made included:

- Downlines are limited to 3 levels of recruiters at Avon. Medifast has 10 levels of downline recruiters. This is a huge distinction. It limits the potential for "kingpins" to develop that can control the business. It forces retail sales, since no one could make a lot of money merely on the personal purchases of a vast downline..
- The upline people receive a shrinking percentage of each sale as they rise in rank. At Medifast the upper levels get an increasingly larger piece of each sale. An upliner who is five levels away from the sale can receive more on the sale than the person who actually makes the sale. At Avon, you make more only if total sales volume grows.
- Avon does not link the value of its product to making money from selling it. Medifast claims that success in losing weight includes having financial security and then offers its own sales rep work as the way to achieve that security. At Medifast, endless chain recruiting becomes what you sell, the central focus.

"So the big question remains, how does Medifast hit record earnings?" asks Barry Minkow. "The key is all in what they do not say, like how many of their 'coaches' fail and quit within one year's time, or how much does the average 'coach' earn annually, or finally how much of these record sales come simply from the personal use of the coaches? These are all questions any reasonable person is entitled to ask before jumping into a business opportunity," said Barry Minkow.

And while Medifast falls far short of Avon, they do compare well with the recently prosecuted multi-level marketing company YTB Travel which, according to the California Attorney General,



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info@frauddiscovery.net

Phone & Fax:  
1-888-300-8307

must, as of July 1, 2009, disclose to all prospects several things including the average income of potential business building recruits (including expenses against that income) and the amount of money earned by the average person who joins to build a business. To emphasize the seriousness of these material non disclosures, the Fraud Discovery Institute, Inc, created a website especially for Medifast ([www.medifraud.net](http://www.medifraud.net)), where various documents are posted to corroborate these assertions.

"The real reason Medifast resists transparency in the area of disclosing attrition and collapse rates is the material adverse effect it would have on these 'blow out earnings' as no one would intentionally and knowingly sign up for a doomed by design, endless chain business opportunity," added Minkow.





**Jon Leibowitz,  
Chairman, United States Federal Trade Commission**

**Jerry Brown  
Attorney General, California**

Dear FTC Chairman Leibowitz and California Attorney General Brown:

Pyramid Scheme Alert and Fraud Discovery Institute join voices to formally ask that you initiate investigations of the sales company, Medifast Inc. (NYSE: MED), and in particular its multi-level marketing division, Take Shape for Life.

The recent prosecution and settlement of the California Dept. of Justice case against a similar company, Your Travel Biz.com (OBB: YTBLA.OB), establishes a standard for business practice and law enforcement that we ask you to apply also to this company.

The points of similarity between these two companies include:

1. Both identify themselves as "multi-level marketing" companies that offer all consumers an "income opportunity" based upon selling their product and recruiting other consumers into the business opportunity.
2. Both companies charge a fee of hundreds of dollars for the opportunity to earn income from reselling the income opportunity.
3. Both employ 10-levels of pyramid recruiters, which grants enormous financial leverage to the top recruiters while dooming the latest recruits to positions of loss unless they are able to build their own "downline" of new consumer/investors.
4. Both employ an "endless chain" incentive to consumers for investing in the business and purchasing the products. Regardless of market size and saturation in any given area both companies promote continuous and unlimited recruitment of more sales people.
5. Both utilize pay plans that drive endless chain recruiting activity over retail sales. The plans pay more to the recruiters than the retailers and apply payment formulas that transfer the greater share of total payments to the top levels of the pyramid.
6. Both companies showed remarkable growth in the midst of an economic downturn and within respective industries and product sectors that are contracting. Such dramatic upturns under these conditions are classic red flags.

A key reason for an investigation is the lack of transparency for consumers and shareholders who are solicited to invest in the Medifast "business opportunity" and securities. The same lack of transparency, which constitutes deception, was a cause for the 2007 FTC action against another multi-level marketing company, Burnlounge, Inc., which also charged consumers for the right to sell an endless chain income opportunity. In that case, the FTC alleged that Burnlounge "made deceptive earnings claims, and failed to disclose that most consumers don't receive substantial income, but lose money."

We, therefore, respectfully ask that requirements be applied to *Take Shape for Life* that were required in the settlement between the California Attorney General and Your Travel Biz.com and in the Burnlounge settlement with the FTC.

Take Shape for Life recruits consumers into its "business opportunity" without providing consumers with the basic information needed to do due diligence. Though the

company's viability depends on selling an income opportunity to consumers to become "coaches," neither consumers nor shareholders have information about the financial status of the coaches, their incomes, turnover rates, recruitment rates, profitability, costs, or odds for success. Among disclosures required in the YTB settlement, which are not provided to consumers or shareholders of Medifast, include:

- Median average income of sales representatives.
- Typical costs incurred
- Number of sales representatives who had quit the business
- Total number of sales representatives active and inactive.
- Percentage of sales representative who did not receive any compensation
- A statement that later recruits do not have the same chance for success that earlier ones do.

The settlement with Your Travel Biz.com also addressed a financial factor that is fundamental to legitimacy. This factor is how much of the company's total revenue is generated directly and ultimately from the sales representatives versus retail consumers.

We request that Medifast be required to disclose this basic and critical piece of information to both consumers and shareholders. In other words, while we applaud the effort of the California Attorney General and the renewed concern of the FTC to crack down on material non disclosures of certain income promises to potential recruits (as evidenced by the Proposed Business Opportunity Rule), we would simply request that a perception of detection and a perception of prosecution begin through the consistent application of what lead to the YTB action—specifically that the abovementioned disclosures be ordered by law enforcement to be made. In fact on page 16 of Medifast's Inc.'s most recent 10K, it states about the potential of these mandatory disclosures that: *"...should the governing body alter or enforce the law in an unanticipated way, there may be a negative result on the company's operations."*<sup>1</sup>

In the financial markets, lack of regulatory oversight resulted in abuse and debased standards on Wall Street. The same consequences occur on Main Street as millions of consumers are solicited to invest in multi-level marketing "business opportunities." Oversight and regulation are more needed than ever during the current Recession. It is worth noting that both Your Travel Biz.com and Take Shape or Life have been promoted as safe havens in troubled economic times.

We respectfully request your immediate responses.

Sincerely,

Robert L. FitzPatrick  
Pyramid Scheme Alert

Barry Minkow  
Fraud Discovery Institute

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<sup>1</sup> Please see [http://www.sec.gov/Archives/edgar/data/910329/000114420409014237/v142765\\_10k.htm](http://www.sec.gov/Archives/edgar/data/910329/000114420409014237/v142765_10k.htm).



### **Eleven Key Distinctions Between Medifast and Avon**

1. Avon has paid staff (district managers) that recruit the "Sales Leaders". This keeps the focus on sales and does not allow the channel to be nothing more than a self-generating recruitment machine. Avon invested in a professional sales management staff. Medifast, in typical MLM fashion, only has recruiters managing recruiters. The conflicts of interest are legion in that model. Everyone is living off everyone else. No one really represents the company or the customer.

2. Avon extends credit to its sales reps. First orders are shipped and then billed. Future orders are fulfilled after earlier orders are paid off. This prevents forcing payments in advance, as Medifast and all other MLMs do.

3. Only the "sales leaders," who are recruited by professional staff, can recruit. All other -- the great majority -- reps are not allowed to recruit unless they become "leaders". In Medifast, every "coach" is automatically an authorized recruiter. So, in Avon, most salespeople are actually selling product. They can't recruit. To remain active, they only need to place an order of any size each month to stay active.

4. It only costs \$10 to become an Avon rep. Medifast charges \$299 or \$99, with many rewards to buy in at the higher level.

5. Downlines are limited to 3 levels of recruiters at Avon. Medifast has 10 levels of downline recruiters. This is a huge distinction. It limits the potential for "kingpins" to develop that can control the business. It forces retail sales, since no one could make a lot of money merely on the personal purchases of a vast downline.

6. The upline people receive a shrinking percentage of each sale as they rise in rank. At Medifast the upper levels get an increasingly larger piece of each sale. An upliner who is five levels away from the sale can receive more on the sale than the person who actually makes the sale. At Avon, you make more only if total sales volume grows. This promotes growing the business, not just rising in rank. The people making the sales earn a lot more than those doing the recruiting. At Medifast, the recruits collectively, earn more than the seller.

7. The bottom level rep at Avon can earn 40% by selling Avon products on a retail basis to end-user customers. At Medifast the bottom level coach earns 14.7% of the sale to a client. The only way to make money at Medifast is to recruit more coaches.

8. There is an obvious distinction between a sales representative and a customer at Avon while at Medifast, coaches and customers are blended so that recruiting is treated as "sales." At Avon, sales reps buy at wholesale and sell at retail. At

Medifast, everyone pays the same! This leads inevitably to converting customers to sales reps.

9. Avon does not link the value of its product to making money from selling it. Medifast claims that success in losing weight includes having financial security and then offers its own sales rep work as the way to achieve that security. At Medifast, endless chain recruiting becomes what you sell, the central focus.

10. Advertising and brand awareness: Avon invests heavily in advertising its brand in support of its sales reps. Take Shape for Life does no advertising. All marketing funds are used in paying recruiters -- 50% of all revenue. The recruit at the bottom confronts a market with little name recognition against large competitors. This leads to selling the "opportunity" (which needs no brand) over the meal replacement product (which needs marketing support, but has none.)

11. There is one more factor that is more circumstantial, but still relevant. As we have noted, Bernie Madoff's ultimate mistake was his success when markets were down. His consistent success became a signal of wrongdoing. Medifast's strange rise in sales during a Recession is also a red flag. All its competitors' (Nutrisystem and Weight Watchers, for example) sales are down. Why is Medifast shooting up?

Looking at North America for comparison (Medifast is primarily in North America), Avon's sales reflect the real market for cosmetics. It declined in Q-1'09 over same period in 08. So did Revlon and L'Oreal. In fact, Avon's sales in North America are less now than they were in 2004 by 13%. The total number of reps is way up, yet overall sales are down. So, we can see that Avon's sales reflect a real market for its products, not just the market for an "income opportunity."

Robert L. FitzPatrick, Pres.  
PYRAMID SCHEME ALERT  
RFitzPatrick@PyramidSchemeAlert.org  
<http://www.PyramidSchemeAlert.org/>



**5 Points of Similarity Between Medifast and YTB (YourTravelBiz.com)**

1. **Both Medifast and YTB International have 10 levels of commission payouts.** That means on any given sale of actual products or services, the person selling it will receive a small commission, while 9 other levels will receive a total commission exceeding the seller's commission.
2. **Medifast and YTB both have seemingly "low" startup costs, with fees of \$300 and \$400 respectively.** Yet this fee looks far more significant when compared to the minimal fee of \$10 charged by Avon to new business builders. In reality, charging each new recruit several hundreds of dollars to join can add millions to the company's bottom line each year.
3. **Neither Medifast nor YTB have disclosed the average income for one of their coaches or business builders.** YTB will now start disclosing this in July 2009 pursuant to a settlement with the California Attorney General, but apparently believed in the past that potential recruits didn't need to know such things.
4. **Medifast and YTB both do not disclose their "churn rates."** They purposely do not disclose the number of people recruited during the year or the number of people who quit the business during the year, effectively concealing the failure rates for recruits.
5. **Neither Medifast nor YTB disclose the amount of revenue the company receives from actual retailing of products or services,** versus how much revenue is actually derived from recruits who are personally consuming the products or services. This is an important distinction because revealing such numbers would show a potential recruit the true market for sales to third-party, bona fide customers.





***Q-1'09 Updated***  
**Expert Report on**  
***Take Shape for Life*, a Division**  
**of Medifast, Inc. (NYSE: MED)**

Robert L. FitzPatrick

**Submitted to:** Fraud Discovery Institute

**Re:** Analysis of Business Models and Practices of  
Medifast and *Take Shape for Life*; Review and  
Analysis of Q-1'09 Financial Disclosures;  
Implications for Medifast Shareholders

Robert L. FitzPatrick  
1800 Camden Rd. Ste. 107, #101  
Charlotte, NC 28203  
Tel. (704) 334-2047  
Fax (704) 334-0220  
Email: RFitzPatrick@FalseProfits.com

Submitted: \_\_\_\_\_  
Robert L. FitzPatrick  
May 10, 2009

The financial disclosures released by Medifast, Inc. on April 29, 2008 for the company's activities during the first quarter of 2009 further confirm the conclusions I presented in the earlier, comprehensive report on this company.<sup>1</sup>

The company's performance and the fate of shareholders depend on the marketing of an "endless chain" income proposition to consumers. The growth of the "multi-level marketing" division, *Take Shape for Life*, continues to be the only factor for significant revenue growth for Medifast. This sector depends entirely upon geometric expansion of its "coaches," that is, consumers who are persuaded to invest in the implausible income proposition.

### **Core Business in Decline**

Excluding revenue gained from the selling of its endless chain income scheme, Medifast revenue *declined* by \$.6 million or 4% comparing Q-1'08 results for the same period of '09. This is in keeping with the trend of the meal replacement industry. Medifast's decline occurred despite opening additional corporate clinics and the introduction of a franchise model.

#### **2008**

Medifast Total Revenue at End of Q-1'08:	\$25.2 million
<i>Take Shape for Life</i> Revenue at End of Q-1'08:	\$9.8 million
Company Revenue Excluding TSFL:	\$15.4 million
TSFL Revenue as % of Total Medifast Revenue:	39%

#### **2009**

Medifast Total Revenue at End of Q-1'09:	\$33.7 million
<i>Take Shape for Life</i> Revenue at End of Q-1'09:	\$18.9 million
Company Revenue Excluding TSFL:	\$14.9 million
TSFL Revenue as % of Total Medifast Revenue:	56%

### **Redefinition as Peddler of Income Opportunity**

As explained in the earlier report, Medifast has *redefined* itself from a diet and nutrition company into merely another variation of a multi-level marketing company, a mini-Amway. Its main and its true product is the sale of an "income opportunity" not meal replacements. In the classic multi-level marketing model, consumers are induced to pay fees, buy products and purchase marketing materials in the expectation of earning profits. The profits are based not from personal retail sales but from the purchases and sales of a "downline" of other recruits. The payment plans claim each new recruit can gain income from an endless chain of others whom they recruit to also invest. This income scheme can be recognized as the classic "robbing Peter to pay Paul." The Medifast scheme utilizes diet products as the vehicle for disguising and facilitating the money transfer. Without the continuous infusion of new investment capital from more independent distributors (called coaches), the company would collapse.

Medifast now has more in common with any of the companies that sell an income scheme based on purchasing inventory ranging from soap to vitamins and then recruiting others to do the same, than it does with companies such as Weight Watchers and Nutrisystem that actually sell diet products to the public.

<sup>1</sup> <http://www.pyramidschemealert.org/PSAMain/resources/Expert%20Report.Medifast.pdf>

**Regulatory and Legal Minefields**

The shift from selling diet products to selling an income proposition to consumers that is based on *continuous expansion* of coaches in a *contracting* marketplace has profound implications for Medifast shareholders. Extraordinary legal and regulatory issues arise from this transformation from a diet industry company to multi-level marketing, peddling an income promise.

A similar publicly traded company, *Your Travel Biz.com*, which charges consumers fees to become "travel agents" and then rewards them based on the recruitment of more "agents," has been sued by the California Attorney General as a "gigantic pyramid scheme."<sup>2</sup> Amway itself is the target of an enormous class action suit led by two of the country's premier class action law firms. The suit claims Amway is an endless chain scheme and that the vast majority of all new recruits, called "independent business owners", who are promised income based on recruiting other IBOs are "doomed by design" to lose money.<sup>3</sup> Government regulators in England recently sought to close down Amway in that country "in the public interest" based on the revelations of false income claims and financial losses by tens of thousands of British consumers who had invested as Amway "independent business owners."<sup>4</sup>

The Federal Trade Commission had been notably lax in recent years under the Bush Administration in enforcing anti-fraud laws against pyramid selling schemes. However, this policy may be reversed in the coming years under the new Administration. The Direct Selling industry has focused nearly all its lobbying and political contributions on the minority party.

**Limits on "Unlimited" Recruiting**

Setting aside legal and regulatory issues, from a purely economic perspective the shift to multi-level marketing inextricably ties Medifast's continued growth to recruiting an ever-expanding base of "coaches." While a theoretical potential for market expansion of Medifast, based on gaining market share from competitors, might be viable, the continuous expansion of diet coaches is not.

In the April 29 press release, Medifast acknowledged that growth now depends on recruiting more coaches.

*Growth in revenues for the segment was driven by increased customer product sales as a result of an increase in active health coaches. The number of active health coaches during the first quarter increased to approximately 4,000 compared with 2,200 during the period a year ago, an increase of 82% and up from 3,400 at the close of 2008.*

The inherent restraints on Medifast's own growth are revealed by projecting the model forward just 10 years. To sustain the growth for 10 years, which the company has reported this past year, the number of coaches would expand from 4,000 to 1.6 million!

<sup>2</sup> <http://ag.ca.gov/newsalerts/release.php?id=1596>

<sup>3</sup> Jeff Pokorny and Larry Blenn on behalf of themselves and those similarly situated, Plaintiffs, v. Quixtar, Inc., James Ron Puryear, Georgia Lee Puryear and World Wide Group, L.L.C.; Britt Worldwide L.L.C., American Multimedia Inc., Britt Management, Inc. Bill Britt and Peggy Britt, Defendants, Case No. C 07 0201, United State District Court, Northern District of California, Class Action.

<sup>4</sup> <http://www.pyramidschemealert.org/PSAMain/news/AmwayCaseAppealed.html>

To put the limits on the model into a more realistic context, for *Take Shape for Life* to reach the size of its nearest and most similar competitor, Nutrisystem, it would need 160,000 "coaches." Whom would these coaches sell to or recruit? How many potential customers would be available for the coaches in a competitive marketplace? These types of simple projections reveal the trickery of selling "endless" chain income schemes and why they have become the targets of individual and class action lawsuits by "failed" consumers, why they were outlawed in China as frauds, and why the country of England sought to close down the veritable icon of this business model, the Amway Corporation, on the grounds of large-scale deception.

The coach recruitment business is a distinct activity that is essentially unrelated to the meal replacement industry. Its driving incentive is the sale of *income opportunity* for prospective coaches.

Industry trends show that the meal replacement market is contracting.<sup>5</sup> However, as recent revelations of consumer and investor fraud have shown, the market for selling a bogus income proposition in the midst of the Recession is expanding.

### Questions for the SEC

The sales of an endless chain income proposition has extraordinary implications for disclosure and transparency. With Medifast's fate now clearly dependent on the selling of this type of income proposition to consumers, shareholders and the SEC ought to know much more about the "coaches" whose fate and fortunes are the lynchpin of the company's future. On this subject, Medifast is *silent and secretive*.

For example,

- Medifast offers no information on its website or in SEC filings about the actual number of coaches recruited in any time frame or their dropout rates. It only offers a count of "active" coaches at the end of a quarter. Therefore, the churn rate, if there is one, is not disclosed.
- The actual number of retail customers per "coach" is also not disclosed.
- Similarly, the company does not disclose the percentages of incomes of coaches that are based on *personal* retail sales versus "bonuses and overrides."
- The average income of *all* coaches, active and inactive over and extended time, is not reported to shareholders or to prospective coaches.
- The percentage of annual revenue sourced directly from the coaches (their own fees and personal purchases) is not disclosed.
- Perhaps most important, regarding the coaches' profitability, the shareholders do not know how many coaches are in the various levels of the sales hierarchy and the proportions of commission payments made to each of the various levels of coaches. The *Take Shape for Life* pay plan allocates commissions to 10 levels of recruiters, who collectively gain more *per sale* than the person actually making a sale. If most of

<sup>5</sup> Q-1'09 disclosures by diet industry giants Weight Watchers and Nutrisystem report year to year respective revenue declines of 11% and 25% and respective income drops of 18% and 37%. Medifast's anomalous rise in revenue, especially during a general economic decline, is a red flag of possible malfeasance.

the commissions are transferred to the few at the top, the thousands of newly recruited coaches are condemned to a futile struggle to get to the top, where only a few can ever be positioned.

### **Two Bucks a Day Peddled as "Unlimited Income"**

From the current disclosure, Medifast revealed that it increased revenue in the *Take Shape for Life* segment by \$9.1 million between the end of Q-1'08 and the same period in '09. It also reported that the total of "active coaches" at the end of this time period increased by 1,800. This indicates that the total new revenue generated for each new coach is approximately \$5,000 (\$9.1 million ÷ 1,800). That total *revenue* figure per new coach reveals the absurdity of claims about "unlimited" *incomes* available to new coaches.

Medifast's website presents charts showing the potential for \$8,000 and \$20,000 *incomes per month*. Yet, with each new coach equating to just \$5,000 in new revenue, the *rewards* to those coaches must be minimal.<sup>6</sup> 50% of all revenue is paid to the entire network of coaches in commissions but at least 70% of this commission is allocated to 10 levels of recruiters, not the salesperson at the bottom. So the actual *income* available to the newest coaches based on the new revenue gained is less than \$15 a week!

These per capita revenue and income figures presented in the Medifast press release – as small as they are and misleading in their incompleteness – are likely even more bogus. They are based only on the total *current* count of coaches at the end of the quarter, not the *cumulative* count of coaches that were churned through the company during the entire 12-month period. That truer number would reduce the per-coach revenue and income figures further.

### **Capital Investments Versus Retail Sales**

Medifast does not reveal how much of the new revenue came directly out of the pockets of the new coaches, rather than from any retail sales they generated in the open market.

- Each new coach can pay as much as \$300 just to gain the right to get overrides from recruits.
- The *Take Shape for Life* meal replacement products cost about \$300 per month. Presumably most coaches are also buying the products for their own use and to give away as samples.
- Additionally, they must buy marketing materials from the company.

Fees, inventory purchases and marketing investments by the coaches themselves could, therefore, be a substantial portion of total *Take Shape for Life* revenue before any actual sales are ever made.

### **Questionable Legality**

In the earlier report, I explained in detail why I thought *Take Shape for Life* was in jeopardy of violating California's law against endless chain schemes. That law is cited in

<sup>6</sup> The earlier report presented a simple mathematical calculation that included the total number of coaches, and the total commissions paid (50% of TSFL revenue). It revealed that only a tiny percentage of coaches could possibly earn even a sustainable income equivalent to a minimum wage job.

the current class action suit against Amway, on which *Take Shape for Life* is modeled. It was also used as the basis for a recent FTC action against another multi-level marketing company, similar to *Take Shape for Life*, called BurnLounge. That company charged consumers fees to become "moguls" with the right to sell "downloaded music" through the company and then to receive rewards when they recruited other mogul/recruiters.<sup>7</sup>

The California law seeks to ban the use of the endless chain incentive for selling goods or for gaining financial investments.

Other states describe the endless chain incentive as a scheme in which the value of a product or the promised returns on investment depend on the "future action" (recruiting) of others. In those cases, the schemes are viewed as purveyors of unregistered "securities."

In my view, the *Take Shape for Life* income scheme potentially can be seen as a violation of such laws. The law in the state of New York is an example.

**359-fff. Chain distributor schemes prohibited**

1. It shall be illegal and prohibited for any person, partnership, corporation, trust or association, or any agent or employee thereof, to promote, offer or grant participation in a chain distributor scheme.

2. As used herein a "chain distributor scheme" is a sales device whereby a person, upon condition that he make an investment, is granted a license or right to solicit or recruit for profit or economic gain one or more additional persons who are also granted such license or right upon condition of making an investment and may further perpetuate the chain of persons who are granted such license or right upon such condition. A limitation as to the number of persons who may participate, or the presence of additional conditions affecting eligibility for such license or right to recruit or solicit or the receipt of profits therefrom, does not change the identity of the scheme as a chain distributor scheme. As used herein, "investment" means any acquisition, for a consideration other than personal services, of property, tangible or intangible, and includes without limitation, franchises, business opportunities and services, and any other means, medium, form or channel for the transferring of funds, whether or not related to the production or distribution of goods or services. It does not include sales demonstration equipment and materials furnished at cost for use in making sales and not for resale.

3. A chain distributor scheme shall constitute a security within the meaning of this article and shall be subject to all of the provisions of this article.

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<sup>7</sup> <http://www.ftc.gov/opa/2007/06/burnlounge.shtm>



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## **Fraud Discovery Institute blasts Medifast**

Posted by [Tracy Coenen](#) on May 21, 2009 · [5 Comments](#)



In a surprise move, the company known for its outspoken criticism of the direct selling industry, the Fraud Discovery Institute, Inc today released a report portraying direct seller Avon Corporation in a positive light ([www.frauddiscovery.net](http://www.frauddiscovery.net)).

To prove that Medifast, Inc (NYSE:MED) is a "scheme pyramid" business opportunity as evidenced by its record breaking first quarter earnings in the middle of a recession, the Fraud Discovery Institute, Inc enlisted the help of nationally recognized expert Robert Fitzpatrick, who issued an 11 point comparison between Medifast and Avon showing Medifast comes up short. Some of the points that Mr. Fitzpatrick made included:

- Downlines are limited to 3 levels of recruiters at Avon. Medifast has 10 levels of downline recruiters. This is a huge distinction. It limits the potential for "kingpins" to develop that can control the business. It forces retail sales, since no one could make a lot of money merely on the personal purchases of a vast downline.
- The upline people receive a shrinking percentage of each sale as they rise in rank. At Medifast the upper levels get an increasingly larger piece of each sale. An upliner who is five levels away

Exhibit 12, pg. 01



from the sale can receive more on the sale than the person who actually makes the sale. At Avon, you make more only if total sales volume grows.

- Avon does not link the value of its product to making money from selling it. Medifast claims that success in losing weight includes having financial security and then offers its own sales rep work as the way to achieve that security. At Medifast, endless chain recruiting becomes what you sell, the central focus.

“So the big question remains, how does Medifast hit record earnings?” asks Barry Minkow. “The key is all in what they do not say, like how many of their ‘coaches’ fail and quit within one year’s time, or how much does the average ‘coach’ earn annually, or finally how much of these record sales come simply from the personal use of the coaches? These are all questions any reasonable person is entitled to ask before jumping into a business opportunity,” said Barry Minkow.

And while Medifast falls far short of Avon, they do compare well with the recently prosecuted multi-level marketing company YTB Travel which, according to the California Attorney General, must, as of July 1, 2009, disclose to all prospects several things including the average income of potential business building recruits (including expenses against that income) and the amount of money earned by the average person who joins to build a business. To emphasize the seriousness of these material non disclosures, the Fraud Discovery Institute, Inc, created a website especially for Medifast ([www.medifraud.net](http://www.medifraud.net)), where various documents are posted to corroborate these assertions.

“The real reason Medifast resists transparency in the area of disclosing attrition and collapse rates is the material adverse effect it would have on these ‘blow out earnings’ as no one would intentionally and knowingly sign up for a doomed by design, endless chain business opportunity,” added Minkow.

## Related Posts

1. [5 Points of Similarity Between Medifast and YTB \(YourTravelBiz.com\)](#)
2. [Medifast multi-level marketing scheme called into question by expert](#)
3. [Medifast and Take Shape For Life: Weight loss pyramid scheme?](#)
4. [Conflict of interest for Medifast auditors?](#)
5. [Scam Busting: Another cosmetics MLM](#)

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Exhibit 12, pg. 02

## Comments

### 5 Responses to "Fraud Discovery Institute blasts Medifast"

1. *anonymous* says:  
23 May 2009 at 5:40 am

It's amusing that the automated Medifast Spam Blog picked up your item.

2. *Emma* says:  
19 June 2009 at 12:12 am

Is this about their Take Shape for Life program with the health coaches? That's not the only way Medifast sells their product. I sell Medifast as an affiliate (they're on Commission Junction) so I never even talk to anyone and don't have to recruit anyone and don't have to buy the product either. Maybe I'm losing money on recurring sales, but I just can't be bothered with the MLM model and whatever "training" program is involved and/or mandatory purchases.

I would think the failure rate of their coaches is probably similar to Weight Watchers, who also recruit from their successful dieters.

But at any rate, I would think their "record sales" is coming from all of their sales outlets — which includes just regular affiliates, their website and I think they are in some stores now too.

## Trackbacks

1. *Fraud Discovery Institute blasts Medifast | Sequence Inc. Fraud ... - Medifast | Medifast Weight Loss | Medifast Diet Plans* says:  
21 May 2009 at 8:14 pm

[...] post: [Fraud Discovery Institute blasts Medifast | Sequence Inc. Fraud ...](#) Tags: breaking-first, business-opportunity, enlisted-the-help, fraud, fraud-discovery, institute, [...]

2. *Medifast and Take Shape For Life: Weight loss pyramid scheme? | Sequence Inc. Fraud Files Blog* says:  
23 September 2009 at 6:56 pm

[...] this year, Barry Minkow and Fraud Discovery Institute railed on Medifast, a company with a weight-loss plan being marketed with a multi-level marketing plan. The company [...]

3. *Medifast multi-level marketing scheme called into question by expert : Sequence Inc. Fraud Files Blog* says:  
12 January 2010 at 1:58 pm

[...] report is an update to a mid-2009 report issued by FitzPatrick. The full text of the current report is found here. And here is my analysis of Medifast and Take [...]

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Tracy Coenen is a forensic accountant and fraud examiner in Chicago and Milwaukee who investigates white collar crimes, including cases of financial statement fraud, embezzlement, tax fraud, and insurance fraud. She is the author of Expert Fraud Investigation and Essentials of Corporate Fraud and more than 100 articles on fraud featured in industry publications.



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Exhibit 12, pg. 06



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## **5 Points of Similarity Between Medifast and YTB (YourTravelBiz.com)**

Posted by [Tracy Coenen](#) on May 21, 2009 · [1 Comment](#)

1. Both Medifast (NYSE:MED) and YTB International have 10 levels of commission payouts. That means on any given sale of actual products or services, the person selling it will receive a small commission, while 9 other levels will receive a total commission exceeding the seller's commission.

2. Medifast and YTB both have seemingly "low" startup costs, with fees of \$300 and \$400 respectively. Yet this fee looks far more significant when compared to the minimal fee of \$10 charged by Avon to new business builders. In reality, charging each new recruit several hundreds of dollars to join can add millions to the company's bottom line each year.

3. Neither Medifast nor YTB have disclosed the average income for one of their coaches or business builders. YTB will now start disclosing this in July 2009 pursuant to a settlement with the California Attorney General, but apparently believed in the past that potential recruits didn't need to know such things.

4. Medifast and YTB both do not disclose their "churn rates." They purposely do not disclose the number of people recruited during the year or the number of people who quit the business during the year, effectively concealing the failure rates for recruits.

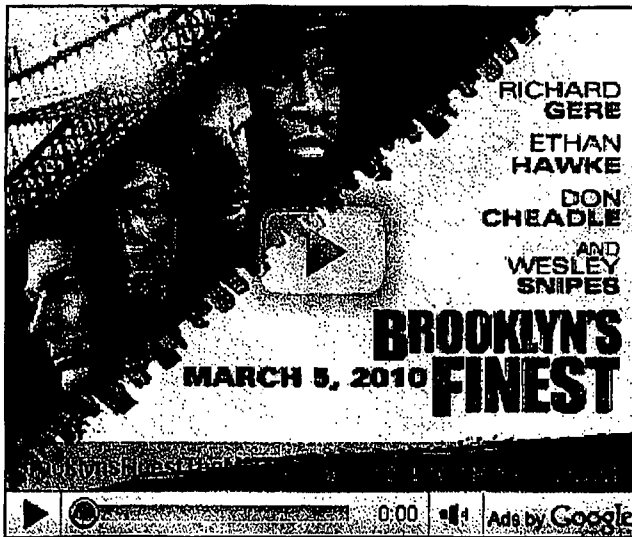
5. Neither Medifast nor YTB disclose the amount of revenue the company receives from actual retailing of products or services, versus how much revenue is actually derived from recruits who are

Exhibit 13, pg. 01

personally consuming the products or services. This is an important distinction because revealing such numbers would show a potential recruit the true market for sales to third party, bona fide customers.

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## Comments

### One Response to "5 Points of Similarity Between Medifast and YTB (YourTravelBiz.com)"

1. [Frank Thomas](#) says:  
13 January 2010 at 12:13 pm

Kudos to Robert for his continued work.

Tracy, keep up the good work. Us oldtime consumer advocates (I am 73) get great real satisfaction knowing another generation will carry the torch

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Tracy Coenen is a forensic accountant and fraud examiner in Chicago and Milwaukee who investigates white collar crimes, including cases of financial statement fraud, embezzlement, tax fraud, and insurance fraud. She is the author of Expert Fraud Investigation and Essentials of Corporate Fraud and more than 100 articles on fraud featured in industry publications.



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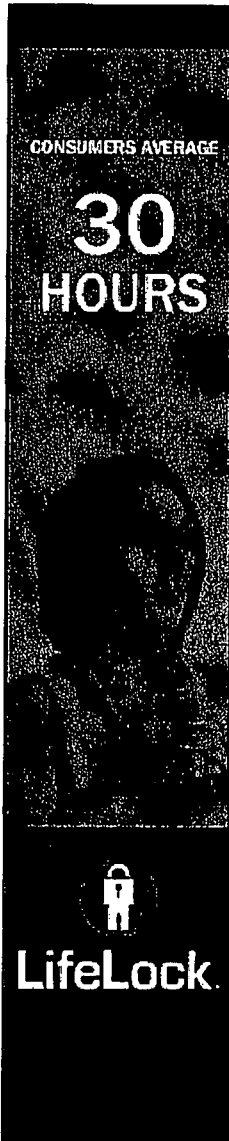


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Exhibit 13, pg. 05





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**For Immediate Release**

**Title: Non Profit Consumer Advocate Group teams up with FDI; files formal complaint against Medifast, Inc (NYSE:ME) with law enforcement**

**Sub title: FDI to roll out You Tube video interviews of past Medifast, Inc (NYSE:MED) "coaches" who enrolled in the business opportunity only to conclude it was an endless chain**

Friday, May 22<sup>nd</sup>, 2009 San Diego, CA

Pyramid Scheme Alert Founder and nationally recognized expert Robert Fitzpatrick released a copy of a letter he authored that was sent to various law enforcement agencies yesterday that was also signed by Fraud Discovery Institute, Inc Co-Founder Barry Minkow ([www.frauddiscovery.net](http://www.frauddiscovery.net)). The letter essentially establishes irrefutable points of similarity between Medifast, Inc and YTB and essentially establishes that if applied consistency, the same result experienced in the YTB case would apply to Medifast, Inc (NYSE:MED).

The points of similarity between the 2008 prosecution of YTB and Medifast, Inc. and forwarded to law enforcement were first reported in a release by FDI earlier this week and include the following:

1. Both identify themselves as "multi-level marketing" companies that offer all consumers an "income opportunity" based upon selling their product and recruiting other consumers into the business opportunity.
2. Both companies charge a fee of hundreds of dollars for the opportunity to earn income from reselling the income opportunity.
3. Both employ 10-levels of pyramid recruiters, which grants enormous financial leverage to the top recruiters while dooming the latest recruits to positions of loss unless they are able to build their own "downline" of new consumer/investors.
4. Both employ an "endless chain" incentive to consumers for investing in the business and purchasing the products. Regardless of market size and saturation in any given area both companies promote continuous and unlimited recruitment of more sales people.
5. Both utilize pay plans that drive endless chain recruiting activity over retail sales. The plans pay more to the recruiters than the retailers and apply payment formulas that transfer the greater share of total payments to the top levels of the pyramid.
6. Both companies showed remarkable growth in the midst of an economic downturn and within respective industries and product sectors that are contracting. Such dramatic upturns under these conditions are classic red flags.



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The Fraud Discovery Institute, Inc also announced that they will begin profiling stories of past "coaches" of Medifast, Inc who attempted to succeed in the business opportunity but failed because of the endless chain, pyramid compensation plan that rewards recruitment over retailing. "Google is wonderful tool" said Barry Minkow, Co-Founder of the Fraud Discovery Institute, Inc. "When people who want to join Medifast, Inc first "Google" the company, YouTube will pop up and the potential recruit will be educated from those with first hand experience about how much money they did not make with a business opportunity that boasts of a potential "\$8,000 to \$20,000 per month in income."

By allowing past recruits to tell their story, FDI hopes to 'level the playing field' for the potential Medifast, Inc recruit.





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**For Immediate Release**

**Title: Former SEC Division of Enforcement lawyer sites potential independence and conflict of issues problems between Medifast (NYSE:MED) and their independent, outside auditors in four-page letter to Commission**

**Sub Title:** Expert's letter sites possible stock-touting of Medifast (NYSE:MED) stock by company's single-officed, New Jersey based, outside auditors through their alleged independent investment entity. Expert also notes that PCAOB cited Medifast auditors for significant deficiencies in three of six audit engagements reviewed by them, or 50% of audits in their sample.

June 9th, 2009 San Diego, CA

Is the Medifast, Inc (NYSE:MED) independent auditor moonlighting as the company's stock promoter to investor clients? That appears to be the conclusion of a six-week investigation conducted by the Fraud Discovery Institute, Inc who today released several documents ([www.frauddiscovery.net](http://www.frauddiscovery.net)) including a letter from Michael Brown, who in addition to working in the SEC Enforcement Division served as the General Counsel for three nationwide securities broker-dealers which uniquely qualifies him to identify alleged impropriety and conflicts of interest issues.

According to the letter by securities expert Michael Brown and other evidence just released on a web site specifically dedicated to the Fraud Discovery Institute's almost year-long investigation of Medifast, Inc ([www.medifraud.net](http://www.medifraud.net)), Medifast's outside accountants, Bagell, Josephs & Levine & Company, LLC, have over the past three years ([http://bagelljosephs.com/abt\\_partners.html](http://bagelljosephs.com/abt_partners.html)), also operated B JL Wealth Management, LLC (<http://bjlwealth.com/new/bjlwealth/gate.asp>) at the same address of the audit firm and have many of the same partners in both firms.

The investigation revealed that B JL Wealth Management, LLC recommended the purchase of Medifast stock to an operative of the Fraud Discovery Institute, Inc, which appears to cross the line of independence according to Mr. Brown, who asserts that *"if such conduct is indeed occurring, then it would appear that B JL's independence as MED's outside auditor has been compromised."*

Other evidence just released includes a recent and now resolved PCAOB (Public Company Accounting Oversight Board) letter of concern ([http://www.pcaobus.org/Inspections/Public Reports/2008/Bagell Josephs Levine.pdf](http://www.pcaobus.org/Inspections/Public%20Reports/2008/Bagell%20Josephs%20Levine.pdf)) and the various recent dismissals of Bagell Josephs Levine & Company, LLC by certain clients (please see [http://www.google.com/search?sourceid=navclient&ie=UTF-8&rlz=1T4HPIC\\_enUS315US315&q=%2b%22bagell+josephs%22+%2bdismissed](http://www.google.com/search?sourceid=navclient&ie=UTF-8&rlz=1T4HPIC_enUS315US315&q=%2b%22bagell+josephs%22+%2bdismissed)).





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The Fraud Discovery Institute, Inc has forwarded their findings to the newly appointed Director of the Division of Enforcement at the SEC, Mr. Robert Khuzami. According to Barry Minkow, Co Founder of the Fraud Discovery Institute, Inc "This is a disturbing finding and one that seems to pass the test of 'the appearance of impropriety'. In a post Enron/Sarbanes-Oxley environment, for an independent, outside auditor that is in this case the corroborator of Medifast's recent blow-out earnings-- which has subsequently induced massive public investment thus dramatically increasing Medifast's stock price-- to apparently have a stake in the game is troubling."



### Summary Explanation of B JL Oddities

Bagell Josephs Levine & Company, LLC appears to operate solely from 406 Lippincott Drive, Suite J, in Marlton NJ 08053. The principal service of the firm is that of certified public accountants. The firm has registered with the Florida Department of Business and Professional Regulation (DBPR) under license number AD0019680 (expires 12/31/2009), however, no Florida address was found. The address shown in the DBPR database is the Marlton (NJ) address shown above. The partners and professionals of the firm include:

- Carl H. Bagell (Managing Partner)
- Neil Levine
- Marc G. Nochimson
- Glenn M. Josephs
- David Firestone
- Ciro Adams

Interestingly, although database information suggests that the firm is small in size, according to information in government databases, the firm sponsored one H1B visa application in 2007, and twelve H1B visa applications in 2008. No information was found which might explain the firm's need for such a large number of foreign workers. The Scientology Critical Information Directory lists the firm under the category of "Scientology-linked?" with the designation of "Yes".

Operating from the exact same address in Marlton (NJ) is the firm of B JL Wealth Management LLC. The principals of this latter firm ("Listed on the "Our Team" page of their website) include:

- Matthew Bagell
- Sam Brand
- Carl H. Bagell
- Charles Holmes

Based on information received, Carl H. Bagell utilizes the social security number 18X-XX-XXXX, and he was born in 08/1952. Matthew Bagell utilizes social security number 15X-XX-XXXX, and he was born in 10/1981. Because of the age difference between the parties, it is believed that the two individuals are father and son.

In a recent report issued by the Public Company Accounting Oversight Board (PCAOB), dated June 19, 2008, copy attached, after completing an inspection of the Bagell accounting firm, the Board identified "what it considered to be audit deficiencies". The report went on to state that, "The deficiencies identified in three of the audits reviewed included deficiencies of such significance that it appeared to the inspection team that the Firm did not obtain sufficient competent evidential material to support its opinion on the issuer's financial statements."



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## **Conflict of interest for Medifast auditors?**

Posted by [Tracy Coenen](#) on June 24, 2009 · [2 Comments](#)

Last week Barry Minkow and Fraud Discovery Institute released a report regarding the independence of the auditors of Medifast Inc. (NYSE:MED). The company is audited by Bagell, Josephs, Levine & Company. The audit partner happens to also be a part of BJL Wealth Management, an investment firm with the same address as the audit firm.

This becomes interesting when you consider that BJL Wealth Mangement recommended the purchase of Medifast stock to an operative of FDI. Is this a conflict of interest? It may be. Does the audit partner, in his role at the investment firm, make recommendations regarding Medifast stock? Does he have any financial interest in transactions involving Medifast stock? If the answer to either of these questions is yes, then the audit partner would have compromised his independence.

An auditor working in the capacity of an investment advisor does not automatically give rise to independence issues. In fact, over the last then years, the accounting powers that be were recommending that CPAs get involved in selling investments to generate additional revenue in their practices. However, when conducting an audit, the CPA has to draw a very clear line and not make recommendations regarding the buying or selling of securities of an audit client. The CPA also must not have any financial interest in the buying or selling of that stock. (i.e. He can't receive any income from the sale of securities of an audit client, even if it was someone else in the investment firm making the sale or recommendation.)

Another interesting factoid uncovered by FDI ... The PCAOB inspected six audits done by Bagell, Josephs, Levine, and found significant audit deficiencies in HALF of them. That's a pretty bad hit rate.

Exhibit 17, pg. 01

Interesting links:

FDI's website detailing its investigation of Medifast – <http://www.medifraud.net>  
Sam Antar suggests Medifast should change auditors –  
<http://whitecollarfraud.blogspot.com/2009/06/compelling-reasons-for-medifast-to.html>  
Bagell, Josephs & Levine & Company – [http://bagelljosephs.com/abt\\_partners.html](http://bagelljosephs.com/abt_partners.html)  
BJL Wealth Management – <http://bjlwealth.com/new/bjlwealth/gate.asp>

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Comments

2 Responses to "Conflict of interest for Medifast auditors?"

1. *Davis Freeberg* says:  
[24 June 2009 at 11:47 am](#)

If this is true, it's a pretty big deal. How are public shareholders supposed to have confidence in the numbers when the auditors have a financial incentive to make sure that things appear rosy. Was this conflict at least disclosed in their 10-K filings or is this something that they've been trying to keep quiet?

2. *Medifast Blog* says:  
[4 September 2009 at 8:59 pm](#)

if it is a solid investment, if the company in question was some other company other than medifast and BJI would make the same recommendation, then i dont see any conflict of interest. but if it was other way around, then there is something to think about

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Tracy Coenen is a forensic accountant and fraud examiner in Chicago and Milwaukee who investigates white collar crimes, including cases of financial statement fraud, embezzlement, tax fraud, and insurance fraud. She is the author of Expert Fraud Investigation and Essentials of Corporate Fraud and more than 100 articles on fraud featured in industry publications.

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## **Medifast and Take Shape For Life: Weight loss pyramid scheme?**

Posted by [Tracy Coenen](#) on September 14, 2009 · [7 Comments](#)

Earlier this year, Barry Minkow and Fraud Discovery Institute railed on Medifast, a company with a weight-loss plan being marketed with a multi-level marketing plan. The company was built primarily through marketing of the weight loss program through physicians. The Medifast executives realized that the MLM structure was their golden opportunity.

Why is multi-level marketing such a cash cow for the owners and executives of companies like these? Because product and service sales become largely irrelevant. The company instead markets the "opportunity" for making extra money and achieving financial freedom. (Almost no one is able to actually achieve either of these when they sign up to sell MLM junk, but that's beside the point. Get people to believe it's **possible**, and you're golden.) Recruit people into the MLM, require "minimum purchases" from each to continue to "qualify" in the pyramid, and you are likely going to have exponential growth for the company.

Once Medifast realized there was a chance to make gobs of money via the multilevel marketing model, they focused on that and the company's earnings have reflected this successful strategy.

With the help of MLM expert Robert FitzPatrick, Barry Minkow demonstrated how a pyramid scheme like Medifast's Take Shape For Life program works. (And this company isn't alone with this method of marketing. Plenty of other companies use it. One such company is YTB, which got nailed by regulators for being a pyramid scheme.)

Exhibit 18, pg. 01

Another financial expert is criticizing Medifast for promoting their alleged pyramid scheme. David Hamilton at BNET has written two articles on Medifast and Take Shape For Life (TSFL). The second really focuses on the pyramid scheme aspect.

He raises some excellent points. The weight loss industry as a whole has suffered greatly thanks to the economy. Big declines in revenue are hitting companies like Weight Watchers International and Nutrisystem. How then, can Medifast be doing so well? For the six months ended June 30, 2009 Medifast reported revenue of \$74.4 million, an increase of 41% over the prior year, according to the company's earnings release.

The answer could be that the company's program is much better than others. There's no objective data that supports that contention however.

There are zillions of diet pills, programs, and meal plans out there. Why is Medifast so successful of late? The growth isn't coming from the physicians who promote the program or the weight loss centers that offer products and service. The success is in the Take Shape For Life unit (the MLM arm of the company), which accounted for 58% of revenue in 2009. In contrast, this part of the company contributed only 33% of the revenue in 2009. TSFL alone had a 96% increase in revenue in 2009 over the prior year.

But maybe the MLM part of the company is so successful because it works so well for the "coaches" recruited into the program? We'll never know for sure, as Medifast doesn't disclose how much money the coaches are making, how much they spend on expenses of the business, what their attrition rates are, or how many recruits are actively selling or recruiting.

Take Shape For Life, however, makes it clear that to make real money, you have to recruit new people into the plan. This is where the allegations of being a pyramid scheme come in. Like all other MLMs that I've looked at, the product or service isn't really the focus. It's simply the bait to get someone in and make the company look legitimate. The real focus, however, is the recruiting of new marks into the scheme.

So the company's products haven't been proven to be stellar. The traditional outlets for the products are not doing well. And the MLM portion of the company is booming, even though there's no evidence that the products themselves are actually selling well. Everything points to the real deal being endless chain recruitment into a pyramid scheme.

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2. [More on the endless chain recruitment scheme of Medifast and Take Shape For Life](#)
3. [5 Points of Similarity Between Medifast and YTB \(YourTravelBiz.com\)](#)
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**Comments**

**7 Responses to "Medifast and Take Shape For Life: Weight loss pyramid scheme?"**

1. *Lauren* says:

12 January 2010 at 7:07 pm

I am a TSFL client. As far as it being a fraud well, I've tried other weight loss programs and this is the best by far (free or cost). The first awesome thing about it is the coaching system. It is so great to have someone who actually cares about my progress and encourages me to stay the course as often as I need them. I don't pay for their services just the food. The second thing I love about it is the food. I am so busy a busy mom of 6 so having my daily proteins, carbs, and AND daily vitamins already prepackaged for me takes a load off. I just add water and microwave or turn on the blender. If I'm away I have bars or shakes that I can take with me. Third it's a simple system that's honest to the client. They forewarned me that the first 3-5 days was hard. Yes the food is a bit more then I would normally spend but I think I'm worth the investment. Also as I transition (coach guided) off the diet I purchase less food. Until I am eating mostly regular food, but smaller portions 6 times a day of healthy food. As far as the coaches getting more people into the program I think that's awesome! Most of our country is fat and out of shape, and so many have diabetes or heart disease which the food was actually designed for. People with diabetes/heart disease live healthier lives when on the program. My opinion? If someone can lose weight, be healthy, and help others to be healthy why shouldn't they be compensated? Are you telling me every doctor, lawyer, or accountant got into their field simply for to help people. Of course that's not true or these people would drastically lower their fees. Health coaches in Beverly Hills, New York, and Hollywood charge huge fees for their services. TSFL Coaches need to be rewarded for their time and effort. I don't compensate my coach for his services TSFL does...and I'm glad!  
As far as our economy, people are still spending money on what they want. Think goodness they want to be healthy.

2. *Tracy Coenen* says:

13 January 2010 at 10:48 am

Lauren – I don't think anyone has suggested the products are bad or don't work. And no one has suggested that people shouldn't get paid for selling the products. **QUITE THE CONTRARY.** The people making the "real" money (and there are very, very few of those) aren't making money from selling the products. They're making money by recruiting people with the promise of riches. That's the problem.

3. *Lauren says:*

13 January 2010 at 12:09 pm

Hi Tracy,

The word "opportunity" is not the same as the word "promise". Do you have anything that TSFL has written or said stating that they promise whoever coaches will get rich? If you do I'd like to get the link. I honestly think that so many people are looking for an easy way out, get quick rich scheme. That they see the upside of something and just think it's going to happen overnight. As you obviously know success requires hard work and may take years to obtain. There are so many who just aren't willing to sacrifice that much work, train themselves, wait, or how about this one....change. We can know that because those at the top are few and those at the bottom unfortunately are many. Human nature is like water, it takes the path of least resistance. I wonder how many people go into anything hoping for a quick turn over and when it doesn't happen they get disgusted and quit. I saw it in college, the military, and, my goodness, even Walmart and my neighborhood grocery has a high turn over rate.

I've been scammed before (at 22 yrs) by real pyramid schemes and it doesn't feel good. But I've learned to ask questions and discipline my self that anything worth doing is going to cost me. I've learned if something sounds too good to be true then get away from it. But I've also learned there are possibilities out there that may pay off and then again they may not. Hence the California gold Rush...few got rich but hey the country expanded. That's just life but if you don't have to sell your first born to try something go for it. Just being alive is a risk. Have a great day!

4. *Ben says:*

22 January 2010 at 2:01 pm

Hi Tracy: Your comment, "They're making money by recruiting people with the promise of riches" is not accurate. I worked as a Health Coach for a year and the money came from selling food NOT recruiting people. As a Health Coach, you make very little from the people below you and you make nothing from signing people up. I had 13 coaches below me and they generated very little money for me or anyone above me. We all made a pretty good amount 20%-30% on the food we sold, just like any sales job. Here is link to the compensation plan right from the website: [http://www.tsfl.com/pdfs/TSFL\\_CompensationPlan.pdf](http://www.tsfl.com/pdfs/TSFL_CompensationPlan.pdf) There is nothing to hide. I hope this helps you understand the business model. Ben

5. *Tracy Coenen says:*

22 January 2010 at 6:33 pm

Ben – I understand the business model just fine, and you actually proved my point. They recruit with PROMISES of riches, but almost no one makes a living wage in TSFL. You couldn't possibly sell enough of those meals to make a living. And you made almost nothing from recruiting, although that's not what you'll be told when you're recruited.

MLMs are NOT just like any sales job. They're presented that way, but it's just not how it is. Imagine if grocery stores had sales people who went out and tried to sell food person-to-person.

Could the salesperson make a living doing that? Of course not. That's why having YOU retail food is just idiotic.

The bottom line is that Medifast is making money hand over fist from these recruiting activities, but the people being recruited are making next to nothing.

6. *Gina Scalise* says:  
30 January 2010 at 8:47 am

Tracy,

I have to but in on this conversation. I am a client of TSFL my family has lost a total of 200 lbs in less than 3 months. We have tried many programs and have never had this success. This being said, no one has ever approached me or my family members to get rich and become a coach. There is no pressure to sell anything or join anything. My doctors office has been signing up their patients to obtain optimal weight. Who cares who is making the money, it is a program that is very easy to follow and is saving peoples lives from a lifetime of obesity and unhealthiness. I have been on every program out, and this is by far is the only one I can say my family will follow for the rest of our lives. I have also been involved in many mlm companies. TSFL doesn't have to promise financial rewards the program speaks for itself. I am going to become a coach to help my friends and family become healthy. By no means did anyone promise me financial success or freedom. I will keep my job and this will be my contribution to a very unhealthy, overweight community. There will always be those individuals who join one mlm after another, make a killing and move on. This is one mlm that should be for individuals who really care about people not money. You will always find the few opportunists that will promise anything to make a buck. They hit pay dirt because the program sells itself without any promises. It is just plain simple it is a great plan that really works and can become a leader in weight control.

7. *Clay* says:  
4 February 2010 at 2:11 pm

Hi Tracy – my wife and I have lost 110 lbs between us in 6 months. I have gone from a size 40 waist to a size 34 in those 6 months. No promise to get rich was made and only a cursory mention of “oh by the way, if you are interested you can get income by being a coach and helping other people.” No heavy handed recruiting. So now my wife is a coach. What's wrong with this? Isn't this how businesses are supposed to work in a free country? Additionally, the cost of the product without the coaching is exactly the same as the cost of the product with the coaching...because Medifast knows that “with coaching,” the success rate of the diet goes up dramatically. After having tried South Beach, Akins and a host of other diets...this one worked! Your article makes TSFL sound like a Bernie Madoff scheme where greedy little men in penthouses are taking money from unsuspecting dupes who, in the end, are left bankrupt. Those only things TSFL took from me is 53 lbs and 6 inches. And I am happy to pay them for that.

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Tracy Coenen is a forensic accountant and fraud examiner in Chicago and Milwaukee who investigates white collar crimes, including cases of financial statement fraud, embezzlement, tax fraud, and insurance fraud. She is the author of **Expert Fraud Investigation** and **Essentials of Corporate Fraud** and more than 100 articles on fraud featured in industry publications.



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Exhibit 18, pg. 08



*Updated January, 2010*  
**Expert Report on**  
***Take Shape for Life*, a Division**  
**of Medifast, Inc. (NYSE: MED)**

Robert L. FitzPatrick

**Submitted to:** Fraud Discovery Institute

**Re:** Analysis of Business Models and Practices of  
Medifast and *Take Shape for Life*; Review and  
Analysis Financial Disclosures and Trends;  
Implications for Medifast Shareholders

Robert L. FitzPatrick  
1800 Camden Rd. Ste. 107, #101  
Charlotte, NC 28203  
Tel. (704) 334-2047  
Fax (704) 334-0220  
Email: RFitzPatrick@FalseProfits.com

Submitted: \_\_\_\_\_  
Robert L. FitzPatrick  
January 7, 2009

**Background and Overview:**

This report is prepared for Fraud Discovery Institute. It reviews and updates earlier in-depth analyses of Medifast, Inc. submitted in early 2009, the last report using data from the 2008 annual report and the first quarter of 2009. As described and analyzed in those earlier reports, Medifast should now be properly described not as a diet or meal replacement company, but rather as a multi-level marketing scheme that primarily markets a "business opportunity." The company uses several other channels of distribution but more than two-thirds of its revenue now comes from its multi-level marketing segment, called Take Shape for Life (TSFL), which accounts for virtually all Medifast growth and profit. That sector is therefore the focus of this report as it was with the earlier ones.

Medifast's true competitors now are not Weight Watchers and NutriSystem, but Amway and Pre-Paid Legal Services, among other such pyramid selling schemes. Some other companies in this field are now also enjoying revenue or recruitment surges. This reflects the true nature of these businesses as purveyors of an "income opportunity". Selling a promise of "unlimited income" and claiming to be "Recession proof", some companies in that market are experiencing a boom, while the markets for the "products" that the schemes' sell – meal replacements, for example, in the case of Medifast – are in decline due to the Recession.<sup>1</sup>

This updated report moves the analyses forward from Medifast's endless chain "business opportunity" to the inflation of Medifast's stock. Effectively, the pyramid selling scheme based on the lure of income to consumers from an endless recruiting chain, is being leveraged into the securities market. This evolution of a Medifast consumer pyramid on Main Street to an inflated stock scheme on Wall Street has an obvious and unavoidable analogy. That is the recent real estate disaster in which inflated housing prices and exploding mortgages were sold to consumers on the myth of ever-rising housing values. These doomed assets and loans were then sold into financial markets as lucrative securities. The underlying deception and delusion about ever-rising real estate pricing escalated to new levels and spread to new sectors of the economy, vastly increasing the eventual financial harm.

**Review of Medifast's "Income Opportunity"**

The foundation of Medifast's stock surge is the recent rise in its revenue, which is driven by the "endless chain" income opportunity that it markets to consumers. Medifast's income scheme is a solicitation to consumers to become distributors that buy and sell the company's meal replacement products and recruit others to do the same. Medifast seamlessly integrates its "income opportunity" product with its meal replacement products. It makes *earning money* a key part of its three-part "system" for weight control

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<sup>1</sup> The current revenue surge in most pyramid selling schemes, a.k.a. multi-level marketing, is well documented. In a May 15, 2009 article in *USA Today*, the president of the Direct Selling Association stated, "... unfortunately as the unemployment rate rises to 10% or higher, we'll be picking up more people who need an income-earning opportunity."

and good health – the only company in that field to do this – and its offers consumers the company’s own recruitment scheme as the means to meet financial goals.<sup>2</sup>

The earlier reports closely examined the financial plight of consumer-investors who join as Take Shape for Life salespeople, called *coaches*. The report dissected TSFL’s complex, nearly indecipherable pay plan and described it as a disguised *chain letter*. The income opportunity, based on the plan’s structure, rules, bonuses and commission schedule, primarily depends upon endless chain recruiting of more “coaches”, not on retail sales of its products. The cost of selling, competitive factors, and the paltry 15-20% commission offered on retail sales make that option a myth and facade to obscure the recruitment pyramid. The income scheme is a classic “endless chain.” The report also raised the question of the plan’s *legality*, its jeopardy under California’s statute against “endless chain” plans, and the risk of its being challenged by other regulators or by consumers in court as a fraud.

For example, suppose that a buyer was promised a chance to obtain a promised rate of return by referring five others in the first five years, each promised with an opportunity to earn referred income on at the same rate of increase. After 10 rounds, the cumulative number of persons enrolled would be 12,207,031. In any of these schemes never approach the economic proportions. The starting number reached at an early stage. It follows that a large segment of the buyers participating in these schemes will suffer financially.

California Senator (later Mayor) John Brancato, or George Moscone, in a 1966 letter to Governor Ronald Reagan, when the endless chain statute was enacted, described the most basic type of endless chain promotion that the law outlawed.

The promise of a serious income pyramid scheme is primarily to an ongoing ability to recruit others into a state program and the only situation in which the proposed rewards cannot come to the vast majority of participants.

Dr. Peter Vandernat, Sr. Economist and Pyramid Scheme Expert, U.S. Federal Trade Commission

Based on available information, the earlier reports projected that under the Take Shape for Life income plan, the vast majority of participants would not be profitable and that only a small group positioned at the top of the pyramid could achieve the advertised profitable gains. These gains, by design, depend upon a large base of unprofitable consumer-investors *at all times*.

The report cited the often quoted description of an endless chain pay plan by FTC expert, Dr. Peter Vandernat, in which he showed that such plans *always* doom the majority of participants to be in loss positions and that the mathematical expansion requirements of the plan are impossible and unsustainable. An endless chain pay plan, while claiming to offer everyone a chance at income, in fact, doom the vast majority, regardless of ambition, talent and “positive thinking.” For these reasons, such plans are treated under the FTC Act as “unfair and deceptive trade

<sup>2</sup> TSFL Website description of its diet program states that it includes three key components:

- *Healthy Body* - physical health is the foundation of a happy and fulfilling life.
- *Healthy Mind* - how we feel about ourselves also affects long term Optimal Health.
- *Healthy Finances* - debt causes stress - and stress can take a severe toll on both your physical and mental health. By managing and eliminating debt, learning ways to budget, and or *seizing financial opportunities*, you further yourself on the road to Optimal Health. (italics added)

As the promotion goes on to explain, the opportunity to “seize” is to become a sales representative for Take Shape for Life.

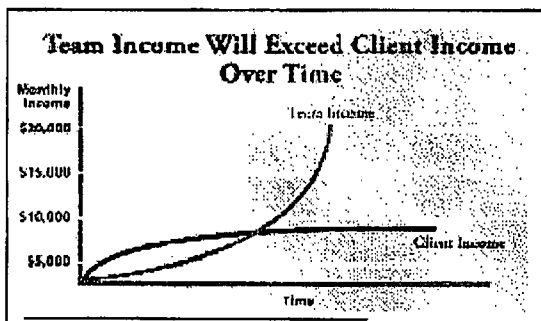
practices” and are declared illegal in California and some other states. The fraud of these plans is not in the physical products offered but in the *marketing ploy used to drive sales*.

At the time of the earlier reports, Medifast did not disclose even the barest details of the income’s scheme *results*. Only “potential income” claims, and “success testimonials” were presented. Consumers were solicited without being provided information on average incomes at the various ranks or the percentages of participants in each rank. After June, 2009, Medifast began to offer consumers some information in the form of its “Official Income Disclosure Statement.”<sup>3</sup>

This document verifies the results that the earlier reports to Fraud Discovery Institute projected. A full analysis of the data, using numbers of “active” coaches disclosed in Medifast’s Q-2’09 10Q, is at the end of this report as an Appendix item.

- The disclosure report, though offering useful data, still does not disclose the most important factors needed for due diligence, that is, what percentage of all coaches earn any income at all, how many drop out within a year, or the average longevity of coaches. It limits the data to what it calls “active” coaches. If *all* coaches were included, the income averages would necessarily be lower, along with the percentages in each rank.
- Relying only on the data provided by Medifast shows that, on average, the bottom 80% of all “active” coaches do not earn as much per month as they would likely expend to participate in the meal replacement plan themselves and for costs of doing business.
  - ✓ The mean average income of the bottom 80% of coaches – that do earn income – is \$52 a week, about one-half of what the meal replacement products cost.
  - ✓ The mean average “income” does not reflect joining fees or expenditures for products, marketing materials, shipping, or any other business costs, and therefore cannot be called *profit*.
- The data show that the pay plan shifts the great majority of the commission dollars paid out by the company to the recruiters, not retailers.
  - ✓ About two-thirds of every commission dollar generated by sales or purchases of the bottom 80% are transferred to the top 20%

2009 income opportunity promotion on  
Take Shape for Life website



<sup>3</sup> <http://www.tsfl.com/IDS.pdf>

- ✓ 67% of *all* commissions paid out on total revenue were transferred to the top 10% of active coaches.
- The data also reveal the egregious deceptions of Medifast website promotions that have illustrated incomes ranging from \$8,000 to \$20,000 per month. The actual data show that only those in the top 1% gained such incomes.



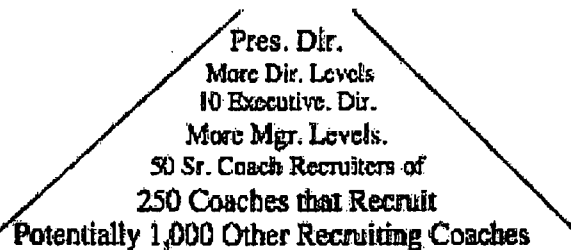
- Take Shape for Life's new disclosure continues to conceal critical data factors. In particular it does not reveal how much of the income of the top 1% is derived from retail sales they themselves made and how much is merely "overrides" on the purchases and sales of the "downline." The mean average commission income for the bottom one-half of the "active" sales channel (Fast Track Coaches and Health Coaches) – \$24 a week – indicates a monthly retail sales level of about 2 meal replacement customers per coach. Medifast does not disclose the overall average retail sales per coach, just as it does not reveal how many coaches are actually enrolled, including those that make no sales but do purchase goods and pay fees.

Over the last 30 years, endless chain trickery has evolved from chain letters, investment plans, "gifting" clubs and penny stock scams into yet another disguise, that of a *business model*. This is the model that Medifast has adopted in its Take Shape for Life division. In the recent real estate sham, investors were called "homeowners". In the Medifast model, they play the role of home-based business owners, "direct sellers" or "coaches". In recent bubbles, investment dollars were dressed up as mortgages and stock portfolios. In the business model, they are disguised as sign-up fees, inventory purchases, marketing fees, seminar registrations, etc.

Medifast's business model manifestly meets the pyramid definition.

- Gaining a position on the Take Shape for Life pyramid pay plan requires a payment of between \$100 and \$300. Each coach would also purchase inventory, marketing materials and possibly attend the TSFL annual convention, with a registration fee of \$250 plus all travel and accommodation costs.
- The coach likely purchases the TSFL meal replacement diet products which cost approximately \$300 per month.
- The new salesperson is lured with claims and testimony of high income potential of \$8,000 to \$20,000 or more.
- The pay plan pays far more – per sale – to those who recruit other coaches than to those who actually sell products to consumers, and the greatest share of all commissions is transferred to those in the top positions of the pyramid.
- The pay plan leverages 10 expanding levels of coaches on a five-recruit-25-recruit-125, etc. plan.
- Bonuses are nakedly paid up front for recruiting new coaches
- Every new coach is authorized to recruit others, with no limit and no control on saturation. Each coach is offered financial rewards to expand the number of "competitor" salespeople!

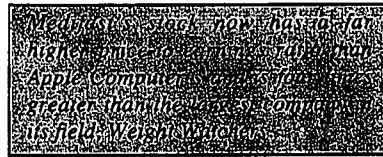
*Take Shape for Life's Endless Chain Incentive Scheme Pays Escalating Bonuses to Recruiters up the chain. From Presidential Director down to the newest recruit, income is based on recruiting more and more coaches in a geometric progression to infinity. By design a profitable coach must have many "below", locking in the vast majority into non-profitable "feeder" roles.*



### Pyramid Meets Pump-and-Dump

The limitless income opportunity spread by Medifast promoters has recently produced a sudden rise in revenue as consumers have become desperate for income. This revenue surge now creates another deception on Wall Street. This is the myth of Medifast as an explosively growing company, a maverick in its field, a company not tethered by market trends or market sizes. In the face of broad market trends to the contrary, Medifast has even claimed that its \$300 a month meal replacement products increase in appeal as the Recession deepens and joblessness spreads because people become more concerned by their appearance!<sup>4</sup> This delusion inflates the stock out of all proportion to revenue because the future expansion is presented as "unlimited", just like the coaches' mythical prospects for earnings.

Medifast's stock now has a far higher price-to-earnings ratio than Apple Computer's and is four times greater than the largest company in its field, Weight Watchers. However, the recent and massive rise in share price for this small company with undistinguished products and operating in a depressed market sector is not new. Indeed, it is part of a pattern for Medifast. Previous market surges were associated with what turned out to be false or grossly exaggerated claims about its product. Rapid declines followed revelations of the deception or, in one case, the discovery that the company CEO was falsely hyping the stock under a pseudonym on the internet.<sup>5</sup>



Additionally, the market surge is accompanied by yet another notable pattern for Medifast, insider stock sell offs. More than \$6 million worth of shares have been dumped in the last two months alone and, no shares were purchased by insiders in the last six months, though many were awarded in 2009.

The 2009 recent market surge, like others before, is attributable to a deceptive claim. This time the company has convinced the Wall Street that the endless chain income scheme of its Take Shape for Life division is truly "limitless." Share price now appears to reflect a belief that company growth, based on ever-expanding recruitment of "coaches", can continue indefinitely.

### Pyramid Power

As revealed in the size of the recent real estate bubble, the scale of the credit-default swap market, and the bloated base of Bernard Madoff investors, the classic pyramid scheme (also known as a bubble, Ponzi scheme, advance-fee fraud or closed market swindle) has enormous market power. Harnessed to stock sales, investment portfolios, product sales, home mortgages, or breeding pigeons, it can mobilize millions of people and draw in billions of dollars very rapidly. Because it is always stealing from the future,

<sup>4</sup> In a December, 16, 2008 press release, announcing Q-3 sales growth, Medifast's board chair, Brad MacDonald stated, "...during tough economic times, consumers turn their attention to improving their health and appearance."

<sup>5</sup> In early 2007, Medifast's stock took yet another sudden dip when CEO, Bradley T. MacDonald, quickly resigned his position. *Barron's Magazine* had disclosed that he had placed postings on Yahoo financial boards under a pseudonym. (*Barron's*, Jan. 8, 2007).

it creates the illusion of extraordinarily fast growth, unstoppable advancement and unlimited expansion. When, it is in "momentum", only a clear-eyed evaluation of the fundamentals can reveal the bad end it is moving toward. Among those profiting from the "growth", such an analysis is typically resisted and denied.<sup>6</sup>

Medifast has vastly outperformed all competitors. This little known company, without advertising, has show spectacular growth during the "Great Recession." While all its competitors who sell essentially the same types of products suffered significant declines Medifast grew rapidly.

Medifast has shown phoenix-like growth. Yet, this unusual growth should be a red flag to investors and regulators that something is awry. It was Bernard Madoff's uncanny consistency of 12% profits each year, and his ability to deliver projected returns regardless of the size of his portfolio and in the face of down market trends that first attracted the suspicion of whistle-blowers.

Nothing in Medifast's product line indicate a competitive advantage. Pricing of its products closely matches others in the field. Only one factor differentiates Medifast. That is its multi-level marketing structure. Revenue growth matched and depended upon the company's ability to continually expand its base of "coaches" who are paid contractors. Though the stock market has resoundingly responded to Medifast's revenue growth, little or no inquiry has been made into sustainability of the recruitment plan, which is the source of the revenue. Each new "coach" is promised a viable opportunity to earn thousands of dollars per month – based on recruiting yet more coaches. It is that promise that generates the Medifast revenue and has catapulted the company's growth rate beyond all its competitors.

The expectation of the continued fulfillment of that promise is the foundation for Wall Street's show of confidence in Medifast. A price-to-earnings ratio that is nearly four times greater than the industry leader surely indicates Wall Street's belief in Medifast's maintaining its current rapid expansion rate.

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<sup>6</sup> The factors of delusion and denial were classically illustrated in Charles Ponzi's 1920 scam as they have manifested in all others ever since. Ponzi attracted the support of newspapers, some politicians, charities and several banks who attacked those who questioned his legitimacy. The crusading journalists and law enforcement officials who investigated Ponzi were vilified in the press. (See the excellent biography of Ponzi, "Ponzi's Scheme" by Mitchell Zuckoff, 2006, Random House.)

As burden of proof rests with regulators and analysts, pyramid operators adroitly hide data and operations. Medifast follows this tradition also by failing to disclose basic factors that many other multi-level marketing companies publish and some have been ordered to disclose by judges and regulators, e.g., drop-out rates, actual retail sales levels, the facts of saturation, the requirements for intense recruiting, among other indicators that expose the "endless chain" structure and its inevitable large-scale loss rates.

*Expert Report on Medifast, Inc., January 2010*

7

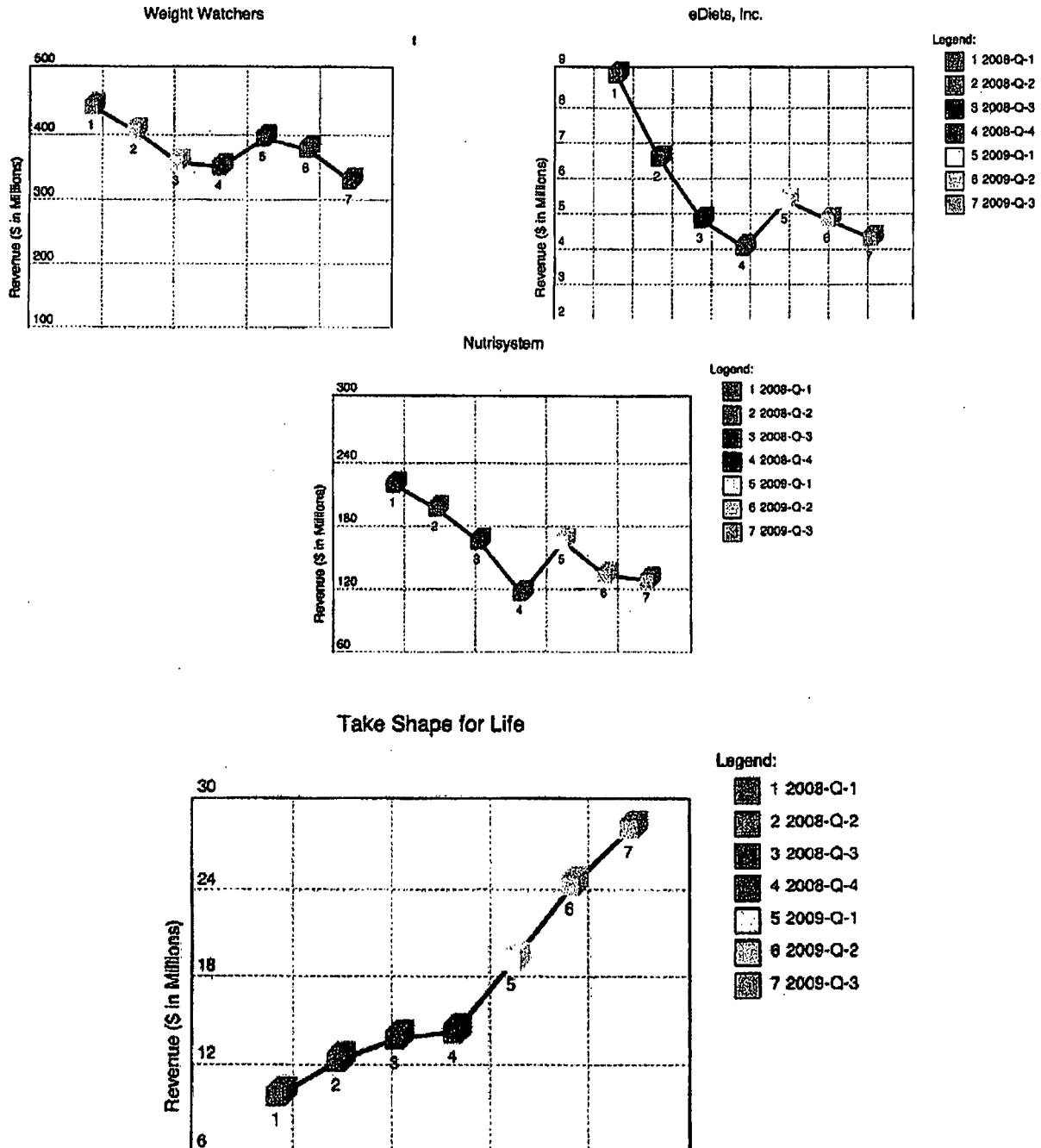
This expectation cannot be warranted as long as Medifast's growth depends on continuing its recruitment rates. While there may be a theoretical potential for Medifast to overtake Weight Watchers, it is indeed not possible to achieve this under the current model. As the base of coaches rises, the income potential for each new coach must diminish. Despite Medifast's "infinite expansion" incentive plan, the real world market for meal replacement consumers and for consumers that will invests in its "endless chain" business opportunity is indeed limited.<sup>7</sup>

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<sup>7</sup> The Research Report from First Research, Inc., "Industry Profile Weight Reduction Services Quarterly Update 11/2/2009" offered no indicators for significant growth for the meal replacement business. It noted that US personal income, which drives consumer ability to pay for weight reduction services, fell 2.6 percent in August 2009. Other noted challenges include minimal growth in the services sector, high drop-out rate among purchasers and high cost to acquire customers compared to costs in 2008.

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### Declining Revenue Trends of Main Competitors Contrasted with Take Shape for Life's Extraordinary Growth Trend in Same Time Frame



### Forward Looking Stock

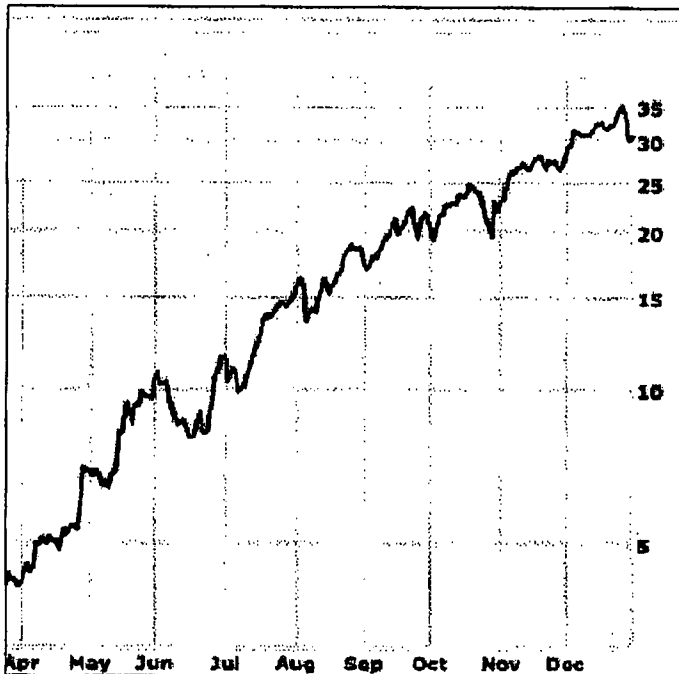
Revenue growth is often accompanied by shareholder price increase. Yet, Medifast's rocket-like stock rise cannot be so simply explained. Given its history of deception, the company CEO's controversial attempt to surreptitiously hype the stock, and the company's record of great price drops following its questionable rises, the current surge gives even more cause for inspection.

From the start of the 2<sup>nd</sup> quarter, 2009, Medifast stock has risen from 4.24 to an astonishing 33.23, a rise of 800% in nine months.

While stock prices are not always indicators of a company's current performance, they are, in general, considered valid indicators of future developments. Higher share price relative to current revenue or earnings indicates belief in a company's prospects for robust future growth. Lowered share prices on currently sound and profitable businesses

point to Wall Street fears of looming declines.

Medifast Share Price Rise from April, 2009 to Dec. 31, 2009



During the period of Medifast's great share price rise, Medifast's quarterly revenue has also shown strong growth but it pales in proportion to the rise in its stock value. The company now trades at 50 times its earnings, a far higher ratio than even Apple Computer's or Microsoft. Its market capitalization is approaching one-fourth that of the giant Weight Watchers, while its revenue is less than 9% of that company's.

Wall Street is obviously engaging in extremely optimistic forecasting for

Medifast. How is this justified in a company that few had heard of just one year ago when the stock was in the \$4 range and the credibility of which *Barron's* magazine in 2006 had questioned for falsely hyping its product and for "rampant" insider trading?<sup>8</sup>

<sup>8</sup> "Medifast's Diet Disorder: Heavy insider selling only strengthens the case against diet-food maker Medifast, which already suffers from credibility problems," by Neil A. Martin, September 4, 2006

### The Mirage of Pyramid Expansion

The classic pyramid scheme pattern of expansion shows rapid, almost astonishing growth. With multiples of investors feeding money back to earlier investors, extraordinary gains are recorded by those first investors, giving the impression of a get-rich-quick opportunity for all others as well. The system appears magical in its money-producing capability. Its popularity soars.

Here is where reality metastasizes into a fateful delusion. A belief arises that the money transfer system can continue indefinitely, without regard to the limits of available investors. This is the delusion that Medifast has cultivated on Wall Street. Only arithmetic can break the spell.

Medifast has recorded a 100% increase in quarterly revenue over the course of the last four quarters in which SEC filings are available. Q-3'08 produced \$13.65 million in revenue for Take Shape for Life. Q-3'09 generated \$27.9 million. However, as the company clearly acknowledges in its 10-Q filings, these gains were directly tied to corresponding increases in the recruitment of coaches.

3,200 coaches produced Q-3'08's results. One year later, to double sales, the company reported 5,800 coaches. Exactly how many coaches actually were enrolled over the year is not disclosed. Most multi-level marketing companies report a 50-70% annual dropout rate. If this were applied to Take Shape for Life, the company may have used the investments and labors of as many as 7,400 coaches during the 12-month period (3,200 plus 1,600 new recruits to replace the 50% dropouts, plus another 2,600 gained to produce a net of 5,800 by the end of the year.)

Using Medifast's net figures, the data shows an inextricably bound relationship of revenue growth to coach recruitment. Coaches must increase 80% for the company to double its revenue each year. 3,200 coaches produced approximately \$14 million. A year later, 5,800 coaches produced approximately \$28 million.

Wall Street, which is paying 50 times earnings for Medifast share in January 2010, is clearly expecting continued growth at or near current rates. Yet, because Medifast's growth is tied to pyramid recruitment of coaches, this growth is jeopardized. The threat to Medifast's growth is due to its dependence on pyramid recruitment. The market for "coaches" is unknown but surely not "unlimited."

If Medifast were to maintain its current 100% growth rate – which has driven in its high share price – over the next five years, the coaches must be increased proportionately by 80% per year. To achieve just one-half the current rate, coaches must grow at a rate of 40%.

Medifast "Coach Growth" to Maintain Revenue Growth	At Current Rate of Revenue Growth	At One- half Current Rate
2010	10,440	8,120
2011	18,792	11,368
2012	33,826	15,915
2013	60,886	22,281
2014	109,595	31,193

It may indeed be possible for Medifast to recruit tens of thousands of new coaches, over the next several years but this could not be done *legally*. Deception would have to be employed on a large-scale to convince all new recruits that they too could all continue to recruit tens of thousands more. The myth of unlimited

market expansion will be increasingly difficult to maintain.<sup>9</sup> No industry can expand its market base by merely authorizing more and more sales representatives, unless the "salespeople" are the prime customers. Yet, if only the salespeople consumed the goods and the company gained revenue primarily by recruiting more salespeople, the business would be likely declared a naked pyramid scheme, as other multi-level marketing schemes have been that lacked significant retail sales.

The real estate market, currently in decline, cannot be magically expanded by licensing more and more real estate brokers. Yet, Take Shape for Life's marketing program is based firmly on this very concept – more and more salespeople, despite a flat or declining market for meal replacements.

As market saturation for sales representatives grows within a product market already in decline, three developments will occur, and may already be underway at Medifast:

1. The growth rate of coaches must eventually slow considerably.
2. In reaction to the declining enrollments, intensified recruiting with bonuses and other rewards will be undertaken, but these efforts will not produce the corresponding revenue growth that it had historically. Between Q-1'09 and Q-2'09, TSLF increased its revenue by more than \$7,800 for each new coach it reportedly gained. Yet, from Q-2'09 to Q-3'09 each new coach that the company netted produced less than a \$4,000 increase in company revenue, the lowest net gain in revenue per new coach in the last six quarters. This decline in revenue per new coach may fluctuate but will eventually settle into an unalterable pattern.
3. A larger proportion of total revenue will eventually begin to come directly from the salespeople themselves, rather than from retail customers. This pattern can be seen clearly in one other publicly traded multi-level marketing company with many similarities to Medifast, Pre-Paid Legal.<sup>10</sup>

Two realities intrude into Medifast's cultivated Wall Street myth of long term expansion at today's current rates of growth.

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<sup>9</sup> The real world limits of this market are shown in First Research, Inc.'s study, "Industry Profile Weight Reduction Services Quarterly Update 11/2/2009." It estimates the total US market at \$2 billion. This includes revenue from program fees, food supplements, and other merchandise sales related to diet and weight reduction as well as real food, which Take Shape for Life markets. Food and other merchandise sales account for about 40 percent. Typical meal replacement customers spend about \$100 a week and stay on the programs about 11 weeks.

<sup>10</sup> Pre-Paid Legal (NYSE: PPD), like Medifast, charges a fee to become a salesperson and then rewards the salespeople to recruit more new salespeople. Average sales per salesperson is about 4 customers (Medifast does not disclose actual retail sales ratios but that number is probably comparable). Prices for its services are the same for retail customers as for the salespeople, as they are at Medifast. Pre-Paid also enjoyed rocket-like growth as Medifast is now. Then, sales and recruiting ebbed, followed by recent gains in recruiting as the Recession worsened, as at Medifast. In 2009, the pattern of generating revenue more and more from recruiting salespeople, with the lure of income over product sales, has become fixed at Pre-Paid Legal. For the year 2009, enrollments of salespeople grew 52.2% while the customer base decreased about 1.0%. The number of salespeople enrolled during the year was three times that of the retail customers. Since the sales people are also customers – as is also true at Medifast – the Pre-Paid data for Q-4'09 show that the number of salespeople recruited accounted for over 300% of the increase in sales.



1. The market for health coaches is limited more so than the total market for meal replacement customers. To grow market share, TSFL must continue to make the case to all new coaches that they can always recruit an unlimited number of new coaches.
2. Under the Medifast's chain letter pay plan, the great majority of the coaches can *never* reach the tantalizing income lures that are used in Take Shape for Life's promotion. A typical web-based solicitation<sup>11</sup> makes the often repeated statement, "The average Health Coach at the Executive level makes about \$3,000 per month supporting roughly 30 people. It goes up from there."

This statement omits the crucial fact that Executive Level coaches constitute only 6% of the entire organization. They and those "up from there" are in the top echelon, with at least 90% of all other coaches below them. The incomes of the top 10% of executives exist only if there are 90% below. Recruiting more coaches is required to achieve Executive level. For every new "Executive Level" coach there must be a corresponding growth of 90 more coaches below.

### **History Repeating Itself**

*Barron's Magazine* singled out Medifast in 2006 for one unusual characteristic, its uncannily sudden rises followed drops in share pricing.

- It noted that in 2003, shares shot from 3.79 to 18 and then soon went back to below 3.
- Then, in 2005, shares surged by nearly 600% to a high of 21, then fell down to 12. In those cases, the surges were driven by hype about a new system of generating sales leads and a supposed medical breakthrough. Neither proved to be substantive or sustainable.
- In 2006 Medifast shares went from a low of about 5 to over 21 and then down again to 8.
- 2007 shares ranged from a high to 13, falling to more than 50% to about 6 and then another surge of 50% upward to 9 and falling back to 4.
- 2009's 800% stock surge is now based on Medifast's use of the pyramid recruitment model in its Take Shape for Life Division. The surge coincides with the deepening Recession and follows the pattern of sudden growth in salespeople – who are also customers – among other pyramid selling schemes.

Unlike other multi-level marketing schemes, Medifast has key limitations. Its market is not universal. It is limited to those who suffer from weight problems and are able and willing to pay thousands of dollars on meal replacement regimens. Its salespeople cannot enroll just anyone they meet in grocery stores, such as Amway's reps famously do. The market for meal replacements is defined and the number of people who could possibly gain a profit from endlessly recruiting other salespeople into this field has severe limits.

Those limits will be reached in due time. Its current revenue growth, as a basis for its extraordinary 800% rise in share price, is as unsustainable as the previous sparks that ignited share price rises and were similarly hyped.

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<sup>11</sup> See <http://www.getyouhealth.com/medifast-healthCoach.asp>

**Analysis of Take Shape for Life's Official Income Disclosure Statement**

Active Health Coach Ranks	Number of Active Coaches in Rank	% of "Active" Health Coaches by Rank	Avg. Monthly Commission by Rank	Total Dollars Paid to all "Active" Coaches in Each Rank per month	% of Total Commissions Paid to Each Rank per Month
Presidential Director	12	0.20%	\$48,241.09	\$578,893	11.77%
Global Director	27	0.47%	\$16,747.18	\$452,174	9.19%
National Director	35	0.61%	\$9,546.78	\$334,137	6.79%
Total for Top of Pyramid	74	1% (rounded)	\$18,449	\$1,365,204	28% (rounded)
Regional Director	172	2.97%	\$4,435.17	\$762,849	15.51%
Executive Director	366	6.31%	\$3,253.26	\$1,190,693	24.21%
Director	63	1.09%	\$1,919.41	\$120,923	2.46%
Associate Director	171	2.95%	\$1,438.38	\$245,963	5.00%
Manager	294	5.07%	\$897.93	\$263,991	5.37
Total for Upper Level Recruiters	1,066	19% (rounded)	\$2,424	\$2,584,419	52% (rounded)
Senior Coach	1,695	29.23%	\$402.86	\$682,848	13.88%
Fast Track Coach	2,544	43.86%	\$99.90	\$254,146	5.17%
Health Coach	421	7.25%	\$76.83	\$32,345	0.66%
Total for Bottom Level Coaches	4,660	80% (rounded)	\$208	\$969,339	20% (rounded)
Total for all Groups	5800	100%		\$4,918,962.00	100%

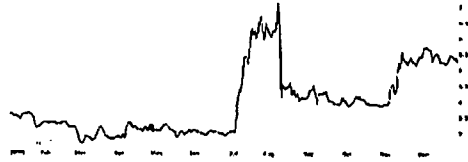
- Top 1% (1.28) receive 28% of all commissions
- Top 4% (4.25) receive 43% of all commission
- Top 10% (10.56) receive 67% of all commissions
- Bottom 50% (51.11) receive 6% of all commissions

**Note:**

- Raw data for this analysis is posted on the Take Shape for Life website at <http://www.tsfl.com/TDS.pdf>
- The company disclosure uses a time frame of the first six months of 2009. It offers average dollar figures and percentages of "active" coaches at each level, but it does not apply the data to actual numbers of coaches involved. Medifast does not disclose churn rates of coaches or average tenure of coaches, or the number of "inactive" coaches, (those that do not earn at least \$25). It is therefore not known how many coaches fail to make any sales at all, but paid in fees and purchased goods and generated commissions for the other coaches.
- If inactive coaches were disclosed, percentages per level would be adjusted downward to reflect the larger size of sales force, and overall average incomes of coaches would be degraded to include those who made no income at all.
- Without hard data on the true number of coaches enrolled over time, it is also not known how much of Take Shape for Life's total revenue is attributable to the direct purchases and fee payments of coaches.
- This analysis applied the percentages and monthly averages to the last total number of "active" coaches disclosed by Medifast: 5,800 at the end of Q-3'09.

**Medifast's Volatile Stock Performance**

**2005**



**2006**



**2007**



**2008**



**2009**







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**For Immediate Release**

**Title: Multi-level marketing expert releases new findings on Medifast, Inc. (NYSE:MED): calls company a 'consumer pyramid'**

**Sub-Title: Expert: "Under the Medifast (NYSE:MED) chain letter pay plan, the great majority of the coaches can never reach the tantalizing income lures that are used in Take Shape for Life's promotion"**

January 8, 2010 San Diego, CA

The Fraud Discovery Institute, Inc. today released a new, updated report on Medifast, Inc. (NYSE:MED). The report reveals that the company derives almost two-thirds of their revenue from their multi-level marketing company, making them competitors with companies like Mannatech, Amway and PrePaid Legal, Inc. and not Weight Watchers, Jenny Craig or NutriSystem as Wall Street analysts assert. Nationally recognized multi-level marketing expert Robert Fitzpatrick makes the following observation about Medifast, Inc.'s meteoric stock price rise from April of 2009 to January 2010:

*"The foundation of Medifast's stock surge is the recent rise in its revenue, which is driven by the "endless chain" income opportunity that it markets to consumers. Medifast's income scheme is a solicitation to consumers to become distributors that buy and sell the company's meal replacement products and to recruit others to do the same. Medifast seamlessly integrates its "income opportunity" product with its meal replacement products. It makes earning money a key part of its three-part "system" for weight control and good health – the only company in that field to do this – and it offers consumers the company's own recruitment scheme as the means to meet financial goals."*

Mr. Fitzpatrick goes on to make the following observations that are not readily disclosed by Medifast, Inc.

- \* About two-thirds of every commission dollar generated by sales or purchases of the bottom 80% are transferred to the top 20%
- \* 67% of all commissions paid out on total revenue were transferred to the top 10% of active coaches
- \* Take Shape for Life's new disclosure continues to conceal critical data factors. In particular it does not reveal how much of the income of the top 1% is derived from retail sales they themselves made and how much is merely "overrides" on the purchases and sales of the "downline."



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\* The mean average commission income for the bottom one-half of the "active" sales channel (Fast Track Coaches and Health Coaches) – \$24 a week – indicates a monthly retail sales level of about 2 meal replacement customers per coach.

\* Medifast does not disclose the overall average retail sales per coach, just as it does not reveal how many coaches are actually enrolled, including those that make no sales but do purchase goods and pay fees.

Medifast has shown phoenix-like growth. Yet, this unusual growth should be a 'red flag' to investors and regulators that something is awry. It was Bernard Madoff's uncanny consistency of 12% profits each year, and his ability to deliver projected returns regardless of the size of his portfolio and in the face of down market trends that first attracted the suspicion of whistle-blowers. Under the Medifast chain letter pay plan, the great majority of the coaches can never reach the tantalizing income lures that are used in Take Shape for Life's promotion.

The report, included in entirety at [www.medifraud.net](http://www.medifraud.net), goes on to add: "A typical web-based solicitation makes the often-repeated statement, 'The average Health Coach at the Executive level makes about \$3,000 per month supporting roughly 30 people. It goes up from there.' This statement omits the crucial fact that Executive Level coaches constitute only 6% of the entire organization." The Fraud Discovery Institute, Inc. also responded to Medifast, Inc's (NYSE:MED) alleged 'independent investigation' of past claims about the pyramid scheme compensation plan that lures in new prospects and is the only reason for the company's growth ([www.frauddiscovery.net](http://www.frauddiscovery.net)).





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**For Immediate Release**

**Title: FDI responds to Medifast's (NYSE:MED)'Independent' review of 'convicted felon's allegations'**

**Sub-Title: Through the utilization of the fraud technique of diversion, Medifast (NYSE:MED) misleads the public in public response to critic**

January 8, 2010 San Diego, CA

In Medifast Inc.'s (NYSE:MED) latest 10-Q released on November 9<sup>th</sup>, 2009, the company makes the following assertion: *"An Independent Committee of the Board of Directors of Medifast was constituted to review the public allegations of a third party "Convicted Felon" on his website. The Independent Committee of the Board of Directors of Medifast Inc. recommended that the Company make a formal complaint to the Securities and Exchange Commission and the Attorney General of Maryland as it pertains to the convicted felon Minkow and his "for profit" company's false and misleading claims against Medifast. There are currently no pending matters of a material nature related to any government investigation of the case involving Mr. Minkow, his company, its affiliates or associates. Any actions related to any government investigation pertaining to this complaint have been deemed confidential at this time."*

According to FDI Co-Founder Barry Minkow, "there is only one problem with the above statement. Neither FDI nor myself made the detailed allegations in previous reports released on the official FDI website. On the contrary, FDI sought the outside opinion of nationally recognized, multi-level marketing expert Robert Fitzpatrick, who has testified for law enforcement on numerous occasions about these kinds of schemes. Mr. Fitzpatrick is not a short-seller and has never had a financial interest in Medifast's stock at any time nor would Mr. Fitzpatrick, for the nominal fee paid for his analysis of the Medifast business model, make up out of thin air the specific problems inherent with the company."

In fact, nowhere in the Medifast 10-Q are any of Mr. Fitzpatrick's calculations or evaluations refuted or addressed. Mr. Minkow goes on to point out: "The company and its 'independent committee,' dismissed, a-priori, the Fitzpatrick findings through smoke and mirrors and name calling. Don't be confused with all these facts, figures and expert analysis because Barry Minkow is a short-seller. The problem is the person who made the findings is not a short-seller and his conclusion about the Medifast "doomed by design business model" still stands un-refuted."







info@frauddiscovery.net

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**Open Letter to Mr. Bradley MacDonald, Chairman, Medifast, Inc.  
and the "Independent Committee of distinguished members of the  
Board of Directors of Medifast, Inc."**

January 12<sup>th</sup>, 2010

Dear Mr. MacDonald and "Committee,"

I am writing in reference to your recent press releases where you indicated that our past and current reports prepared by our expert were "false, misleading, and/or without merit... The same is true for the re-issue of the report posted January 8, 2010 – the allegations are false, misleading, and/or without merit."

I will immediately retract and formally apologize to you, your stockholders and your Board of Directors (including the "distinguished members of the Board of Directors of Medifast, Inc.") if you can simply show me where we are factually incorrect.

Were we 'false, misleading or without merit' when we demonstrated that Medifast knowingly and willingly omits and fails to disclose that only 6% of the entire organization of TSFL ever reaches the Executive level? Were we 'false, misleading or without merit' when we demonstrated that 67% of all commissions paid in the TSFL scheme go to a 10% remnant of the organization?

Were we 'false, misleading or without merit' when we stated that the foundation of Medifast's recent stock surge is tied to the recent rise in its revenue, which is driven by the "endless chain" income opportunity that it markets to consumers through the integration of its "Income opportunity" product with its meal replacement products?

Were we 'false, misleading or without merit' when we stated that the pyramid selling scheme of Medifast, based on the lure of income to consumers from an endless recruiting chain, is now being leveraged by the company into the securities market on Wall Street?

Were we 'false, misleading or without merit' when we demonstrated that the mean average income of the bottom 80% of coaches – of those that do earn income – is a modest \$52.00 (that is fifty two dollars only) a week, which is about one-half of what the meal replacement products cost?

I look forward to receiving the documentation from the independent committee of the Board of Directors of Medifast, Inc. as they must have them right at their fingertips



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before publicly stating that our computations are "false, misleading or without merit."  
Since truth is our only real defense against your recent allegations, we would appreciate  
you forwarding the corroborative documentation that substantiates your assertions.

Respectfully Submitted

A handwritten signature in black ink, appearing to read "B. Minkow", is written over the typed name.

Barry Minkow  
Co-Founder  
Fraud Discovery Institute, Inc  
www.frauddiscovery.net



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## **Medifast multi-level marketing scheme called into question by expert**

Posted by [Tracy Coenen](#) on January 12, 2010 · [1 Comment](#)



Robert FitzPatrick, a multi-level marketing expert known around the world for his analysis of the business model, has released a report on Medifast Inc. (NYSE:MED) and its Take Shape For Life division. TSFL is the multi-level marketing arm of the weight loss company, and is the force behind the company's overall increase in revenue.

FitzPatrick writes:

The foundation of Medifast's stock surge is the recent rise in its revenue, which is driven by the "endless chain" income opportunity that it markets to consumers. Medifast's income scheme is a solicitation to consumers to become distributors that buy and sell the company's meal replacement products and to recruit others to do the same. Medifast seamlessly integrates its "income opportunity" product with its meal replacement products. It makes earning money a key part of its three-part "system" for weight control and good health – the only company in that field to do this – and it offers consumers the company's own recruitment scheme as the means to meet financial goals.

Exhibit 23, pg. 01

He also reports the following:

- About two-thirds of every commission dollar generated by sales or purchases of the bottom 80% are transferred to the top 20%
- 67% of all commissions paid out on total revenue were transferred to the top 10% of active coaches
- Take Shape for Life's new disclosure continues to conceal critical data factors. In particular it does not reveal how much of the income of the top 1% is derived from retail sales they themselves made and how much is merely "overrides" on the purchases and sales of the "downline."
- The mean average commission income for the bottom one-half of the "active" sales channel (Fast Track Coaches and Health Coaches) – \$24 a week – indicates a monthly retail sales level of about 2 meal replacement customers per coach.
- Medifast does not disclose the overall average retail sales per coach, just as it does not reveal how many coaches are actually enrolled, including those that make no sales but do purchase goods and pay fees.

This report is an update to a mid-2009 report issued by FitzPatrick. The full text of the current report is found here. And here is my analysis of Medifast and Take Shape For Life from last year.

## Related Posts

1. [More on the endless chain recruitment scheme of Medifast and Take Shape For Life](#)
2. [Medifast and Take Shape For Life: Weight loss pyramid scheme?](#)
3. [Medifast continues to mislead shareholders](#)
4. [Fraud Discovery Institute blasts Medifast](#)
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One Response to "Medifast multi-level marketing scheme called into question by expert"

Exhibit 23, pg. 02



• **About the Author**



Tracy Coenen is a forensic accountant and fraud examiner in Chicago and Milwaukee who investigates white collar crimes, including cases of financial statement fraud, embezzlement, tax fraud, and insurance fraud. She is the author of Expert Fraud Investigation and Essentials of Corporate Fraud and more than 100 articles on fraud featured in industry publications.



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  - shirley: I must have hit the enter key before I finished my post, so...
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## More on the endless chain recruitment scheme of Medifast and Take Shape For Life

Posted by [Tracy Coenen](#) on January 13, 2010 · [Leave a Comment](#)



Yesterday I referenced a [new report on Medifast and Take Shape For Life](#) by multi-level marketing expert [Robert Fitzpatrick](#). Here is more from his report. I want to highlight these things because they're the **facts** that many pushers of MLMs will never tell you.

Those recruiting for MLMs are quick to tell you about how much you can make if you sell their product (often glossing over the fact that you'll have to recruit new people into the scheme in order to have any chance of making a living), but they will never tell you that it's next to impossible. They forget all the reasons why people in these MLMs are selling so few products and making so little money from selling.

Fitzpatrick clues us in:

The income opportunity, based on the plan's structure, rules, bonuses and commission schedule, primarily **depends upon endless chain recruiting of more "coaches"**, not on retail sales of its products. The cost of selling, competitive factors, and the paltry 15-20% commission offered on retail sales make that option a myth and facade to obscure the

Exhibit 24, pg. 01

recruitment pyramid. The income scheme is a classic "endless chain." The report also raised the question of the plan's legality, its jeopardy under California's statute against "endless chain" plans, and the risk of its being challenged by other regulators or by consumers in court as a fraud.

And here's my problem with MLMs in general, in the words of Fitzpatrick:

The pay plan pays far more – per sale – to those who recruit other coaches than to those who actually sell products to consumers, and the greatest share of all commissions is transferred to those in the top positions of the pyramid.

That's right... recruiting pays more than selling. The upline is making way more money off the sale of products than those **actually doing the selling.**

And here are some hard numbers:

- Top 1% (1.28) of coaches receive 28% of all commissions
- Top 4% (4.25) of coaches receive 43% of all commission
- Top 10% (10.56) of coaches receive 67% of all commissions
- Bottom 50% (51.11) of coaches receive 6% of all commissions

Check that out. The bottom half of coaches only receive 6% of all the commissions the company pays. The above statistics are typical for MLMs.... unless you can get into that top tier of the pyramid (and almost no one does), you aren't going to make any money.

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2. [Medifast multi-level marketing scheme called into question by expert](#)
3. [MLM Scheme, Mannatech, Pays Millions to Victims for Making False Claims of Cures and Health Benefits](#)
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Tracy Coenen is a forensic accountant and fraud examiner in Chicago and Milwaukee who investigates white collar crimes, including cases of financial statement fraud, embezzlement, tax fraud, and insurance fraud. She is the author of Expert Fraud Investigation and Essentials of Corporate Fraud and more than 100 articles on fraud featured in industry publications.



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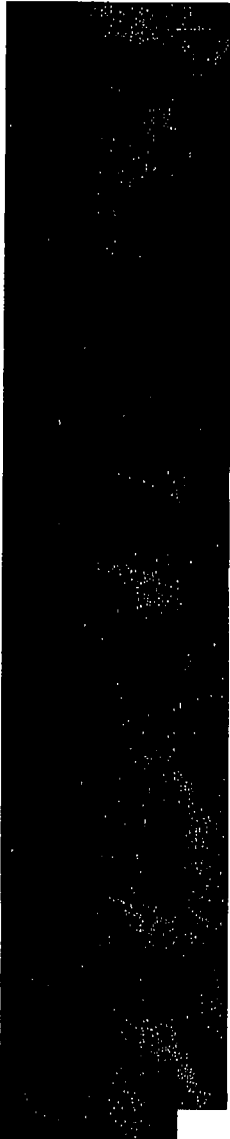
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## Medifast continues to mislead shareholders

Posted by [Tracy Coenen](#) on January 13, 2010 · [Leave a Comment](#)

This week multi-level marketing expert Robert Fitzpatrick released his second report in the last year on Medifast (NYSE: MED) and their Take Shape For Life multi-level marketing division. The report highlights how little money the company's "health coaches" actually earn from selling the products, and makes it clear that the real money (if there is any) is in recruiting new marks into the scheme.

Following the release of FitzPatrick's first report last year, Medifast management came out with bizarre statements. The most recent version of their statement was included in a 10-Q filed with the Securities and Exchange Commission on November 9, 2009:

An Independent Committee of the Board of Directors of Medifast was constituted to review the public allegations of a third party "Convicted Felon" on his website. The Independent Committee of the Board of Directors of Medifast Inc. recommended that the Company make a formal complaint to the Securities and Exchange Commission and the Attorney General of Maryland as it pertains to the convicted felon Minkow and his "for profit" company's false and misleading claims against Medifast. There are currently no pending matters of a material nature related to any government investigation of the case involving Mr. Minkow, his company, its affiliates or associates. Any actions related to any government investigation pertaining to this complaint have been deemed confidential at this time.

The problem is that the allegations weren't made by convicted felon Barry Minkow. The allegations were made by multi-level marketing expert Robert Fitzpatrick, who has researched hundreds of

MLMs. Minkow didn't make any "false and misleading claims." FitzPatrick made claims based on Medifast's own published numbers, none of which the company has refuted in any forum.

The madness doesn't stop there, however. In reaction to FitzPatrick's most recent report, Medifast issued a press release entitled "Medifast, Inc. Comments on False and Misleading Allegations." It states in part:

The independent Directors' Committee, after investigation of facts and information concluded the allegations were false, misleading, and/or without merit. The same is true for the re-issue of the report posted January 8, 2010 – the allegations are false, misleading, and/or without merit.

Yet the company has not seen fit to point out what might be false or misleading about FitzPatrick's report. They have the data at their fingertips that could supposedly refute any allegations made, yet the company declines to provide any specifics.

Why not? Because FitzPatrick printed the truth based on Medifast's own numbers. Apparently it isn't bad enough that the company doesn't tell the whole story about the business to either stockholders or health coaches. Now they're maligning an independent expert who merely used the company's own data to show what an awful "opportunity" TSFL offers health coaches, and how heavily the company relies on the recruiting of coaches to grow revenue.

Barry Minkow has issued an invitation to Medifast executives. He's inviting them to point out exactly what is false or misleading about FitzPatrick's report, and to provide the documentation that proves their points. Certainly if there really are material points that FitzPatrick has made which are false or misleading, the company would like to immediately identify them? And Minkow has even offered to retract his statements about FitzPatrick's report and apologize to the company in return for them backing up their allegations about the report.

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Tracy Coenen is a forensic accountant and fraud examiner in Chicago and Milwaukee who investigates white collar crimes, including cases of financial statement fraud, embezzlement, tax fraud, and insurance fraud. She is the author of Expert Fraud Investigation and Essentials of Corporate Fraud and more than 100 articles on fraud featured in industry publications.



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- Wisconsin politicians screwing taxpayers one dollar at a time (3)
  - Brian: Its time for Wisconsinites(those here legally, I mean) to WAKE UP and...
- Fraud Discovery Institute releases new report about Pre-Paid Legal Services, Inc. (34)
  - Tracy Coenen: Have you ever wondered why no other company offers this type of...
  - Chris Hancock: The fact that PPL delivers on its product and promises is...
- FTC taking action against Pre-Paid Legal Services Inc. (4)
  - Doo Dilly: Unfortunately, MLM's still operating...
  - john swindle: Yeah, it is just a lie that these folks say their primary...
- Who is making money as a United First Financial agent? (8)
  - Sandy: Good point. If the program actually worked as promised, then I would...
  - Craig Hansen: It's not that people are making money – it's...



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JANUARY 13, 2010, 6:41 P.M. ET

## Barrack, Rodos & Bacine Announces Investigation of Medifast, Inc.

Urges Shareholders Who Lost More Than \$100,000 to Inquire About This Matter

PHILADELPHIA-- (BUSINESS WIRE)--January 13, 2010--

Barrack, Rodos & Bacine, a leading securities litigation law firm, is investigating potential violations of the federal securities laws by Medifast, Inc. ("Medifast" or the "Company") (NYSE: MED), a Maryland-based weight management company. The investigation focuses on the sustainability of the Company's rapidly growing direct sales distribution channel and the possibility that management made false and misleading statements regarding Medifast's revenues and earnings results and growth potential.

A report was recently issued that questions the validity of Medifast's business model. In particular the report alleges that one of the Company's distribution channels, its direct selling company, Take Shape for Life, Inc., a Medifast subsidiary, is effectively a "pyramid selling scheme" that is driven by an "endless chain" income opportunity. The Company reported that revenues in this segment increased 105% in the third quarter of 2009, which helped to fuel more than a seven-fold increase in Medifast's stock price from April 1, 2009 to January 7, 2010. During the same time period, several members of Medifast management sold significant amounts of their personal stock holdings reaping millions of dollars in gains.

As a result of the dissemination of the report, Medifast's stock price declined dramatically, losing 14% of its value, resulting in losses for investors who purchased Medifast stock since early November 2009. The Company has vigorously disputed the findings made in the report and has made a formal complaint against its creators to the U.S. Securities and Exchange Commission and Maryland Securities Commissioner.

If you purchased shares of Medifast stock since early November 2009, have suffered losses of more than \$100,000 on your investment, and would like to learn more about your legal rights or wish to discuss the matter further, please contact Jeff Golan of Barrack, Rodos & Bacine, 3300 Two Commerce Square, 2001 Market Street, Philadelphia, PA 19103, by telephone at (215) 963-0600, or by email at [jgolan@barrack.com](mailto:jgolan@barrack.com).

CONTACT: Barrack, Rodos & Bacine  
Jeffrey W. Golan,

Esq.

215-963-0600

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The work of iBusiness Reporting is funded by the Fraud Discovery Institute, founded by Barry Minkow, an ex-

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**Medifast** Medifast's rise in revenue traced to unsustainable pyramid-style marketing model

**Summary:** Medifast's rapid revenue growth during the recession has been fueled by its pyramid-style marketing program that is unsustainable and earns the bottom 80% of its citizen sales force about \$52 a week (about half the cost of a single order of the company's replacement meals), according to public documents and a report by Robert L. FitzPatrick, a national authority on multi-level marketing schemes. You can read his 15-page report, commissioned by the Fraud Discovery Institute, [here](#).

Here are seven red flags about Medifast's business model.

**Two-thirds of Medifast's revenue comes from its multi-level marketing program (Take Shape for Life), and most of that revenue comes from attracting citizen sales people**

(called coaches) and not from its products, according to its public filings.

Only 1% of the Take Shape for Life sales forces earns the \$8,000 to \$20,000 per month commissions shown in the company's promotions; the vast majority of citizen sales people don't make enough to cost the cost of a single order of the company's replacement meals, not to mention out-of-pocket expenses such as membership, marketing and shipping fees. And just 6% of sales associates reach the "Executive Level," where they make about \$3,000 per month, according to an analysis by FitzPatrick of Take Shape for Life's official income disclosure statement

If Medifast was to continue its 100% growth rate over the next five years, it would have to recruit 109,595 sales associates (it now claims to have 5,800 "coaches"), according to FitzPatrick.

In promotional materials, Take Shape for Life claims that earning money is one of three key ingredients (along the diet and exercise) to "Optimal Health."

Weightwatchers, Nutrisystem and eDiets--which don't use multi-level marketing--have seen sharp declines in revenue (and stock prices) since Jan. 2008, as fewer customers can afford to buy replacement meal products during the recession. However, Medifast's quarterly revenue has increased 100% in the latest figures available because it's generating much of its money from recruiting new sales associates (people in need of income in these tough economic times), not meal replacement products.

■ Medifast insiders have dumped more than \$6 million worth of stock in the past two months, and no shares were purchased by insiders in the last six months (though many were awarded in 2009), according to SEC filings.

FALSE

■ Barrack, Rodos & Bacine, a leading securities litigation law firm, is investigating potential violations of the federal securities laws by Medifast. The investigation focuses on the sustainability of the company's rapidly growing direct sales distribution channel and the possibility that management made false and misleading statements regarding Medifast's revenues and earnings results and growth potential.





Lainie Cohen

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**(AP) Brad McDonald gets Prestigious Award**

24-Jan-10 03:12 pm

(AP) Las Vegas. At this years AVN awarded Brad McDonald (A.K.A. Pimp-Daddy-Brad) with the Prestigious Award as Pimp of the Year for 2010. The AVN recognizing outstanding achievement in the adult film industry and supportive trades. Founded in 1984 by the publisher of the industry trade magazine Adult Video News.

www.gotpimp.com

Mr. T presented the award saying: "Man this dude has it down. He recruits his Ho's then trains them with the skills they need to go out across the nations to sell their goods then the betches just send him the check. This dude even has his Ho's go recruit other Ho's for him. Man this is the Pimp of the decade."

Pimp-Daddy-Brad was quoted as saying "Well I am honored but I was kind of holding out for the Nobel Prize for fighting Global Hunger by having

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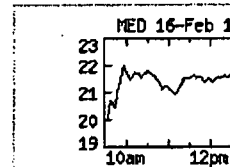
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Pimp-Daddy-Brad was not able to attend the AVN Awards as crowds of angry TSFL Distributors and MediFAT Investors have surrounded his Palace demanding answers to the allegations the MediFAT is a Ponzi Scheme.

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Re: (AP) Brad medisdead (1 Rating) 26-Jan-10 10:44 am  
McDonald gets  
Prestigious  
Award  
What you say  
CG??????????

Re: (AP) Brad medisdead (1 Rating) 26-Jan-10 03:55 pm  
McDonald gets  
Prestigious  
Award  
Hey CG is it  
true MediFAT  
does not  
currently  
have ...

Re: (AP) Brad medisdead (1 Rating) 27-Jan-10 12:13 pm  
McDonald gets  
Prestigious  
Award  
Hey CG. How  
is the TSFL  
SCAM going  
today?

Re: (AP) Brad medisdead Rate it 13 minutes ago  
McDonald gets  
Prestigious  
Award  
Hey CG, how  
is Pimp-  
Daddy-Brad  
doing?  
Getting r...

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Get Message Board for:

**Re: criminal** 13 minutes ago

You wrote:  
deceptive derpertrators such as madoff and lewis and many exec. bankers out there.

I disagree. Brad McDonald is worse than any of them. He preys on those that cannot afford to lose their Investment. He seeks out the desperate that will spend every dime they have pursuing that golden promise of a MediFAT pay check.

Pimp-Daddy-Brad is a low life scum bag and a disgrace to the Marine uniform he once wore.

Rating: ★★★★★ (No ratings) Rate it: ☆☆☆☆☆

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medisdead



50/Male

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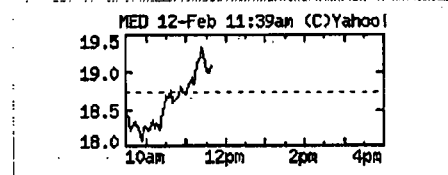
Minimum rating: | 1 star + unrated [What's this?](#)

Subject	Author	Rating	Time of Post (ET)
criminal I think medisdead is a hired help of the creeps ambar a...	jpbjtt	Rate it	20 minutes ago
<b>Re: criminal</b>	medisdead	Not rated	13 minutes ago

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**Medifast Inc. (MED)**



At 11:39AM ET: **19.08** ↑0.34 (1.81%)

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e.g. YHOO, ^DJJ

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Get Message Board for:

**WOW!!!** 8-Feb-10 04:03 pm

WOW, Basically using MediFAT products you are only 1 bite away from sickness or death!!!!

No wonder Pimp-Daddy-Brad does not consume MediCRAP!!!!!!



medisdead  
50/Male

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Rating: ★★★★★ (No ratings)      Rate it: ☆☆☆☆☆

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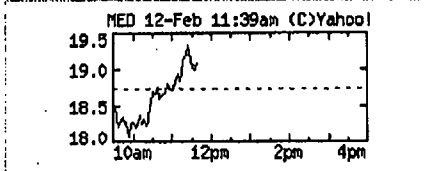
		
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Messages in Topic      Minimum rating: 1 star + unrated    What's this?

Subject	Author	Rating	Time of Post (ET)
Hershey Canada's Claims Salmonella Contamination from s...	zeeyourself	Rate It	8-Feb-10 03:41 pm
Hershey Canada's Claims Salmonella Contamination from s...	Infinitebul...	Rate It	8-Feb-10 04:02 pm
Good try. The lawsuit is for alleged contaminatio...			
WOW!!!	medisdead	Not rated	8-Feb-10 04:03 pm
Re: WOW!!! Now that is sensationalism at its best. I tr...	Infinitebul...	Rate It	8-Feb-10 04:13 pm
Re: WOW!!! One other point on this, the soy referenced i...	Infinitebul...	Rate It	8-Feb-10 04:57 pm
Re: WOW!!!	medisdead	Rate It	8-Feb-10 05:19 pm

**Medifast Inc. (MED)**



At 11:40AM ET: **19.1399** ↑ 0.3999 (2.13%)

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**Re: MED Diabetic Study presented to American Diabetic Association**

8-Feb-10 02:06 pm

You have been listening to CG for too long.

Not one piece of evidence has been submitted in defense of MediFAT and the growing list of allegations against the SCAM Company.

All that has been submitted is "Liar-Liar Pants on Fire."

And for the record, I am not associated with the FDI in anyway. I am just a Board Basher beating the heck out of one of the slimmest Company's operating today.

But that is about to change.

As soon as the FDA takes control over nutrition supplements MediFRAUD will go down.

Pimp-Daddy-Brad will be in prison along with Madoff.

Y guess is that The Department of Justice will also go after the distributors like CG who recruited investors into MediFAT.

Rating: ★★★★★ (1 Rating)      Rate It: ☆☆☆☆☆

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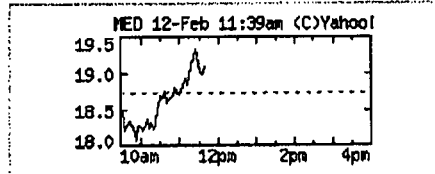
medisdead



50/Male

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**Medifast Inc. (MED)**



At 11:41AM ET: **19.13** ↑ 0.39 (2.08%)

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Minimum rating: 1 star + unrated

Subject	Author	Rating	Time of Post (ET)
MED Diabetic Study presented to American Diabetic Assoc... MED was a presentation at the American Diabetic Associa...	southcott6	(2 Ratings)	8-Feb-10 12:20 pm
Re: MED Diabetic Study presented to American Diabetic...	medisdead	(1 Rating)	8-Feb-10 12:23 pm

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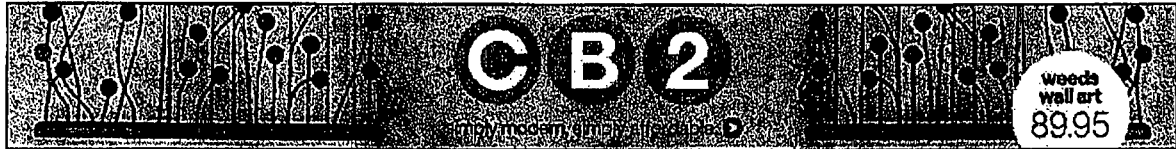
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**Re: Beware of Spreading False Information about MED**

29-Jan-10 05:28 pm

Pimp-Daddy-Brad McDonald is a disgrace to our Armed Forces for running a Madoff Ponzi Scheme and ripping off good people.

medisdead



50/Male

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Rating : ★★★★★ (1 Rating)

Rate it: ☆☆☆☆☆

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**Messages in Topic**

Minimum rating: 1 star + unrated What's this?

Subject	Author	Rating	Time of Post (ET)
Beware of Spreading False Information about MED MED has and will continue to improve and focus on its b...	southcott6	(1 Rating)	29-Jan-10 05:13 pm
Re: Beware of Spreading False Information about MED	medisdead	(1 Rating)	29-Jan-10 05:28 pm
Re: Beware of Spreading PUMPER Information WHILE INSI... GET YOUR FACTS STRAIGHT. WE TAKE CARE OF OUR OWN. ...	k_barhe	(1 Rating)	29-Jan-10 05:32 pm

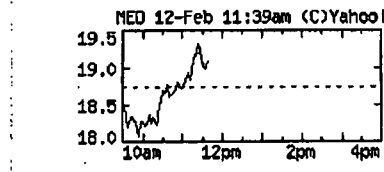
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At 11:42AM ET: **19.17** ↑0.43 (2.29%)

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**Re: 13 easy** 28-Jan-10 12:16 pm

We all miss TANK!!!

I think \$13 is a stretch. Once Pimp-Daddy-Brad is indicted and TSFL shut down MediFAT will implode.

My question is with the TSFL Distributors like CG also be indicted for Fraud?

medisdead



50/Male

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Rating: ★★★★★ (No ratings) Rate it: ☆☆☆☆☆

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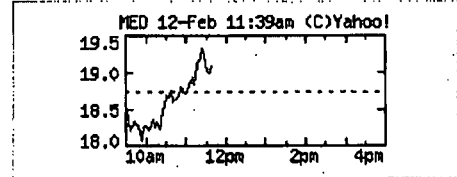
Minimum rating: 1 star + unrated

Subject	Author	Rating	Time of Post (ET)
13 easy Anyone buying this stock now is a gambler or a fool. ...	justmoney00	Rate It	28-Jan-10 12:12 pm
Re: 13 easy	medisdead	Not rated	28-Jan-10 12:16 pm
Re: 13 easy actually.Ive got a bad feeling about this market, ...	morefunthan...	(1 Rating)	28-Jan-10 12:18 pm

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**Medifast Inc. (MED)**



At 11:42AM ET: **19.23** ↑ 0.49 (2.61%)

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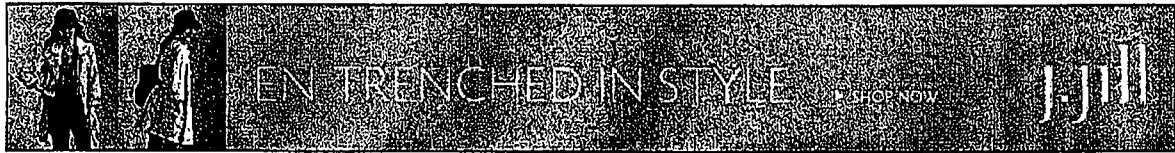
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**Re: Diden't I tell you ? I sure did but** 30-Jan-10 10:40 am

Everybody is kicking poor CG's A\$\$!!

medisdead

Once again Brad McDonald is a spineless Pimp running as Madoff Ponzi Scheme ripping off good people. A disgrace to the US Armed Forces.



50/Male

Nell claims he is Trolling for Tots on the Internet!!!

I predict Pimp-Daddy-Brad will do more time in Prison then Madoff!

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Rating: ★★★★★ (1 Rating)

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Minimum rating: 1 star + unrated What's this?

Subject	Author	Rating	Time of Post (ET)
Diden't I tell you ? I sure did but some ediot that blindly keep pumping this crap and they...	reachsean	(1 Rating)	29-Jan-10 02:43 pm
Re: Diden't I tell you ? I sure did but	medisdead	(1 Rating)	30-Jan-10 10:40 am

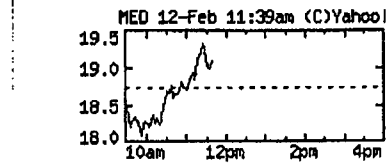
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Lainie Cohen

**From:**  
**Sent:** Tuesday, February 16, 2010 1:13 PM  
**To:** Lainie Cohen  
**Subject:** Emailing: threadview (2)

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**The Secret Is Out- Medifast makes Soy Cancer Claims**

19-Nov-09 03:48 pm

The Secret Is Out- Medifast makes Soy Cancer Claims

zeeyourself



47/Male  
Pasadena,  
C...

The Secret Is Out, The Medifast Program  
By Lisa Davis, Ph.D., PA-C  
And Col. Bradley T. MacDonald, USMCR (retired)

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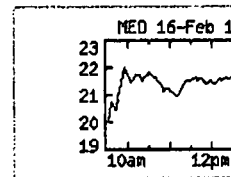
"Soy Protein:

Protects against some of the most harmful diseases we face, including cancer and heart disease."

Medifast has neither absolutely no scientific basis nor any paid by Medifast promotional studies to support this claim regarding cancer.

Medifast has variously referred to Johns Hopkins as "the gold standard" of the medical industry and

**Medifast Inc. (M**



At 12:57PM ET: **21.7**

credited "studies like that as being the cornerstone of our business" by reinforcing "clinically proven" and "scientifically proven" claims in its advertising and public relations.

Medifast engages in deceptive, unpalatable sales and marketing practices that do not comply with SEC and FTC regulations.

Good luck TSFL newbie investors! Viva Dan Bell!

Rating : (3 Ratings) Rate it:

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Subject	Author	Rating	Time of Post
The Secret Is Out-Medifast makes Soy Cancer Claims	zeeyourself	★☆☆☆	19-Nov-09 03:18:00
Re: The Secret Is Out- peeyourself IS.. A LIAR AND A DOUCHE BAG!!!!!! IT REALLY GOT TO ...	gib4u2	(2 Ratings)	19-Nov-09 03:59 pm
LADIES! : The Secret Is Out- Medifast makes Soy Cance... CREDITGUY_97132, PHOTOBUTT GUY AND GIBBYBUTT DO NOT...	k_barhe	(2 Ratings)	19-Nov-09 04:36 pm
Re: LADIES! : The Secret Is Out- Medifast makes Soy... Abstracted from Vanderbilt University (...)	photojourna...	★★★★★	19-Nov-09 07:45 pm
Re: The Secret Is Out- Medifast makes Soy Cancer Clai... And, as relates to Heart Disease (and more), from ...	photojourna...	★★★★★	19-Nov-09 08:11 pm

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[Med Diet Exposed](#) - This Popular Diet Is Not What You Think It Is. You Must Read This ... [DidWeLoseWeight.com/medifast](http://DidWeLoseWeight.com/medifast)

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[Beware of Medifasts Diet](#) - Read My Diet Story Before You Buy! Get All The Facts - Good & Bad Now. [Diet911.com/medifast-diet-reviewed](http://Diet911.com/medifast-diet-reviewed)

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[My Wrinkles Melted Away](#) - Sunnyvale Firm, combines 2 Free products to erase wrinkles forever. [goodbye-aging.com](http://goodbye-aging.com)

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**From:**  
**Sent:** Tuesday, February 16, 2010 1:22 PM  
**To:** Lainie Cohen  
**Subject:** Emalling: Yahoo! Message Boards - Medifast, Inc. (MED) - Latest Skinny on Medifast & FDA to Drop Soy Health Claims -

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**Latest Skinny on Medifast & FDA to Drop Soy Health Claims -**

19-Oct-09 11:17 am

Tell me something I don't know.

zeeyourself

The TSFL Gnome says the U.S. Food and Drug Administration will drop heart disease health claims for soy protein.



47/Male  
Pasadena,  
C...

Better yet-

Medifast Chairman Brad MacDonald will not eat any Soy product(s) because of heart concerns & this same reason

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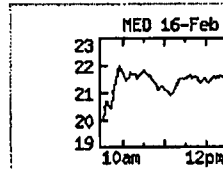
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Medifast on the Wrong Side of Obesity, FTC & the FDA

Stay financially fit and avoid Medifast insider gamed stock.

Good luck TSFL investor newbies! Viva Dan Bell!

**Medifast Inc. (M**



At 1:06PM ET: **21.8**

**Rating :** **Rate it:**  
 ★★★★★ (2 Ratings) ☆☆☆☆☆  
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Minimum rating: **1 star + unrated**  What's this?

Subject	Author	Rating	Time of Post (ET)
Latest Skinny on zeeyourself Medifast & FDA to Drop Soy Health Clai...		(2 Ratings)	19-Oct-09 11:17 am
Re: Latest Skinny on Medifast & FDA to Drop Soy Healt... Get a life LOOSER!!!! All You do is distort tru...	longonmed	(2 Ratings)	19-Oct-09 12:16 pm
Re: Latest Skinny on Medifast & FDA to Drop Soy Healt... Weak!!!!	wvhillvilly	(2 Ratings)	19-Oct-09 12:17 pm

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[DidWeLoseWeight.com/medifast](http://DidWeLoseWeight.com/medifast)

**Beware of Medifasts Diet - Read My Diet Story Before You Buy! Get All The Facts - Good & Bad Now.**  
[Diet-911.com/medifast-diet-reviewed](http://Diet-911.com/medifast-diet-reviewed)

**My Wrinkles Melted Away - Sunnyvale mom combines 2 Free products to erase wrinkles forever.**  
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Lainie Cohen

**From:**  
**Sent:** Tuesday, February 16, 2010 1:21 PM  
**To:** Lainie Cohen  
**Subject:** Emalling: Yahoo! Message Boards - Medifast, Inc. (MED) - Medifast Shorts Patiently Waiting for the Inevitable

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ADVERTI

**Medifast Shorts Patiently Waiting for the Inevitable**

20-Oct-09 11:20 am

NO WORRIES.


1.5 million shares but the TSFL gnome says Medifast insiders have a handle on 800,000 shares.

Medifast management are hypocrites and unethical.

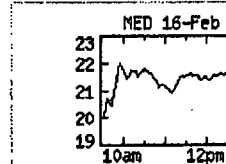
Good luck TSFL newbie investors! Viva Dan Bell!

Medifast Inc \$ 24.84  
MED 0.19

Short Interest (Shares Short) 1,534,400  
Days To Cover (Short Interest Ratio) 1.9  
Short Percent of Float 12.80 %  
Short Interest - Prior 1,609,200  
Short % Increase / Decrease -4.65 %

zeeyourself  
  
47/Male  
Pasadena, C...  
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**Medifast Inc. (M**



At 1:05PM ET: **21.809**

% From 52-Wk High (\$ 24.74 ) 0.40 %  
 % From 52-Wk Low (\$ 3.35 ) 86.51 %  
 % From 200-Day MA (\$ 12.94 ) 47.91 %  
 % From 50-Day MA (\$ 20.74 ) 16.51 %  
 Price % Change (52-Week) 395.00 %

Shares Float 11,990,000  
 Total Shares Outstanding 15,220,960  
 % Owned by Insiders 18.37 %  
 % Owned by Institutions 36.30 %  
 Market Cap. \$ 378,088,646  
 Trading Volume - Today 202,816  
 Trading Volume - Average 812,800  
 Trading Volume - Today vs. Average 24.95 %  
 Earnings Per Share 0.54  
 PE Ratio 45.60  
 Record Date 2009-OctA

Sector Services  
 Industry Specialty Retail Other

Rating : Rate It:  
 ★★★★★ (1 Rating) ☆☆☆☆☆

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**Messages in Topic**

Minimum rating:  1 star + unrated  What's this?

Subject	Author	Rating	Time of Post (ET)
Medifast Shorts Patiently Waiting for the Inevitable	zeeyourself	(1 Rating)	20-Oct-09 11:20 am
Re: Medifast Shorts Patiently Waiting for the Inevita... Blah,blah,blah,blah,blah. ....	creditguy_9...	(1 Rating)	20-Oct-09 11:28 am
Re: Medifast Shorts Patiently Waiting for the Inevita... Didn't you show us the same numbers when Med was \$...	creditguy_9...	(1 Rating)	20-Oct-09 11:29 am
Re: Medifast Shorts Patiently Waiting for the Inevita... what you mean is that another 1.5M shares need to ...	ngula	(1 Rating)	20-Oct-09 11:35 am
Re: Medifast Shorts	longonmed	(1 Rating)	20-Oct-09 01:07 pm

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[Catalyst Value Fund Earns 5 Stars - CTVAX Earns Morningstar Highest Rating 5 Stars, Sunnyvale](#)  
[quicktake.morningstar.com](http://quicktake.morningstar.com)

[Medifast - Official Site - Lose Up To 2-5 lbs per Week. Easy, Fast, Medifast. Order Direct.](#)  
[www.Medifast1.com](http://www.Medifast1.com)

[Med Diet Exposed - This Popular Diet Is Not What You Think It Is. You Must Read This ....](#)  
[DidWeLoseWeight.com/medifast](http://DidWeLoseWeight.com/medifast)

Patiently Waiting for the  
Inevita...  
So You do have a grudge  
against Medifast, TSFL  
and...

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Lainie Cohen

**From:**  
**Sent:** Tuesday, February 16, 2010 1:21 PM  
**To:** Lainie Cohen  
**Subject:** Emailing: Yahoo! Message Boards - Medifast, Inc. (MED) - Prior FTC conviction of Medifast on FALSE ADVERTISING

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**Prior FTC conviction of Medifast on FALSE ADVERTISING**

22-Oct-09 02:55 pm

Footnote to 20,000 Medical doctors recommending Medifast since 1980

zeeyourself



\* 20,000 Medical doctors since 1980 deceived with Medifast FALSE ADVERTISING as convicted by FTC in the 1990s

47/Male Pasadena, C...

**FACT: LESS THAN 200 DOCTORS FILLING ORDERS WORTH LESS THAN \$1k a YEAR**

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Medifast practices FALSE ADVERTISING today

Ignore User

Prior FTC conviction of Medifast on FALSE ADVERTISING

Report Abuse

History Repeats Again

<http://news.google.com/newspapers?nid=13...>

Good luck TSFL investor newbies! Viva Dan Bell!

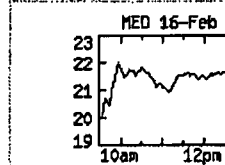
Rating:

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**Medifast Inc. (MED)**



At 1:05PM ET: **21.767**

Enter Symbol(s):  
e.g. YHOO, ^DJI

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Not What You Think  
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Minimum rating: **1 star + unrated** What's this?

Subject	Author	Rating	Time of Post (ET)
---------	--------	--------	-------------------

Prior FTC conviction of Medifast on FALSE ADVERTISING	zeeyourself	★★★★★	22-Oct-09 02:55 pm
---	-------------	-------	--------------------

Re: Prior FTC conviction of Medifast on FALSE ADVERTI...  
 October 17, 1991 article!  
 THAT WAS 18 YEARS AGO Y...

Re: Prior conviction of Medifast on FALSE ADVER... You must be out of work and GOING BROKE from ...	longonmed	★★★★★	22-Oct-09 03:51 pm
--	-----------	-------	--------------------

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DidWeLoseWeight.com/medifast

Beware of Medifasts Diet - Read My Diet Story Before You Buy! Get All The Facts - Good & Bad Now.  
Diet-911.com/medifast-diet-reviewed

My Wrinkles Melted Away - Sunnyvale mom combines 2 Free products to erase wrinkles forever.  
goodbye-aging.com

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Lainie Cohen

From:

Sent: Tuesday, February 16, 2010 1:20 PM

To: Lainie Cohen

Subject: Emailing: Yahoo! Message Boards - Medifast, Inc. (MED) - Medifast Contaminates the Internet w- FALSE ADVERTISING

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ADVERTI

**Medifast Contaminates the Internet w/ FALSE ADVERTISING**

23-Oct-09 02:48 pm

Medifast implements a toxic combination of self minded focus and arrogance which leads Medifast insiders to believe that the end justifies the means.

zeeyourself



47/Male  
Pasadena, C...

Medifast lacks transparency in 10Ks and 10Qs for bad reasons- omission of facts=LIE therefore misleading the investment community (as in 2003-2004) and again with a unsustainable MLM business model integrated with FALSE ADVERTISING.

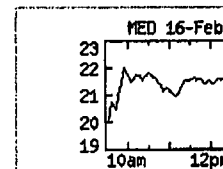
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<http://www.casewatch.org/ftc/news/1991/v...>

Do the math on 20,000 doctors since 1980 / subtract the less than 200 now selling Medifast/ means 18,800 doctors are dead or stopped selling Medifast for a GOOD REASON...

Medifast as a Company CANNOT BE TRUSTED.

**Medifast Inc. (M**



At 1:04PM ET: **21.8**

2/16/2010

Exhibit 29, pg. 13



Good luck TSFL newbiw investors! Viva Dan Bell!

Rating : **Rate it:**  
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Minimum rating: **1 star + unrated** What's this?

Subject	Author	Rating	Time of Post (ET)
Medifast Contaminates the Internet w/ FALSE ADVERTISING	zeeyourself	☆☆☆☆☆	23-Oct-09 02:48 pm
Re: Medifast Contaminates the Internet w/ FALSE ADVER...	creditguy_9...	★★★★★	23-Oct-09 02:54 pm
THX! : Medifast Contaminates the Internet w/ FALSE AD...	zeeyourself	☆☆☆☆☆	23-Oct-09 03:23 pm
Re: Medifast Contaminates the Internet w/ FALSE ADVER...	creditguy_9...	★★★★★	23-Oct-09 03:34 pm

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**Beware of Medifasts Diet** - Read My Diet Story Before You Buy! Get All The Facts - Good & Bad Now. [Diet-911.com/medifast-diet-reviewed](http://Diet-911.com/medifast-diet-reviewed)

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Lainie Cohen

From: [redacted] |] |]  
Sent: Tuesday, February 16, 2010 1:19 PM  
To: Lainie Cohen  
Subject: Emailing: Yahoo! Message Boards - Medifast, Inc. (MED) - Medifast Insider Selling PUMPS UP BIG

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**Medifast Insider Selling PUMPS UP BIG**  
27-Oct-09 11:13 am

Medifast Insider Selling PUMPS UP BIG zeeyourself

October 20, 2009 

The Story of the 3 Little Pigs and Medifast built on straw foundation. 47/Male  
Pasadena,  
C...

On deck with Planned Sales the list of Insiders waiting to come OUT: View  
Messages

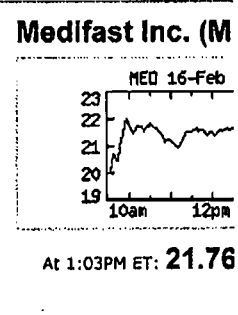
<http://moneycentral.msn.com/investor/inv...> Ignore  
User

Wayne Andersen SELLING Medifast --- \$7 Million Report  
Abuse

Michael McDevitt SELLING Medifast--- Another \$1 Million

Assorted Directors SELLING Medifast --- \$\$\$\$ Priceless

Brad MacDonald --- Hiding from an Insider Short



2/16/2010

**Position**

Good Luck TSFL newbie investors! Viva Dan Bell!

**Rating :** ★★★★★ (2 Ratings) **Rate it:** ☆☆☆☆☆

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Subject	Author	Rating	Time of Post (ET)
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Medifast Insiderzeeyourself Selling PUMPS UP BIG		(2 Ratings)	27-Oct-09 11:13 am
--	--	-------------	--------------------

Re: Medifast Insider Selling PUMPS UP BIG doctorpoooh (2 Ratings) 27-Oct-09 11:31 am

There were a few fluff articles covering this stoc...

Re: Medifast Insider Selling PUMPS UP BIG creditguy\_9... (2 Ratings) 27-Oct-09 11:34 am

To see the character of the shorts like docto...

Re: Medifast Insider Selling PUMPS UP BIG doctorpoooh (2 Ratings) 27-Oct-09 11:40 am

...

Re: Medifast Insider Selling ngula (2 Ratings) 27-Oct-09 01:14 pm

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My Wrinkles Melted Away - Sunnyvale mom combines 2 Free products to erase wrinkles forever. [goodbye-aging.com](http://goodbye-aging.com)

PUMPS  
UP BIG  
ooops, i  
thought  
that is  
his  
face...

Re: Medifast creditguy\_9... (2 Ratings) 27-Oct-09 11:32 am  
Insider  
Selling  
PUMPS UP  
BIG  
ONCE  
AGAIN,  
YOU  
DISTORT  
THE  
TRUTH!  
The truth  
is: ...

Re: doctorpooh (2 Ratings) 27-Oct-09 11:46 am  
Medifast  
Insider  
Selling  
PUMPS UP  
BIG  
...

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Lainie Cohen

**From:** [Redacted]  
**Sent:** Tuesday, February 16, 2010 1:18 PM  
**To:** Lainie Cohen  
**Subject:** Emailing: Yahoo! Message Boards - Medifast, Inc. (MED) - Where Medifast HIDES the DIRT

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ADVERTI

**Where Medifast HIDES the DIRT**

2-Nov-09 03:07 pm

Where Medifast HIDES the DIRT

z8eyourself

1) Start with a compromised auditor who rubber stamps anything for a small fee:



47/Male  
Pasadena,  
C...

<http://seekingalpha.com/article/142379-w...>

The PCAOB inspection of six audits by Bagell, Josephs, Levine & Company L.L.C. identified significant audit deficiencies in three of those audits, or a WHOPPING 50% of the audits sampled.

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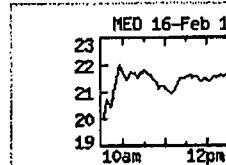
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According to the PCAOB report:

The deficiencies identified in three of the audits reviewed included deficiencies of such significance that it appeared to the inspection team that the Firm did not obtain sufficient competent evidential matter to support its opinion on the issuer's financial statements.

**Medifast Inc. (M)**



At 1:02PM ET: **21.800**

Since the June 19, 2008 PCAOB report, at least five companies have dismissed Bagell, Josephs, Levine as their auditors:

- July 23, 2008: City Loan Inc.,
  - February 2, 2009: Global Resource Corporation,
  - March 10, 2009: Thomas Pharmaceuticals Ltd,
  - March 24, 2009: Champions Biotechnology,
  - May 4, 2009: DK Investors Inc.
- And there is more forthcoming.

Medifast may or may not have been in the sample but Medifast's Audit Committee is NOT serious about the quality of its auditors, because of the very poor quality of Medifast earnings.

Good luck TSFL newbie investors! Viva Dan Bell!

**Rating :** **Rate it:**  
 ★★☆☆☆ (6 Ratings) ☆☆☆☆☆

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Minimum rating:  What's this?

Subject	Author	Rating	Time of Post (ET)
Where Medifast HIDES the DIRT	zeeyourself	★★★☆☆	2-Nov-09 03:07 pm
Re: Where Medifast HIDES the DIRT Kiss your shorts goodbye!!! You are truly a los...	longonmed	★★★★★	2-Nov-09 06:49 pm

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**Medifast Shorts up 2.9% & More Coming**

3-Nov-09 01:48 pm

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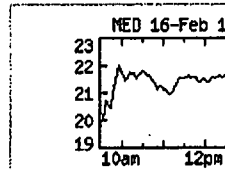
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Medifast Inc \$ 23.05  
MED 0.14

Short Interest (Shares Short) 1,580,200  
Days To Cover (Short Interest Ratio) 2.4  
Short Percent of Float 13.18 %  
Short Interest - Prior 1,534,400  
Short % Increase / 2.98 %

**Medifast Inc. (M**



At 1:02PM ET: **21.848**

% From 52-Wk High (\$ 24.97 ) -8.32 %  
 % From 52-Wk Low (\$ 3.35 ) 85.47 %  
 % From 200-Day MA (\$ 14.15 ) 38.62 %  
 % From 50-Day MA (\$ 21.90 ) 5.00 %  
 Price % Change (52-Week) 324.30 %

Shares Float 11,990,000  
 Total Shares Outstanding 15,220,960  
 % Owned by Insiders 17.64 %  
 % Owned by Institutions 36.70 %  
 Market Cap. \$ 350,867,482  
 Trading Volume - Today 311,679  
 Trading Volume - Average 656,500  
 Trading Volume - Today vs. Average 47.48 %  
 Earnings Per Share 0.54  
 PE Ratio 42.40  
 Record Date 2009-OctB

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Good luck TSFL newbie investors! Viva Dan Bell!

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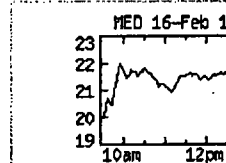
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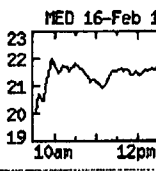
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Re: Medifast Stock Bubble Special \$30 How appropriate, Pimp Daddy Brad advertising on a ...	medisdead	(1 Rating)	5-Nov-09 03:26 pm
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Re: Medifast Stock Bubble Special \$30 You guys simply have TOO MUCH free time on your ha...	csi1055	(1 Rating)	5-Nov-09 03:51 pm
Re: Medifast Stock Bubble Special \$30 It might not be free. They may be getting min...	Hapihammer	(1 Rating)	5-Nov-09 03:54 pm
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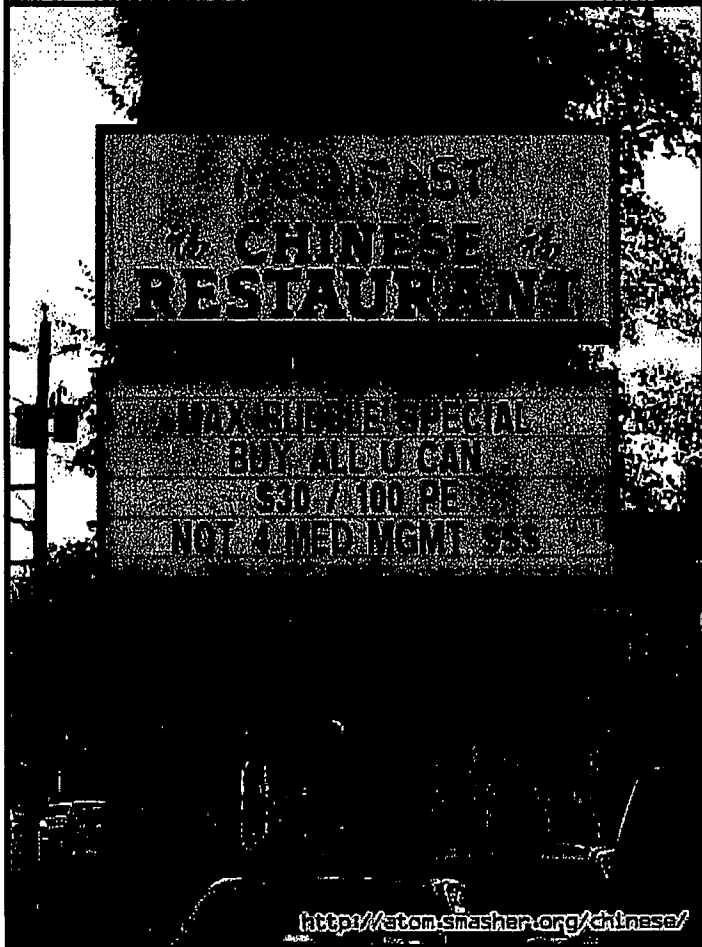
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**\$\$\$\$ Near Future of Medifast** 16-Oct-09 03:50 pm

The Near Future of Medifast w the MLM business model zeeyourself


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Billionaire among 6 arrested in inside trade case

Billionaire hedge fund boss, 5 others charged in \$20 million insider trading case

- By Larry Neumeister, Associated Press Writer
- On 1:10 pm EDT, Friday October 16, 2009

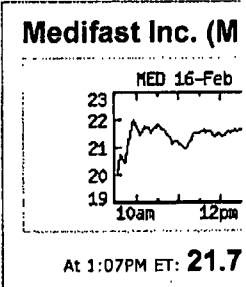
NEW YORK (AP) -- One of the wealthiest men in America was among six financially influential people arrested by federal authorities Friday in a hedge fund insider trading case that prosecutors say reaped \$20 million in illegal profits. Raj Rajaratnam, a partner in Galleon Management and a portfolio manager for Galleon Group, a



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hedge fund with up to \$7 billion in assets under management, was accused of conspiring with others to cause trades based on insider information about several publicly traded companies, including Google Inc. Rajaratnam, 51, was ranked No. 559 by Forbes magazine this year among the world's wealthiest billionaires, with a \$1.3 billion net worth.

<http://finance.yahoo.com/news/Billionair...>

Good luck TSFL newbie investors! Viva Dan Bell!

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14-Oct-09 04:05 pm

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Buy Medifast stock at 50 cents / \$2.87 / \$3.65

Medifast insiders have impeccable timing on buying and selling Medifast stock.

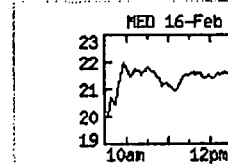
Medifast management and TSFL insiders have ZERO (o) confidence to buy at \$25 but all the confidence to buy at \$2.87 and \$3.65.

A TSFL pep rally pumping stock!

Fraud File blog Sept 14 2009

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**Medifast Inc. (M**



At 1:07PM ET: **21.7**

Tracy Coenen, Forensic Accountant weighs in:

<http://www.sequenceinc.com/fraudfiles/20...>

Good luck Newbie TSFL investors! Viva Dan Bell!

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Minimum rating:  1 star + unrated  What's this?

Subject	Author	Rating	Time of Post (ET)
the Medifast Fraud File EXPANDS w/ MED Stock Bubble	zeeyourself	★★☆☆☆	14-Oct-09 04:05 pm
Re: the Medifast Fraud File EXPANDS w/ MED Stock Bubb... Blah.. Blah...Blah...	longonmed	★★★★★	14-Oct-09 04:15 pm
Re: the Medifast Fraud File EXPANDS w/ MED Stock Bubb... Nice work! Expose this POS!!!	medIsdead (2 Ratings)		15-Oct-09 12:13 pm

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 e.g. YHOO, ^DJI

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[TheGoodStocks.com](http://TheGoodStocks.com)

[Catalyst Value Fund Earns 5 Stars - CTVAX Earns Morningstar Highest Rating 5 Stars, Sunnyvale](#)  
[quicktake.morningstar.com](http://quicktake.morningstar.com)

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[www.Medifast1.com](http://www.Medifast1.com)

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Lainie Cohen

**From:**  
**Sent:** Tuesday, February 16, 2010 1:24 PM  
**To:** Lainie Cohen  
**Subject:** Emailing: Yahoo! Message Boards - Medifast, Inc. (MED) - NO FTC SAFE HARBOR ON Medifast FALSE ADVERTISING

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ADVERTI

**NO FTC SAFE HARBOR ON Medifast FALSE ADVERTISING**

13-Oct-09 11:05 am

Medifast is on the WRONG side of the FTC

zeeyourself

Medifast continues to promote FALSE ADVERTISING.



47/Male  
Pasadena, C...

Medifast False Advertising Misleads the Public Consumer.

Medifast Scientific Advisory Board are Paid Consultants, including one from Hershey's chocolate kisses.

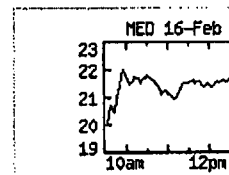
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Medifast consistently states 20,000 doctors (implying today) recommending Medidast is misleading and FALSE ADVERTISING.

John Hopkins Study is a PAID and STALE study by Medifast, ask Lisa Davis.

John Hopkins says NO to Medifast.

**Medifast Inc. (M)**



At 1:08PM ET: **21.8**

Medifast False Advertising by TSFL websites.

Visit the John Hopkins Weight Management Center website and search for Medifast

You will find nothing  
<http://www.jhsph.edu/weight/>

But Medifast websites and advertising imply John Hopkins endorses and is recommending Medifast.

Good Luck TSFL newbie investors! Viva Dan Bell!

Rating :  Rate It:  
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Minimum rating:  What's this?

Subject	Author	Rating	Time of Post (ET)
NO FTC SAFE HARBOR ON Medifast FALSE ADVERTISING	zeeyourself	(2 Ratings)	13-Oct-09 11:05 am

Re: NO FTC SAFE HARBOR ON Medifast FALSE ADVERTISING  
 Hey Zeewie!  
 Once again ZERO proof!!  
 What's new!!...

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[Diet-911.com/medifast-diet-reviewed](http://Diet-911.com/medifast-diet-reviewed)

[Sunnyvale Mom Cures Skin Wrinkles](#) - I wasted more than \$1000 before I found Two FREE Products that work.  
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Lainie Cohen

**From:**  
**Sent:** Tuesday, February 16, 2010 1:25 PM  
**To:** Lainie Cohen  
**Subject:** Emailing: Yahoo! Message Boards - Medifast, Inc. (MED) - Medifast WEBSITES Practice False Advertising Misleading the Public Consumer

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ADVERTI

**Medifast "WEBSITES" Practice False Advertising Misleading the Public Consumer**

7-Oct-09 10:34 am

Medifast "WEBSITES" Practice False Advertising Misleading the Public Consumer

zeeyourself



47/Male  
Pasadena, C...

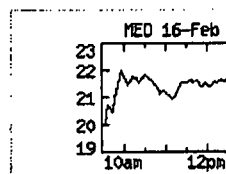
FTC Truth in Advertising  
<http://www.ftc.gov/bcp/edu/pubs/business...>

**I. SUMMARY**

Certain elements undergird all deception cases. First, there must be a representation, [omission] or practice that is likely to [mislead the consumer].<sup>4</sup> Practices that have been found misleading or deceptive in specific cases include false oral or written representations, misleading price claims, sales of hazardous or systematically defective products or services without adequate disclosures, [failure to disclose information

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**Medifast Inc. (M**



At 1:09PM ET: **21.7**

regarding pyramid sales], use of bait and switch techniques, failure to perform promised services, and failure to meet warranty obligations.<sup>5</sup>

Second, we examine the practice from the perspective of a consumer acting reasonably in the circumstances. If the representation or practice affects or is directed primarily to a particular group, the Commission examines reasonableness from the perspective of that group.

Third, the representation, omission, or practice must be a "material" one. The basic question is whether the act or practice is likely to affect the consumer's conduct or decision with regard to a product or service. If so, the practice is material, and consumer injury is likely, because consumers are likely to have chosen differently but for the deception. In many instances, materiality, and hence injury, can be presumed from the nature of the practice. In other instances, evidence of materiality may be necessary.

Thus, the Commission will find deception if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances, to the consumer's detriment. We discuss each of these elements below.

**II. THERE MUST BE A REPRESENTATION, OMISSION, OR PRACTICE THAT IS LIKELY TO MISLEAD THE CONSUMER.**

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Minimum rating:  What's this?

Subject	Author	Rating	Time of Post (ET)
Medifast "WEBSITES" Practice False Advertising Mislead...	zeeyourself	(1 Rating)	7-Oct-09 10:34 am
Re: Medifast "WEBSITES" Practice False Advertising Mi... Hey	creditguy_9...	(2 Ratings)	7-Oct-09 11:03 am

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[My Wrinkles Melted Away - Sunnyvale mom combines 2 Free products to erase wrinkles forever. goodbye-aging.com](#)

[Latest Medifast Deals - Save \\$25, \\$50, even \\$200 off Your Order! The Latest Medifast Coupons. www.TheMedifastPlan.com/Deals](#)

Peeonyourself!  
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Med  
misrepresent?  
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Lainie Cohen

**From:**  
**Sent:** Tuesday, February 16, 2010 1:29 PM  
**To:** Lainie Cohen  
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ADVERTI

**David Hamilton, Wall Street Journal writer says "Beware" of Medifast stock and diet**

25-Sep-09 10:55 am

David Hamilton, Wall Street Journal writer says "Beware" of Medifast stock and diet

zeeyourself



47/Male  
Pasadena,  
C...

Medifast financials lack credibility and transparency.

Medifast has no credibility with FALSE ADVERTISING lying to the general public and public investors implying 20,000 doctors recommend Medifast.

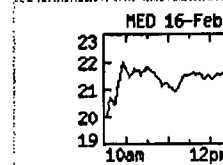
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The truth is there are 200 doctors recommending Medifast TODAY

and

18,800 who did since 1980 and who now do not for reasons Medifast will not disclose.

**Medifast Inc. (M**



At 1:12PM ET: **21.7**



What David Hamilton, a 14 year veteran of Wall Street Journal says

<http://industry.bnet.com/healthcare/1000...>

Good luck TSFL newbie investors! Viva Dan Bell!

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Subject	Author	Rating	Time of Post (ET)
David Hamilton, Wall Street Journal writer says "Beware..."	zeeyourself	(2 Ratings)	25-Sep-09 10:55 am
Re: David Hamilton, Wall Street Journal writer says "... Good Point and well taken. Brad claims 20,000 doc..."	springearnc...	(2 Ratings)	25-Sep-09 11:00 am

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Lainie Cohen

From:
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To: Lainie Cohen
Subject: Emailing: Yahoo! Message Boards - Medfast, Inc. (MED) - Weight Watchers up on Karft acquisition rumor

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ADVERTI

Weight Watchers up on Karft acquisition rumor

22-Sep-09 12:12 pm

Weight Watchers (WTW) is up on a rumor circulating that Kraft (KFT) is a potential acquirer.

zeeyourself
47/Male
Pasadena, C...

WTW trading at 10PE, 2.70% Div and the financials stack up with real auditors.

Medifast up on M&A back wash.

Medifast at 100PE (factor in dilution from secondary PIPE and insiders selling), no dividend, and smelly financials with no-name audit firm.

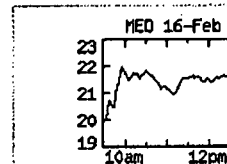
Medifast financials will not pass an M&A due diligence review and smell test.

Sugar high speculation in Medifast stock and the consequences have yet to arrive.

Medifast financials do smell. Read the 10Qs and 10Ks.

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Medifast Inc. (M



At 1:15PM ET: 21.8

Smelly  
<http://www.youtube.com/watch?v=-5JE5KNff...>

Good luck TSFL newbie investors! Viva Dan Bell!

**Rating :**                      **Rate it:**  
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Weight Watchers up on Karft acquisition rumor	zeeyourself	(2 Ratings)	22-Sep-09 12:12 pm
Re: Weight Watchers up on Karft acquisition rumor The LOSER peeyourself is back in town with his BS ...	creditguy_9...	(2 Ratings)	22-Sep-09 12:42 pm

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**I. (a) PLAINTIFFS**  
**MEDIFAST, INC. and BRADLEY MacDONALD**

**DEFENDANTS**  
**BARRY MINKOW; FRAUD DISCOVERY INSTITUTE, INC.; ROBERT L. FITZPATRICK; TRACY COENEN; SEQUENCE, INC.; WILLIAM EBBEL; BUSINESS REPORTING; ZEEYOURSELF**

U.S. DISTRICT COURT  
 SOUTHERN DISTRICT OF CALIFORNIA  
 County of Residence of First Listed Defendant **San Diego**

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Attorneys (If Known)

10 CV 0382

JLS WMC

(b) County of Residence of First Listed Plaintiff **Baltimore**  
 (EXCEPT IN U.S. PLAINTIFF CASES)

(c) Attorney's (Firm Name, Address, and Telephone Number)  
**Michael I. Neil, Esq SBN 40057**  
**Neil, Dymott, Frank, McNeil & Trexler**  
**1010 Second Avenue, Suite 2500**  
**San Diego, CA 92101**  
**(619) 238-1712**

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- 2 U.S. Government Defendant
- 3 Federal Question (U.S. Government Not a Party)
- 4 Diversity (Indicate Citizenship of Parties in Item III)

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| Citizen of Another State                | <input checked="" type="checkbox"/> 2 | <input type="checkbox"/> 2            | Incorporated and Principal Place of Business In Another State | <input checked="" type="checkbox"/> 5 | <input type="checkbox"/> 5            |
| Citizen or Subject of a Foreign Country | <input type="checkbox"/> 3            | <input type="checkbox"/> 3            | Foreign Nation  | <input type="checkbox"/> 6            | <input type="checkbox"/> 6            |

**IV. NATURE OF SUIT** (Place an "X" in One Box Only)

CONTRACT	TORTS	PERSONAL INJURY	REAL PROPERTY	PROCEDURE/DEFENSE	BANKRUPTCY	OTHER STATUTES
<input type="checkbox"/> 110 Insurance <input type="checkbox"/> 120 Marine <input type="checkbox"/> 130 Miller Act <input type="checkbox"/> 140 Negotiable Instrument <input type="checkbox"/> 150 Recovery of Overpayment & Enforcement of Judgment <input type="checkbox"/> 151 Medicare Act <input type="checkbox"/> 152 Recovery of Defaulted Student Loans (Excl. Veterans) <input type="checkbox"/> 153 Recovery of Overpayment of Veteran's Benefits <input type="checkbox"/> 160 Stockholders' Suits <input type="checkbox"/> 190 Other Contract <input type="checkbox"/> 195 Contract Product Liability <input type="checkbox"/> 196 Franchise	<input type="checkbox"/> 310 Airplane <input type="checkbox"/> 315 Airplane Product Liability <input checked="" type="checkbox"/> 320 Assault, Libel & Slander <input type="checkbox"/> 330 Federal Employers' Liability <input type="checkbox"/> 340 Marine <input type="checkbox"/> 345 Marine Product Liability <input type="checkbox"/> 350 Motor Vehicle <input type="checkbox"/> 355 Motor Vehicle Product Liability <input type="checkbox"/> 360 Other Personal Injury	<input type="checkbox"/> 362 Personal Injury - Med. Malpractice <input type="checkbox"/> 365 Personal Injury - Product Liability <input type="checkbox"/> 368 Asbestos Personal Injury Product Liability <b>PERSONAL PROPERTY</b> <input type="checkbox"/> 370 Other Fraud <input type="checkbox"/> 371 Truth in Lending <input type="checkbox"/> 380 Other Personal Property Damage <input type="checkbox"/> 385 Property Damage Product Liability	<input type="checkbox"/> 210 Land Condemnation <input type="checkbox"/> 220 Foreclosure <input type="checkbox"/> 230 Rent Lease & Ejectment <input type="checkbox"/> 240 Torts to Land <input type="checkbox"/> 245 Tort Product Liability <input type="checkbox"/> 290 All Other Real Property	<input type="checkbox"/> 610 Agriculture <input type="checkbox"/> 620 Other Food & Drug <input type="checkbox"/> 625 Drug Related Seizure of Property 21 USC 881 <input type="checkbox"/> 630 Liquor Laws <input type="checkbox"/> 640 R.R. & Truck <input type="checkbox"/> 650 Airline Regs. <input type="checkbox"/> 660 Occupational Safety/Health <input type="checkbox"/> 690 Other <b>LABOR</b> <input type="checkbox"/> 710 Fair Labor Standards Act <input type="checkbox"/> 720 Labor/Mgmt. Relations <input type="checkbox"/> 730 Labor/Mgmt. Reporting & Disclosure Act <input type="checkbox"/> 740 Railway Labor Act <input type="checkbox"/> 790 Other Labor Litigation <input type="checkbox"/> 791 Empl. Ret. Inc. Security Act <b>IMMIGRATION</b> <input type="checkbox"/> 462 Naturalization Application <input type="checkbox"/> 463 Habcas Corpus - Alien Detainee <input type="checkbox"/> 465 Other Immigration Actions	<input type="checkbox"/> 422 Appeal 28 USC 158 <input type="checkbox"/> 423 Withdrawal 28 USC 157 <b>INTELLECTUAL PROPERTY</b> <input type="checkbox"/> 820 Copyrights <input type="checkbox"/> 830 Patent <input type="checkbox"/> 840 Trademark <b>SOCIAL SECURITY</b> <input type="checkbox"/> 861 HIA (1395ff) <input type="checkbox"/> 862 Black Lung (923) <input type="checkbox"/> 863 DIWC/DIWW (405(g)) <input type="checkbox"/> 864 SSID Title XVI <input type="checkbox"/> 865 RSI (405(g)) <b>FEDERAL TAX</b> <input type="checkbox"/> 870 Taxes (U.S. Plaintiff or Defendant) <input type="checkbox"/> 871 IRS - Third Party 26 USC 7609	<input type="checkbox"/> 400 State Reapportionment <input type="checkbox"/> 410 Antitrust <input type="checkbox"/> 430 Banks and Banking <input type="checkbox"/> 450 Commerce <input type="checkbox"/> 460 Deportation <input type="checkbox"/> 470 Racketeer Influenced and Corrupt Organizations <input type="checkbox"/> 480 Consumer Credit <input type="checkbox"/> 490 Cable/Sat TV <input type="checkbox"/> 810 Selective Service <input type="checkbox"/> 850 Securities/Commodities Exchange <input type="checkbox"/> 875 Customer Challenge 12 USC 3410 <input type="checkbox"/> 890 Other Statutory Actions <input type="checkbox"/> 891 Agricultural Acts <input type="checkbox"/> 892 Economic Stabilization Act <input type="checkbox"/> 893 Environmental Matters <input type="checkbox"/> 894 Energy Allocation Act <input type="checkbox"/> 895 Freedom of Information Act <input type="checkbox"/> 900 Appeal of Fee Determination Under Equal Access to Justice <input type="checkbox"/> 950 Constitutionality of State Statutes

**V. ORIGIN** (Place an "X" in One Box Only)

- 1 Original Proceeding
- 2 Removed from State Court
- 3 Remanded from Appellate Court
- 4 Reinstated or Reopened
- 5 Transferred from another district (specify)
- 6 Multidistrict Litigation
- 7 Appeal to District Judge from Magistrate Judgment

**VI. CAUSE OF ACTION**

Cite the U.S. Civil Statute under which you are filing (Do not cite jurisdictional statutes unless diversity):  
**Diversity jurisdiction under 28 U.S.C. § 1332**

Brief description of cause:  
**Defamation and violations of California law**

**VII. REQUESTED IN COMPLAINT:**

CHECK IF THIS IS A CLASS ACTION UNDER F.R.C.P. 23  
**DEMAND \$ 270,000,000.00**  CHECK YES only if demanded in complaint.  
**JURY DEMAND:**  Yes  No

**VIII. RELATED CASE(S) IF ANY**

(See instructions): JUDGE \_\_\_\_\_ DOCKET NUMBER \_\_\_\_\_

DATE  
**February 17, 2010**

SIGNATURE OF ATTORNEY OF RECORD

*Michael I. Neil*

FOR OFFICE USE ONLY  
 RECEIPT # **10313**

AMOUNT **\$350** APPLYING IFP \_\_\_\_\_ JUDGE \_\_\_\_\_ MAG. JUDGE \_\_\_\_\_

CR

MB 02-17-10

Court Name: USDC California Southern  
Division: 3  
Receipt Number: CAS010313  
Cashier ID: mbain  
Transaction Date: 02/17/2010  
Payer Name: NEIL DYMOIT

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CIVIL FILING FEE  
For: MEDIFAST V MINKOW  
Case/Party: D-CAS-3-10-CV-000382-001  
Amount: \$350.00  
-----

CHECK  
Check/Money Order Num: 106989  
Amt Tendered: \$350.00  
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Total Due: \$350.00  
Total Tendered: \$350.00  
Change Amt: \$0.00

There will be a fee of \$45.00  
charged for any returned check.