

MULTI-LEVEL MARKETING UNMASKED -



A Complete and Compelling Case against MLM as an Unfair and Deceptive Practice

By Jon M. Taylor, MBA, Ph.D.
Consumer Awareness Institute

The most thorough guide to understanding MLM (multi-level marketing) ever published – MLM's appeal, its unique features and inherent flaws, its deceptions, its devastating effects, its culpability to federal and state laws, and needed regulatory reforms. The book also explores key legal cases and answers the most frequently asked questions – all based on 20 years' research, worldwide feedback, consultation with top experts, and analysis of over 600 MLMs by a qualified analyst. For federal and state regulators, legislators, attorneys, consumer advocates, financial advisors, researchers, educators, the media, and consumers.

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Earlier versions under similar titles: *The Case against Multi-level Marketing as an Unfair and Deceptive Practice*, copyrighted in 2013 and *The Case (for and) Against Multi-level Marketing* copyrighted in 2011 and 2012

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LEGAL DISCLAIMER

These opinions, calculations, analyses, and reports are intended purely to communicate information in accordance with the right of free speech. They do not constitute legal or tax advice. Anyone seeking such advice should consult a competent professional who has expertise on endless chain or pyramid selling schemes (MLMs). Readers are invited to validate the author's research using the analytical tools provided. Readers are also advised to obey all applicable laws, whether or not enforced in their area. Neither the Consumer Awareness Institute nor the author assumes any responsibility for the consequences of anyone acting according to this information.

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Letter of endorsement from Bruce Craig, who litigated some early pyramid scheme cases:

RE: the book *MULTI-LEVEL MARKETING UNMASKED* (revised title¹), and the separate report titled *REGULATORY CAPTURE: The FTC's Flawed Business Opportunity Rule*

Dear Dr. Taylor:

As an Assistant Attorney General with the State of Wisconsin (1967-1997) I litigated a number of pyramid cases and drafted Wisconsin's prohibition of 'Chain Distributor Schemes'. Since retiring, I have been active in attempting to obtain a meaningful regulatory response to these highly destructive schemes. These efforts include a number of contacts with the Federal Trade Commission, the agency primarily responsible for regulation in this area.

For at least the past eight years I have been in frequent contact with you, and others, on this topic. I think it would be fair to say that the FTC has been less than effective in dealing with this problem, culminating in its exemption of Multi-level Marketing from the recently enacted Business Opportunity Rule.

Your two publications reflect an impressive body of research on this topic, detailed analyses of actual profitability and the mechanics of these plans, considerable and extensive efforts to communicate your concerns to the Commission and other interested parties, and a thoughtful effort to communicate with those contemplating joining these plans.

Further, the publications represent a detailed repository of existing pyramid legislation, earnings, evaluations of a large number of multi-level companies, the many legal cases dealing with this subject, explanations of the mechanics of these plans, and detailed communications by interested parties on the subject of effective regulation by the Federal Trade Commission. The comment on 'Regulatory Capture' is compelling and thoroughly documented.

You are to be complimented on these efforts. They fill the considerable need for a single source of virtually all information on this subject. I would recommend that those interested in these documents download them from your website, as they contain a number of active hyperlinks to the extensive documentary record involved.

Sincerely,

Bruce A. Craig, former Assistant Attorney General for Wisconsin

¹ Originally *The Case (for and) against Multi-level Marketing*, originally published in 2011

Praise from other MLM experts:

Kudos to Dr. Taylor for shining the light of truth into every nook and cranny of network marketing. Prudent readers should conclude that if the so-called "MLM business opportunity" were presented honestly, no one would buy into it.

- Stephen Barrett, M.D., sponsor, Quackwatch.org and MLMwatch.org

A truly remarkable and comprehensive resource for consumers, lawyers, legislators and regulators. I am particularly impressed with the detailed comparison of state anti-pyramid scheme laws, and the collection of many other legal materials. . . you have done a beautiful job in organizing and presenting it in a methodical fashion. I cannot imagine anyone reading this and coming to any conclusion other than that MLM is a monumental fraud. This book is truly a legacy of which you must be very proud. As I have said before, in the MLM world you are "the voice of one crying in the wilderness."

- From letter to Jon Taylor from Douglas M. Brooks, a Boston attorney who has tried many MLM cases

NOTE: Both the methodology and calculations in my research were validated by five financial experts –

See Appendix 7A at the end of Chapter 7 ("MLMs Abysmal Numbers")

PREFACE

This book – and the research behind it – is intended to meet the need for a thorough analysis of the business model called multi-level marketing (MLM – a.k.a. “network marketing”) and its embodiment in the emergence of hundreds of MLM programs (MLMs). Worldwide, tens of thousands of consumers are approached daily with promises of income and independence from joining one of these MLMs. From the research reported here I conclude that tens of millions of consumers lose tens of billions of dollars every year.

At the outset it should be noted that *Multi-level Marketing Unmasked* is not strictly a report of legal arguments against any MLM, although attorneys and law enforcement officials should find it invaluable in building their cases.

I am writing from the perspective of a qualified business analyst, consumer advocate, instructor in entrepreneurship, management, and ethics, and experienced entrepreneur and salesman. Since I am not an attorney, when commenting on legal matters I have been careful to consult with qualified legal counsel and/or experts with extensive law enforcement experience.

While I have made tedious efforts to edit the report for errors, I do not claim that it is perfect or free for any errors in grammar, spelling, and other minor problems. I supplied descriptive tables of contents for easy reference, but with their detail, there may be some mistakes. Hopefully, the reader will see beyond these and acknowledge the value of the important research reported herein.

SUMMARY OF FINDINGS ABOUT MLM (MULTI-LEVEL MARKETING)

By Jon M. Taylor, MBA, Ph.D., Consumer Awareness Institute

My preparation for this book includes (but is not limited to) the following:

- MBA with 2 years study in statistics, economics, accounting, and finance
- PhD in applied (industrial) psychology
- As college and seminar instructor, taught ethics, communications, salesmanship, entrepreneurship, and management
- Initiated 47 home businesses, including several sales oriented businesses
- Conducted over 20 research studies on MLM and home business opportunities
- Received worldwide feedback for 20 years from web site: mlm-thetruth.com
- Reviewed applicable federal and state laws
- Tested the Nu Skin program for one year.
- Analyzed the compensation plans of over 600 MLMs (MLM programs) and average income (loss) figures for 50 MLMs.
- Wrote and published *The Network Marketing Game* (1997), *Regulatory Capture: the FTC's Flawed Business Opportunity Rule* (2013) and *Complaints Filed with the FTC against Multi-level Marketing Programs* (2014), plus this book.
- Testified as expert witness in several legal cases against MLM companies.
- Presented at state and national conferences on MLM and pyramid schemes

With all this background, I come to the conclusions below in answer to key questions about MLM. These will be fully explained in the chapters that follow..

What is the appeal of multi-level marketing?

1. The “easy money” appeal of MLM is often couched in terms such as “time freedom” (to do what you want), perpetual or “residual income” (like author’s royalties), and “unlimited income possibilities,” with the success of recruits limited only by their efforts.
2. MLMs are often sold as a viable alternative to an unfavorable job market

and as a better route to retirement than traditional plans.

3. MLM programs typically sell “pills, potions, and lotions” or other products that are consumable, that have unique appeal, and that can be claimed to deliver benefits not available elsewhere.
4. One sees a strong sense of belonging, or an “us versus them” cultish mentality.

As a business model, is MLM legal and ethical?²

1. MLMs depend on unlimited recruitment of a network of *endless chains of participants*.
2. As endless entrepreneurial chains, or “opportunity” recruitment schemes, MLMs assume an infinite market, which does not exist in the real world. They also assume virgin markets, which don’t exist for long. They would be doomed to eventual market saturation and collapse, except that some avoid this by expanding (“re-pyramiding”) to other markets and/or through the same markets with new product offerings.
3. Participants advance to ranks or positions in a pyramid (“downline”) of participants based on timing and recruitment, rather than on merit or appointment.
4. MLMs typically finance their operations from purchases by participants who are incentivized to buy overpriced products to qualify for commissions and for “rank advancement” (to advance to higher levels in the pyramid of participants). With the exception of some party plans, the majority of sales are typically to participants.
5. Typically, MLM products are unique (making it difficult to compare with competing products), consumable (to encourage repeat purchases), and priced higher than products sold elsewhere (to pay commissions on many levels of participants).

² For a thorough analysis of what separates MLM from other business models, read Chapter 2.

6. MLM compensation plans are cleverly rigged to reward the bulk of commissions to TOPPs (top-of-the-pyramid promoters), which is typical of all pyramid schemes. This is due to a commission structure that is upside-down from a legitimate direct selling program, in which the bulk of the commissions are paid to the person making the sale. It is this extreme concentration of commissions paid to TOPPs that motivates them to tirelessly promote recruitment to expand downlines, thereby assuring not only their outsized income, but the MLM's survival and growth. Also, continual recruitment is needed to replace large numbers of dropouts, most of whom will have lost money.
7. Another explanation for MLMs unfairness is that *relative vertical equality in commission structure* – which appears benign – results in extreme inequality in distribution of income to participants. (See Exhibits 7g and 7h in Chapter 7.) This extreme inequality is further proof that MLM is an unfair and deceptive practice, which the FTC and Attorneys General of the 50 states should be actively combatting.
8. Most MLMs become even more top-weighted with five or more layers in their compensation plans – more than are justified to manage the sales function.
9. *MLMs are inherently flawed, unfair, and deceptive – profitable primarily for those positioned at or near the top of the hierarchy of participants, which I call "TOPPs" (top-of-the-pyramid promoters) – who are often the first ones in the endless chains of recruitment.* New recruits are being sold a ticket on a flight that has already left the ground.
10. Worldwide feedback suggests that *MLMs can be extremely viral and predatory.* As endless chains, MLMs quickly spread from state to state and often to vulnerable foreign markets. As a result, they are far more prevalent than legitimate business opportunities.
11. *I have challenged state and federal law enforcement officials to identify any packaged "business opportunity" that is systemically more unfair and deceptive,*

and more viral and predatory than MLM. No one has met the challenge.

12. Some ask: Is possible to design an MLM that is honest and fair to all participants. To accomplish this would require major adjustments, such as the following:
 - a) Commissions would be paid only on sales to non-participants – and no overrides or commissions paid for purchases of downline participants.³
 - b) For each sale, over 50% of total commissions paid by the company would be paid to the front-line person who sells the products, with amount of commissions decreasing at each higher level rank.
 - c) There would be no minimum ongoing purchase quota to qualify for commissions or rank advancement.
 - d) The number of levels on which commissions can be paid would be limited to four (the maximum needed to manage any standard sales function, including branch, division, regional, and national managers).
 - e) Unfair features of breakage and highly leveraged breakaway programs would be banned.

Unfortunately, to my knowledge, *none of the MLM founders have taken such steps to achieve honesty and fairness.* (See "What would a good MLM look like" in Chapter 2)

13. The villain in MLM abuse is not so much the leaders as a flawed system of unlimited recruitment of participants as primary customers. *MLMs enable the transfer of money from a rapidly churning supply of new recruits* to TOPPs, founders, and the company itself.
14. MLM promises what it cannot deliver. To be successful, *MLM promoters depend on a litany of deceptions, including much self-deception. Misrepresentations regarding products, income potential, and legitimacy are commonplace in MLM.*⁴

Based on the foregoing and on the research discussed below, if asked if MLM

³ See Omnitrition case in Chapter 10..

⁴ See Chapter 8

is a moral or ethical business model, I would have to answer with an unqualified “no!”⁵

MLM is clearly an unfair and deceptive practice and *should be illegal under Section 5 of the FTC Act*, as well as state statutes that mandate against unfair and deceptive acts or practices (UDAP). Some states also have laws against endless chains,⁶ and MLMs clearly violate these. However, *the Direct Selling Association (DSA) and the MLM industry, has lobbied successfully for weakening of laws and rules and the needed enforcement that could offer needed protection for consumers.*

What are the effects of MLM on participants and on society?

1. Based on available company data, approximately 99.7% of all MLM participants lose money – spending more on company purchases and promotion and operating expenses than they receive in commissions from the company. Attrition rates are high. And if one removes TOPPs from the calculations of average income, the loss rate is closer to 99.9%, which means that the *chance of new recruits profiting is virtually zero.*
2. *As is true with any scam, those who invest the most, lose the most, having accepted deceptive claims that the MLM is a legitimate income opportunity, and having continued to invest in the vain hope of eventually profiting handsomely.*
3. Sales reported by MLM companies represent losses to participants. So based on DSA statistics, aggregate losses⁷ suffered by tens of millions of victims exceeds ten billion dollars a year in the U.S., with losses suffered increasingly by vulnerable populations overseas. This means that *total aggregate losses from hundreds of millions of victims worldwide since the 1979 FTC v. Amway decision (allowing Amway to continue its endless chain recruitment scheme) would amount to hundreds of billions of dollars.*
4. Damages from participation in MLM are widespread among participants. In many

⁵ See Chapter 12

⁶ See Appendixes 10B and 10G in Chapter 10

⁷ These losses are counted as “sales” by the DSA and MLM industry.

cases, monetary losses from MLM participation lead to heavy indebtedness, bankruptcy, foreclosed mortgages, and failed education and career pursuits.

5. Some MLM participants lose more than money. *Divorces and rifts among extended families are commonplace. Even suicides and murders related to participation in MLM, have been reported.*
6. Addiction to MLM can result from excessive commitment to MLM – which can become a cutish lifestyle. “MLM junkies” – who have internalized its “easy money” appeal – may find it difficult to work again in a normal work setting. They may hop from one MLM to another in hopes of finding one that works for them..
7. *MLM is an unfair and deceptive practice (UDAP) that siphons money away from legitimate businesses.* And with the FTC’s granting of an exemption to MLMs from having to comply with its Business Opportunity Rule, the market for legitimate non-MLM direct selling and business opportunities could be virtually eliminated, as packaged business opportunities and formerly legitimate direct sales opportunities are converted to an MLM model to escape regulation.

Are MLMs legal? If not, what explains the inaction by law enforcement?

1. The case can easily be made that virtually all MLMs are violating some federal and state laws, although law enforcement seldom acts against them – partly because victims of endless chains rarely file complaints. For the same reason (as well as financial support from MLMs and the DSA – see #3 below), the Better Business Bureau seldom issues a negative report on major MLMs. The media have been largely silent about MLM abuses.
2. The DSA, together with major MLMs, function as a cartel to choreograph deceptive arguments defending the industry – and to weaken laws and regulatory efforts against product-based pyramid schemes. Through promised votes and carefully placed political contributions to Attorneys General and other key politicians, *they have been*

successful in getting laws passed in Utah and other states that exempt MLMs from prosecution as pyramid schemes. They have donated to the political campaigns of presidential candidates and to those with oversight responsibility for the Federal Trade Commission to assure that no significant action is taken on the federal level by the FTC or any other agency. They have also recently influenced the establishment of a “direct selling” caucus in Congress to protect their interests.

3. Even the Better Business Bureau is corrupted by support from the DSA/MLM cartel, members of which are “corporate sponsors” of the BBB. Amway, for example, gets an A+ rating from the BBB – which says more about the BBB than it says about Amway.
4. Regulators, the media, and MLM victims, have become conditioned to focus on the question of whether or not an MLM is a pyramid scheme. Since the DSA/MLM lobby has obfuscated this issue with the indeterminate question of what percentage of products are consumed, nothing gets done. *The issue of whether or not MLM as a business model and industry is structurally flawed and fundamentally an unfair and deceptive practice is more easily determined, as this book proves.*
5. Most MLM participants spend no more than a few hundred dollars in products and services and then drop out. They are the lucky ones. Despite having spent more than they received, few blame the company for their losses – even losses of many thousands of dollars. They have been taught that they – not the company – are responsible for any failures. They are kept in ignorance about unfair and deceptive practices in their MLM program.
6. *The silence of victims of MLMs is also explained by the fact that in every endless chain, major victims are also perpetrators, having recruited as many people as possible to recover costs of participation. So they fear self-incrimination if they file a formal complaint, and they fear consequences from or to those they recruited – which often include close friends or family members.*

MLM is not legitimate direct selling!

Recruitment-driven MLMs (which is virtually all MLMs) can be distinguished from legitimate direct selling by the following characteristics in their compensation plans:

1. *They assume unlimited recruitment of endless chains of participants as primary customers, completely ignoring laws of supply and demand.*
2. *Except for TOPPs, participants advance by recruitment, rather than by appointment like other businesses.*
3. *In order to qualify for commissions or advancement, participant must make minimum incentivized or “pay to play” purchases of products or services.*
4. *Most of the commissions paid by the company are paid to those at or near the top of a pyramid of participants – often the first to join. Founders may also skim a percentage of all revenues.*
5. *For most MLMs, company payout is to five of more levels of participants, with commissions to those at the bottom levels seldom enough to cover the cost of “pay to play” purchases and other expenses.*

Actions needed

1. *Consumers, law enforcement, and the media must get informed; and regulatory officials must be willing to expose and challenge the inherent flaws and unfair and deceptive practices in the MLM industry.*
2. Crucial information must be disclosed to prospects to make informed decisions about MLM participation, such as average commissions from – and payments to – the company for all participants.
3. *MLM promoters must not be allowed to make (or imply) promises of substantial or residual income potential.*
4. *A 7-day waiting period should be required before any investment is made by prospects.*
5. *Victims must be more active in complaining to authorities.*
6. *Class action lawsuits and filings in Small Claims Courts should be pursued to recover damages.*

Conclusion – definition & effects of MLM

Persons honestly seeking a good understanding of multi-level marketing (MLM) find that MLM does not yield itself to a short and simple definition. I conclude with what I believe to be the only accurate, research-based definition of the business model labeled “multi-level marketing.” This definition applies to all of over 600 MLMs I have analyzed:

Multi-level marketing (MLM) is a purported income opportunity, in which persons in company-sponsored pyramids of participants qualify for commissions and for rank advancement primarily by meeting “pay-to-play” purchase quotas and by recruiting others in endless chains of recruitment, and in which rewards are stacked in favor of participants at the top of the pyramid.

Taken together, the following distinguishing characteristics separate MLM from all other forms of business activity:

(1) Endless chains of participants are recruited without limit into the bottom level of company-sponsored pyramids of participants.

(2) Rank advancement up the levels in the pyramid is achieved by recruitment and/or purchases, not by appointment. It should also be noted that compared to the incentives for recruiting a large and active downline, rewards for selling to non-participants is insignificant.

(3) Minimum “pay-to-play” purchases, or quotas, are required to qualify for commissions and/or to attain or maintain ranks or levels in the pyramid.

(4) The bulk of rewards are paid to those at the top levels of the pyramid, whose positions are usually established early in the formation of the pyramid. Also, most MLMs have five or more levels in their compensation plan, with additional levels exponentially increasing rewards to those at the top of the pyramid at the expense of those at the bottom levels.

NOTE: *This set of four distinct characteristics is not found in any other type of business – except pyramid schemes. In fact, the fundamental structure of MLMs is virtually identical to that of classic, cash-based (no-product) pyramid schemes, except that in lieu of cash exchanged directly between participants, products are purchased and commissions processed through*

an MLM company sponsor. Such commissions are drawn chiefly from purchases of their “downline” (those recruited beneath them). It is appropriate to refer to MLMs as “product-based pyramid schemes.”

This definition of MLM requires explanation of its *assumptions* and *effects*, which have been identified from 20 years of research and worldwide feedback. Both the definition and the effects described below provide a true and complete picture of multi-level marketing as a business model and as an industry, which again has been confirmed in analyses of over 600 MLMs:

As a business model incentivizing unlimited recruitment, MLMs (MLM programs) assume an infinite market, which does not exist in the real world. MLMs also assume virgin markets, which cannot exist for long. Since MLM compensation plans are heavily weighted towards recruitment, rather than retail sales, stable retail markets never materialize. Consequently, MLMs must “re-pyramid” (expand) into new markets to compensate for saturation of existing markets. And with its high attrition rate, constant recruitment is necessary to replace dropouts. This re-pyramiding and constant churning of recruits is necessary to prevent total market saturation and collapse, as is true of any pyramid scheme.

In addition, some MLM recruiters sell books, lead generation systems, and other “sales tools” to assure success, but which wind up increasing costs and eventual losses.

MLMs depend on a myriad of misrepresentations⁸ to survive and grow and to defend against regulatory action. Exaggerated product and income claims are common in recruitment and in company communications.

Prospects are typically lured into MLM with exaggerated product and income claims. Since approximately 99% of participants lose money, most eventually drop out, to be replaced by a continual stream of new recruits, who are likewise destined for loss and disappointment.

MLMs are therefore inherently flawed and have been proven to be the most unfair and deceptive of all purported business

⁸ See Chapter 8, which lists and debunks 111 deceptions used in MLM recruitment campaigns.

opportunities. Technically, as extremely unfair and deceptive acts or practices (UDAP), MLMs in the USA violate Section 5 of the FTC Act, as well as UDAP statutes in many states.

As recruitment-driven systems, MLMs can also be extremely viral and predatory. MLMs, or product-based pyramid schemes, do far more damage than classic, cash-based (no-product) pyramid schemes by any measure – loss rates, aggregate losses, and number of victims. Tens of millions of MLM victims suffer tens of billions of dollars in losses every year. MLM may be the most successful consumer fraud in history.

While financial losses can be significant, adverse effects can also sometimes be seen in bizarre or cultish behavior, divorces, loss of “social capital” or ruined relationships with family and friends, and even addiction to MLM’s empty promises. Some sacrifice careers or education to pursue MLM’s vaporous promises of easy wealth (“time freedom” or “residual income”) and a mystique of personal and spiritual fulfillment.

Closing comments

The above definition is strengthened by information from the chapters that follow. MLM is dependent on aggressive recruitment of new recruits as primary customers. Products are overpriced to accommodate large downlines. Loss rate and attrition rates are extremely high, and a myriad of misrepresentations are necessary to lure new prospects. And because MLM victims seldom file complaints with law enforcement, there is little incentive for law enforcement to act against them or for legislators to enact better laws to protect against MLM fraud.

MLM is a class of systemic fraud, meaning that it is not so much the intentional fraud of individual perpetrators that causes the damage, but it is the underlying system that is flawed and fraudulent. Though MLM is a fundamentally flawed business model manifested in bogus “business opportunities,” MLMs are protected by the FTC with an exemption from having to comply with its Business Opportunity Rule – which was originally intended to protect the public from such practices.⁹ As an unintended consequence, other packaged “business opportunities” will be incentivized to adopt the same flawed MLM model to avoid having to comply with the Rule – hurting rather than helping those they target.



Cartoon by Cal Grondahl. From the book THE NETWORK MARKETING GAME. © 1997 by Jon M. Taylor.

⁹ See the author’s report titled *REGULATORY CAPTURE: The FTC’s Flawed Business Opportunity Rule*, which can be downloaded from his web site at mlm-thetruth.com

INTRODUCTION: MLM's appeal – and questions to be answered

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MLM's powerful appeal

People join an MLM for a variety of reasons. Most are recruited by a family member or friend – or from contacts at work. Some learn about a program over the Internet.

The products may seem to answer some unmet need, such as protection from illness or aging. They may be very unique and offer benefits that promoters claim are not available elsewhere.

The opportunity to be self-employed from home appeals to many who are tired of depending on fickle employers who can lay them off at any time. They see their work as dead-end jobs with no real long term potential. Others are unemployed and find in MLM the chance for at least some income. Even some professionals tire of trading time for money and like the option of owning a business that promises passive income.

MLM offers an inexpensive alternative to more expensive options for owning a business. It can cost a small fortune to buy a franchise or an established business from someone else, and starting a business from scratch may take months to get off the ground. MLM is easy to get into and appears to be a good way to be your own boss.

Some get into MLM because of a promoter's promise of virtually unlimited income, or at least income proportional to the time and effort put forth. But some get into MLM in hopes of supplementing their income, paying off debts, or financing college

for their children. Others are led to believe they can earn a little extra cash for Christmas or for family vacations by working seasonally.

And of course you can't beat the feeling of camaraderie that MLM offers. You are told that you can be in business for yourself, but not be by yourself, and that in helping yourself, you will be helping others – often hundreds in the organization you recruit and build, who look to you for support, as they each build their own business under you.

Robert Kiyosaki, author of *Rich Dad, Poor Dad* stated: "MLM levels the playing field and allows the average person to become financially free. This means not having to punch a time clock, the time freedom to pursue other interests without having to worry about money, and the means to be in control of your future."¹⁰ Who would not want all that?

The Amway precedent

In 1979, James Timony, a rookie FTC Administrative Judge wrote the controversial decision that Amway was "not a pyramid scheme."¹¹ This ruling assumed Amway's compliance with certain "retail rules" to assure that products were sold to the public and not just stockpiled. These rules were never significantly enforced.



MLM promoters cite the Amway precedent as justification for their programs, in spite of mounting evidence of misrepresentations in MLM recruitment campaigns and high loss rates among participants. Thousands of MLMs have come and gone since 1979, and many hundreds remain – spreading virally from state to state and to vulnerable markets overseas. Anyone reading the evidence with an open mind will understand why I and other consumer advocates lament the Amway

Amway

¹⁰ Cited in "The Truth about Multi-level Marketing," by Angela Lee – betternetworker.com, June 26, 2011

¹¹ 93 F.T.C. 618, 716-17 (1979).

ruling – and failure to take remedial action since – as repudiation by FTC officials of the agency’s mission to protect consumers from “unfair and deceptive acts or practices in or affecting commerce.”¹²

This is an important topic because since 1979, hundreds of millions of MLM participants have in the aggregate been affected in amounts totaling hundreds of billions of dollars worldwide. And whether these participants were benefitted or victimized is a topic of hot debate between those who see MLM as a legitimate type of direct selling or home business opportunity – and those who see it as an inherently flawed unfair, and deceptive business model – causing nearly all participants to suffer losses, only to enrich founders and those at or near the top of their respective pyramids of participants – who are generally the first ones to join the endless chains of recruitment.

A much needed investigation

This independent detailed investigation is long overdue. A survey of legal and business journals, Internet web sites, and a library of MLM promotional and training materials yields a mountain of opinions on both sides of a very contentious and ONGOING debate about the legitimacy of MLM. But nothing approaching this level of research and analysis on the underlying business model has ever been undertaken by a qualified independent research entity not underwritten by the MLM industry. I have brought together not only a brief sampling of opinions on both sides, but an assimilation of analytical thinking and independent research that effectively answers a host of questions.

To illustrate the many facets of this topic, the list below is just a sample of the many questions that have arisen in my 20 years of research on this topic – and that will be addressed in this publication. In addressing these issues, I make no claim to cover every possible aspect of MLM, but surely those who take the time to read this material will have a much more thorough understanding of what they need to know to

make decisions regarding participation in and/or regulation of this industry.

The many questions to be answered in this book

- Is MLM a viable business model? Or is it seriously and fundamentally flawed?
- Is MLM a pyramid scheme in disguise?
- How can MLM be clearly differentiated from other business models?
- What is the impact of MLM on individuals, families, and on society at large?
- How much money is gained or lost individually and in the aggregate?
- Are rewards proportional to effort; or do those who invest the most, lose the most?
- Should those who fail, blame themselves for not “working the system” – or blame the MLM as a scam?
- Can MLMs with their endless chain of recruitment continue indefinitely, or are they destined for saturation and ultimate collapse?
- Are MLMs profitable as business opportunities? And is a lifetime of “residual income” possible for all who work hard at MLM?
- Can a person profit from working in MLM just part-time or seasonally?
- Is MLM an honest business, or is it a system dependent on misrepresentations and unfair business practices?
- Are some MLMs legitimate, and others scams; and how can one tell the difference?
- Is a “good MLM” an oxymoron?
- Can everyone profit from MLM? Or is it just the founders and those at the top levels that reap most of the company payout?
- Do most recruits merely join to get the products at a discount – as promoters claim?
- Are products sold by MLMs what promoters claim they are? Or are they overhyped and misrepresented?
- Does MLM cut out the middleman? Or are MLM products overpriced to pay off the many levels of distributors?
- Are prices of MLM products competitive enough to be sold at listed retail prices? Or do MLMs depend on purchases by participants for most of their sales revenues?



¹² 15 U.S.C. § 45(a)(1)

- Do MLMs foster good relationships? Or does a person risk squandering one's social capital by participating in MLM?
- Does MLM invite openness, or does it lead to more closed and cultish behavior?
- Do endorsements by famous people and support of charities make MLM legitimate?
- Do “success tools” really benefit users, or do they primarily enrich upline sponsors?
- Does the DSA (Direct Selling Association), the MLM lobby, serve only the interests of its members, or does it also – with its “Code of Ethics” – seek to protect consumers from harmful programs?
- Do its chance elements qualify MLM as a form of gambling, or as a lottery?
- Are MLMs legal everywhere? Or are they technically legal in some jurisdictions, and not legal in others?
- If MLM is technically illegal in some states, why are they still operating?
- Where are consumer protection agencies, such as the FTC, in all this? Do officials have the skills, the resources, and the will to challenge fraudulent MLMs?
- Is MLM ethical? Is unethical behavior of participants rewarded more than ethical behavior?
- What actions can a victim take to recover losses from MLM?
- Can a person be addicted to MLM? If so, what can friends and family members do to deprogram an “MLM junkie”?
- What actions are needed to protect the public from “unfair and deceptive acts or practices?”

While a resolution of these issues may seem a daunting task, I am confident that these questions are answered here as well as they can be answered from available research, and that all who read with an open mind will be better able to answer these questions for themselves. Hopefully, readers will also be willing to share this information with others to protect them from loss and disappointment.

As a business model, is MLM an unfair and deceptive practice?

Many look at MLM as a legitimate business model and attempt to single out individual programs as “bad actors.” However, in chapters 2 through 8, the reader will find compelling evidence for the extreme unfairness and deceptive nature of MLM as business model and as practiced throughout the industry. Technically, this should make MLMs subject to prosecution under Section 5 of the FTC Act, as well as statutes in some states against unfair and deceptive practices – or endless chain recruitment schemes.

Loss rates are extraordinary – averaging 99.7% (or about 99.9% for new recruits) for the MLMs for which I have been able to obtain relevant data. This in itself would not be so bad, except that it is promoted as an “income opportunity” – or even as a “business opportunity” – a misrepresentation in itself. As will be explained in Chapter 7, the odds are far better at the gaming tables in Las Vegas.

After reading these chapters, the reader may wonder if it is appropriate to refer to an MLM such as Nu Skin, with its inherent flaws, as a “business” at all. Some who are familiar with MLM’s abysmal statistics feel it is more appropriate to refer to any MLM as a scam.

The book unmask the mystique of multi-level marketing.

MLM lobbyists and defenders have managed to confuse and obfuscate the realities of the business model called multi-level marketing. Reduced to its essence, MLM as a business model is based on unlimited recruitment of endless chains of participants, as are “pay to play” chain letters and classic no-product (cash-based) pyramid schemes – both of which are illegal. In fact, every one of the compensation plans of the 600 MLMs I have analyzed assume an infinite market – which does not exist in the real world. They also assume virgin markets, which don’t exist for long, necessitating that the MLM promoters enter – or “re-pyramid”¹³ into – new markets with the same deceptive

¹³ The term “re-pyramid” will be explained in Chapter 3.

promises of “residual” or even “unlimited” income.

MLM is almost always unprofitable for participants, except for TOPPs (top-of-the-pyramid promoters) at or near the top of the pyramid – who are usually the first ones to join and who may profit from the purchases of what is often a huge “downline” of recruits churning beneath them. Typically, MLMs have little sustainable customer base and are primarily dependent for revenues from purchases of a network of participants – 99% of whom lose money.

Thus, MLM as a system is fundamentally flawed, unfair, and deceptive. In addition, worldwide feedback suggests that MLM is extremely viral and predatory. The evidence from independent research as reported in this book will clearly support these conclusions. This is why the case for MLM is not given much attention in this work, though some typical arguments put forth by MLM promoters and defenders are briefly discussed, where appropriate.

The FTC considers classic, no-product (cash-based) pyramid schemes unfair and deceptive and therefore illegal¹⁴. Bruce Craig, former assistant to the Attorney General of Wisconsin (who worked on several early MLM/pyramid scheme cases) wrote: **“The premise of ‘multi-level vs. pyramid’ marketing may well represent a distinction without a difference.”**¹⁵ (See Appendix 2F) The addition of products may merely serve to disguise or launder the investment in a pyramid scheme.

This is not merely author bias. Looked at objectively, any independent analyst with basic understanding of markets and statistics who had objectively reviewed this research would agree with this conclusion. And to

¹⁴ In a letter to me dated May 22, 2001, FTC attorney Robert Frisby wrote: *Section 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. 45(a)(1), states that “Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.” While the Federal Trade Commission Act does not specifically address pyramid schemes, such schemes have been deemed unlawful under the Federal Trade Commission Act. In re Koscot Interplanetary, Inc., 86 F.T.C. 1106 (1975).*

¹⁵ Letter dated February 25, 2000, from Bruce Craig to Robert Pitofsky, Chairman of the FTC (Appendix 2F) – and the official who drafted the Commission’s 1979 Amway opinion

those who claim I am biased in my research and writings, I would respond that I have gone where my research has taken me. At one time I was actually quite enthusiastic about MLM. But as my research, experience, and understanding of the unfairness and deceptions in the fundamental MLM business model grew, I became increasingly critical of the MLM industry. I am now convinced that no modern business is more unfair and deceptive than multi-level marketing. Chapters 2 through 7 demonstrate the unfairness of MLM as a business model and as an industry. In Chapter 8 (“A Litany of Misrepresentations”) is a list of at least 111 typical misrepresentations used in MLM recruitment – which are refuted one by one.

The author’s “\$10,000 ‘unfair and deceptive practices’ challenge”

After 20 years of research, I challenged anyone in law enforcement, academia, or the media to identify any purported business opportunity that is more unfair and deceptive – and more viral and predatory than MLM. FTC and state AG officials were mailed copies of my research and told that if by September 1, 2015, any of them could meet the challenge (as specified in Appendix 10A), I would take \$10,000 out of his retirement and give it to his/her favorite charity. None of them even attempted to meet the challenge.

Qualifications of author/analyst

One of the common criticisms by pro-industry spokesmen is that I don’t understand the MLM business or that I lack the qualifications to make rather harsh judgments of the industry.

It might be helpful to list my qualifications – which could be ideal for an expert witness in MLM cases:

- Solid business education – a two-year MLM degree with extensive training in micro economics, statistics, accounting, and finance.
- Consultant and expert witness in numerous legal cases related to

MLM and consultant/advisor to hundreds of persons seeking advice.

- Ph.D., with training in performing a research, and subsequent experience at two universities evaluating the research of others
- Experience teaching and writing on entrepreneurship, business ethics, and money management.
- At least 25 years' experience and research in the field of home business opportunities, and the need or desire to work from home
- Experience as a distributor in an MLM program, having succeeded at recruiting a downline for at least a year. (Except for top distributors, "success" did not yield profits.)
- 20 years' experience as a consumer advocate in the field of MLM fraud.
- Analysis of the compensation plans of over 600 MLMs, after having developed a model that defines MLM (product-based pyramid schemes), and reveals MLMs to be recruitment-driven, top-weighted, and financed primarily by internal consumption.
- Author of two books and numerous research reports on MLM topics

To put anyone's mind at ease on this subject, I am telling my story in Chapter 1. Anyone seeking an expert for consultation or who wants more information about me is welcome to write for my full vita, or they can download it from the Consumer Awareness Institute page at – www.mlm-thetruth.com

Source material for the book

The information for this book is compiled from extensive research and writing I and other independent analysts have done, while incorporating over 20 years of worldwide feedback. Most of the information about specific MLMs is downloaded from their company web sites. Additional input from regulators, attorneys, scholars, and other independent consumer advocates has been utilized. Where appropriate, communications from MLM defenders has been incorporated, even

though their arguments may seem convoluted, deceptive, and/or misleading.

In making decisions on which research and comments to include in the book, I assume full responsibility. However, I am confident – based on extensive training, research and experience (see Chapter 1) – that this book will be the most thorough and reliable overall source of information available on the viability, profitability, legality, and ethics of MLM as a business model; on the consequent unfair and deceptive practices in the industry as they affect consumers; and on ways to protect consumers from major losses.

The issue of consumer harm – which this book addresses in depth – has relevance both for consumer protection and for legal or regulatory actions. It is my hope that this book will serve as an invaluable tool for consumer advocates, law enforcement officials, educators, media reporters, and MLM recruits and prospects faced with decisions about participation. It should also be helpful as a primary reference guide for plaintiff attorneys representing MLM victims.

NOTE: This information has been updated several times. If any of the latest statistics or references have changed slightly since this printing, I am fully confident that the analyses and conclusions will still remain valid.

Recommended reading and annotated web sites

For serious students of the subject, I would strongly suggest reading the rather lengthy article titled "*All you need to know about MLM.*" In it you will find thorough reporting on legal issues related to MLM. Though very factual in her approach, the author has been sued for expressing her opinions and prefers to remain anonymous. For the article and interesting details, go to – <http://www.financialindustryscam.com/mlm.htm>

For general legal background, the serious student will benefit from an older, but extremely relevant, article published in the William and Mary Law Review entitled: "Regulation of Pyramid Sales Ventures," go to – <http://scholarship.law.wm.edu/wmlr/vol15/iss1/6/>

Several treatises written by Robert FitzPatrick of Pyramid Scheme Alert are very helpful in gaining a better understanding of the subject. They can be downloaded from his two web sites – www.pyramidschemealert.org and www.falseprofits.com – which also has some insightful blogs worth reading.

I also highly recommend the following: “What’s Wrong with Multi-level Marketing,” by Dean VanDruff, which presents powerful arguments to help grasp the fundamental flaws in MLM. Go to – www.vandruff.com www.mlmlwatch.org, one of several informative web sites by Dr. Stephen Barrett, focusing on questionable supplements and other health quackery, which seems to be a favorite product category for MLMs.

www.sequenceinc.com – sponsored by forensic accountant Tracy Coenen. Check out her [articles on pyramid schemes](#).

A scholarly article titled “*Marketing Fraud: An Approach to Differentiating Multilevel Marketing from Pyramid Schemes*”¹⁶ was written by economists Peter VanderNat (with the FTC) and William Keep and has been referenced by the FTC in connection with the Business Opportunity Rule, as discussed in Chapter 2. However, the article assumes that MLM is a legitimate business model, an assumption that must be challenged, based on research and analysis reported in this book.

Dave Ritchie, who lost the love of his life over her addiction to MLM, presents some interesting experiences and insights in his web site at – www.scamm.org.

Many other useful reports and blogs are available at www.mlm-thetruth.com. And check out numerous other recommended web sites, which are annotated for the reader’s convenience. Go to –

www.mlm-thetruth.com/updates/recommended-sites/

If you want specific information on specific MLM programs, by going a Google search, you can usually locate numerous web sites touting the MLM. But if you want to know the downside for any given MLM, just enter

the name of the company and add search terms such as “scam,” “fraud,” “complaints,” “legal actions,” etc.

A group of us consumer advocates have a web site on which is posted a petition titled: “Global Coalition Petitions FTC to Protect Consumers against Unfair and Deceptive Practices in the MLM (multi-level marketing) Industry.” Visitors to the site are invited to sign the petition and post their complaints. Go to – www.mlmpetition.com

William “Bill” A. Ackman, founder of Pershing Square Capital Management, gave a presentation at a Sohn investor conference December 20, 2012, at which he claimed to have proven that Herbalife was a pyramid scheme. He shorted the stock to the tune of a billion dollars, betting the stock price would eventually drop to zero. Other hedge fund managers invested hundreds of millions of dollars against him, and a battle of counter-investments and arguments on both sides ensued. Many articles appeared on the investor web site www.seekingalpha.com. For some well-researched articles from Pershing Square Capital Management, go to - www.factsabouttheherbalife.com. Particularly helpful is their video “PyramidSchemes: A Primer.” Everyone should see it.

Please read this book carefully, then pass it (and our web address) on to someone else, or better yet – send to your entire email (or Facebook) list the link for downloading it and suggest that they do the same. Then ask that they each encourage those they contacted do the same for their contacts. You can help establish an endless chain of truth-telling to counter the deceptions passed along the chains of MLM recruiters.

¹⁶ See Peter J. Vander Nat and William W. Keep, *Marketing Fraud: An Approach to Differentiating Multilevel Marketing from Pyramid Schemes*, 21 *Journal of Public Policy & Marketing* (Spring 2002), (“VanderNat and Keep”) at 140.

Chapter 1: MLM UNDER THE MICROSCOPE – why and how the research upon which this book is based was undertaken, and why the author can speak with authority on the subject



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My background & qualifications

Important qualifications for an authority on MLM. Some may ask what qualifies me to do this research and to pull all this material together in an authoritative book. That's a fair question and deserves an answer.

If a top consultant were needed to sort out complex issues related to the legitimacy of MLM, what would his ideal set of qualifications look like, including education and both life and career experiences? I think the following list, which is what I bring to the task, answers that need. This is not to boast – just a summary of my background as it applies to this topic:



- Expertise in business analytical skills – ideally an MBA degree
- Doctoral level research, training, and experience evaluating others' research
- Many years of experience in direct selling and in sales management
- A wide range of entrepreneurial and home-based ventures
- Direct experience in a leading MLM and success in building a downline

- Experience analyzing hundreds of MLMs, using a well-researched and consistent analytical model
- Compilation of the experience of thousands of participants in a wide range of MLM programs
- Communications with top executives and communicators of leading MLMs
- Strong grounding in ethical principles, including authorship on MLM ethics
- Extensive writings on MLM quoted by attorneys, legislators, and the media
- Presentations to regulators at nation-wide conferences on MLM
- Promotion of legislation and rulings to protect against MLM fraud.
- Consultant and expert witness in many legal cases regarding MLM abuses

Actually, my whole career led to my expertise and consumer advocacy in this arena. Though the following sketch of my background is lengthy, it should forever put to rest the uninformed opinions of some critics that Jon Taylor "doesn't have a clue what MLM is all about."

As a young man, the last thing I would have imagined was my stepping forth as a leading authority on multi-level marketing. But fate – or an overruling providence – seems to have pointed me in that direction from my early years as a wide-eyed seeker of what the career world had to offer. It is as though my whole life was somehow pointed toward this advocacy on behalf of consumers and regulators struggling with the exploding phenomenon of multi-level marketing, or the commonly accepted acronym "MLM."

Analytical skills and a solid background in sales, entrepreneurship, and ethics. I graduated in education and taught religion at the secondary level for two years before returning to Brigham Young University to complete a full-time MBA program at Brigham Young University,

requiring two years of coursework in economics, statistics, finance, accounting, and the analytical skills essential for business success. From this training, I gained the skills needed to analyze business options and to assess their profitability and viability. I also performed research on entrepreneurship and led a group project surveying corporate executives on “Sales as a Career Option for College Graduates.” This was at a time when both sales and entrepreneurship were not yet considered respectable topics in academia.

In subsequent years, as an adjunct instructor at four different universities, I taught personal finance, entrepreneurship, business ethics, communications, and management – all of which came in handy later as a consumer advocate, communicating about complex MLM issues. I refined and taught skills needed for successful entrepreneurship and sales programs, as well as ethical business practices.

Coincidentally, I founded the non-profit Consumer Awareness Institute to conduct research and teach seminars related to personal finance and entrepreneurship – and wrote several articles that were published by various consumer and entrepreneurship magazines. I’ve also published several consumer guides, some for the distribution through group and commercial channels and some for Internet consumption. For each project – on an ad hoc basis as needed – I consult other experts in the field or hire help – usually college students.

Home income opportunities galore. In



the late 1970s, as a young widower, I was determined to find ways to support my two small children without leaving home. This led to extensive research on the whole field of home-based business opportunities. I read all I could on the topic and undertook research for a planned national Income Opportunity Directory. The project outgrew me, as I uncovered thousands of income options. But I learned of the vast opportunities available outside the standard job market.

I sponsored a trade show called “The Income Opportunity Show,” to showcase income or business opportunities, many of which could be operated from home. Interestingly, MLM promoters scrambled more aggressively than any of the other companies for the best booth locations.

Serial entrepreneur for sure. Because of my creative inclinations and familiarity with the vast array of self-employment options, I started one business after another as a “serial entrepreneur.” I didn’t enjoy managing them, just creating them from scratch – often a business concept that had never been tried before. For those ventures that failed to show positive results, I learned to cut bait early and not continue throwing good money after bad. I would shut it down and begin again with another concept for a venture waiting in the wings.

Conversely, as soon as a business began to show significant profits, I sold out and went on to create another venture. As expected, some failed, and others succeeded; but in the process I learned some valuable lessons on what is required to start and build a successful home business. With careful research and good marketing, about half of these ventures produced profits within the first few months.

Also, because my funds were limited, all these business startups were bootstrap operations, requiring little capital. Such ventures nearly always required much salesmanship, so I honed my sales and marketing skills and trained others in the skills needed to promote new ventures. I know what legitimate selling entails.

Over a period of 30 years, I founded or consulted in the founding of over 40 home-based businesses. These included an educational game simulation company, an advertising and public relations agency, a training video preview service, a national motor home rental referral agency, pre-need funeral sales programs, radio transmission for high school driver education, publishing ventures, numerous trade shows, several traveling seminars, centralized seminars transmitted by satellite, a nationwide nanny screening and referral agency, and research-based resume and self-marketing

programs. One could say I was a bootstrap, serial entrepreneur.

Direct selling experience. Along the way, I often engaged in direct selling, which proved to be the most profitable of the many income options in which I participated. I paid much of my college expenses selling encyclopedias, and I won many salesmanship awards when I sold insurance and pre-arranged funeral plans. *I do know the difference between legitimate direct selling and pyramid or chain selling.*

“Residual income” – and legitimacy. I provided consultation for mid-career changers, many of whom were seeking my guidance in pursuing small business or self-employment options. Also, from authoring books and from promoting health insurance and other programs for small businesses, I experienced the luxury of “residual income” – frequently cited by MLM promoters as the inevitable result of building a downline of distributors (or so they claim).

I was careful to assure that all of these ventures were organized and operated using the strictest of legal and ethical standards. Based on my MBA training, all this experience, and the ethical principles I have always held and taught, I was in a strong position to discern between businesses that were legitimate and those that were not.

Doctoral studies, research, and teaching. Midlife in my varied career, I completed doctoral studies in Applied Psychology at the University of Utah. This gave me research skills that were extremely helpful in my consulting, in teaching adult education classes and private seminars, and in my independent research on many topics, including MLM. Also, for a brief period, I worked on the administrative staff of both Brigham Young University and the University of Utah, evaluating the research of others.

First-hand experience with MLM – “Been there, done that.” I had been aggressively recruited many times by various

MLM participants and witnessed firsthand their powerful motivation to recruit, using dubious and deceptive recruiting methods. But having taught college classes in finance, entrepreneurship, and ethics, and having been a successful salesman and entrepreneur, I was skeptical of recruitment-driven schemes labeled as “network marketing” or “MLM.”

However, under pressure from respected friends to join various MLM programs in 1994, I considered doing a one-year test of an MLM that my research led me to believe was one of the best of the MLMs I could join – Nu Skin. I wanted to prove to myself and to others whether or not MLM was a legitimate business model. Those who recruited me claimed that with my capabilities and contacts, I could rise to the top level of “Blue Diamond” within two years – and that those at this exalted level earned an average of over \$750,000 a year.



\$750,000 per year! I told myself that if that were true, I could live on that. But if it proved to be just a disguised pyramid scheme, as I suspected, I would tell the world about it.

I told myself that if that were true, I could live on that. But if it proved to be just a money trap or disguised pyramid scheme, as I suspected, I would tell the world about it.

Prudence dictated that before finally joining, I do some “due diligence” by reading on MLM and by checking out Nu Skin and other MLMs with the Consumer Protection Division at Utah’s Department of Commerce, as well as with the Better Business Bureau, which had received few complaints against Nu Skin. Both gave out literature that was favorable to MLM, assuming the company was financially solid and that legitimate products were offered.

I later learned that at least one of the pieces of literature handed out was supplied by the Direct Selling Education Foundation, sponsored by the Direct Selling Association (DSA), which lobbies for the MLM industry. But at the time, it seemed credible.

Finally convinced, I dragged my suspicious wife JoAnn out to a couple of Nu Skin



opportunity meetings. The pep rally atmosphere was a big turn-off for her. She concluded, "I have a bad feeling about this."

But I persisted, and she reluctantly gave in to my promise to try it for a year - and then re-evaluate the program. I felt comfortable with this trial period because in all my previous ventures I could assess the potential profitability of a business within the first few months.

As recommended, I bought five of starter packages (for about \$1,600) to jump-start five new recruits, which not only helped me to advance in the distributor hierarchy through their "fast start" program, but also gave me a powerful incentive to recruit to recoup my investment. Fortunately, as a researcher I kept detailed notes of my experiences and records of expenses while recruiting for Nu Skin.

"I drank the Kool-Aid." My decision was to give total dedication to the program for at least a year, as it would not be a valid test otherwise. Even with my extensive background in math, entrepreneurship, and sales, I "drank the Kool-Aid" and eventually bought into the whole MLM mentality.

REMEMBER



JONESTOWN?

Looking back, I am ashamed for having overlooked MLM's mathematical trick – the promise of an unlimited income from an endless chain of recruitment. This was "cognitive dissonance" personified. I became a believer.

I did everything my company and upline recommended – subscribed to and tried a wide range of their products, recruited people I knew, sought any referrals I could get, advertised after exhausting my "warm market" of friends and family, attended all the training and opportunity meetings (conducting some myself), and used my best efforts to train and motivate my recruits.

I tried selling Nu Skin's products, which were then nutritional supplements sold by their "Interior Design Nutritionals" (IDN) Division, but they were expensive, even at wholesale. To satisfy qualifications for commissions as an "executive distributor," I purchased products to give out as samples to any potential prospects – and hyper-consumed them myself.

It soon became apparent that to get to a level where the money was made, I would have to continue my aggressive recruitment campaign, luring prospects of the Nu Skin "business opportunity" to buy a "business in a box," which consisted mostly of an expensive package of products to become a "business builder."

"Wanna play?" While introducing new recruits to Nu Skin, I often asked them to attend "opportunity meetings" at which a high level distributor would give a presentation touting the benefits of Nu Skin and of what was then referred to as "network marketing."

One of these speakers presented Nu Skin as a game. Just like any game, the person has to be willing to enter the game to gain any fun from participating. He pointed out that the "winners" in this game would be handsomely rewarded – as much as \$750,000 a year, which was what Blue Diamonds were then averaging.

At the close of his presentation, he would challenge us to "play the game" of the Nu Skin version of network marketing. His repeated question "Wanna play?" was intended to get us to sign up right then. He said you never know how a person you recruit might catch fire and make you rich from the downline he might build, from which you could draw commissions. In retrospect, this appeal to chance is grounds for the application of lottery statutes to MLM in some states. (See Chapters 2 and 10.)

The 3-foot rule. I became a serious player of this network marketing game. I read everything I could on the subject, followed suggestions of my upline to the letter, and recruited aggressively. I consistently applied the "3-foot rule" – everyone within three feet of me was a prospect.

"It's Nu Skin or me – take your pick." My wife began asking questions after a few months of pitifully small commissions, even though I had risen to a level of the top 1% of distributors – assuming all recruits were counted. She did not like the changes that were occurring in me and in our relationships with treasured friends and family members, whom I was attempting to recruit.

Finally, at the end of a year, JoAnn threatened to leave me if I continued, as it was changing for the worse the man she married. *“It’s Nu Skin or me – take your pick,”* she warned. Where I had ignored my wife’s negative impressions when I first joined Nu Skin, now her ultimatum caused me to take a closer look at my participation – and at our finances.

“It’s Nu Skin or me – take your pick,” she warned.

Ethical conflicts. As a former teacher of ethics and one who considers himself an honest man, one facet of MLM fascinated me even more than the money. In re-examining my participation in MLM, I discovered a whole range of ethical conflicts that for me made MLM an unacceptable way of conducting a business.

In fact, before I quit Nu Skin, after a year of concentrated effort, I could see clearly what I would have to do to earn the huge commission checks that were held out to new recruits. I decided it was simply not worth it. Why? Because I would have to recruit by convincing prospects (like I had been deceived) into believing they too could achieve what I claimed to have achieved – or was on the road to achieving.

For me to receive the income that was held up as possible, thousands (in such a highly leveraged program) would have to lose their investment. After all, the money would have to come from somewhere. In MLM, it would come from purchases of downline distributors, since few products were sold to non-distributors. They were overpriced, and the pay plan was clearly rewarding those who recruited huge downlines, not those who sold to non-participants. Also, I would have to continue to insist that MLM programs like Nu Skin were not illegal pyramid schemes, but legitimate direct selling programs.

Top 1% and losing over \$1,200 a month. Though I was successful at recruiting and climbing the ladder of distributors (again, in the top 1% if all distributors were counted), I was still losing about \$1,200 a month, after

subtracting all expenses, including purchases required to maintain qualification for the “Executive” level in the compensation plan – which was necessary to have any hope of profiting after expenses.

Top 1% of distributors, but losing \$1,200/month. This was NOT what I signed up for!

It soon became apparent that to earn the huge income that was promised, I would have to be at or near the top of a huge pyramid of participants, which I believed was possible. But after carefully considering my situation and coming to recognize the foolishness I had fallen into, I quit Nu Skin and decided to tell the world what I had learned – not just about Nu Skin, but about the entire field of MLM (a.k.a., “network marketing”), about which I had undertaken an intensive research overview.

For me to receive that level of income, thousands would have to lose their investment. The money would have to come from somewhere. Also, I would have to continue to insist that MLMs were not illegal pyramid schemes, but legitimate direct selling programs.

I go public and initiate some serious research

I publish the story of my experience and lessons learned from MLM. After conducting surveys to determine the amount of MLM activity in my state and a cross section of citizens’ opinions about it, I wrote a book titled *The Network Marketing Game*, which exposed the ethical problems of exploiting friends and family for personal gain. While on a speaking tour promoting the book, I got feedback from tax accountants who asked why – with all the MLM promoters’ promises of “residual income” – they were not seeing profits reported on tax returns of MLM participants.

The tax man knows. I decided to interview tax professionals in several counties – totaling almost 300 of them over a period of several months. This included interviews with programmers of tax software and persons involved in seminars for tax professionals. With a total of over two million tax returns represented nationwide, a clear picture emerged of who was making – and who was losing – money in MLM. The results were startling. Finally, in 2004, this research was published in a report published on my web site entitled *Who Profits from Multi-Level Marketing? Preparers of Utah Tax Returns Have the Answer.*



From MLM recruiter to consumer advocate. In 1998, I mailed my initial conclusions to the presidents of 60 of the most prominent MLM companies, asking them to provide specific data to "prove me wrong." To this day, this challenge remains unmet. It was published on my web site as *Network Marketing Payout Distributions Study*. I also published *MLM or Network Marketing – the Ultimate Pyramid Scheme, 12 Tests for Evaluating a Network Marketing “Opportunity, and Product-based Pyramid Schemes: When Should an MLM or Network Marketing Program Be Considered an Illegal Pyramid Scheme?* All of these created quite a stir when posted on the internet.

Why all this detail on my background? My reasons for recounting all of the above is to answer the common charge of critics that “Jon Taylor hasn't a clue of what MLM is about” – or that I have “no real world experience in how to sell or to manage a business.” The foregoing should put all such blind assertions to rest. At least, it answers all the qualifications for an ideal expert for this project as outlined above.

Other MLM promoters charge that my experience with MLM was with a "bad MLM" – Nu Skin. Their typical comment goes something like this. "But – our MLM is different. Everyone can make money at this MLM," or “We have the most powerful compensation plan in the industry,” or “We’re not really MLM, we sign up referral customers,” etc., etc.

My response is that after analyzing the compensation plans of hundreds of MLMs and the average income for those that have released such data, it is now possible for me to make reliable generalizations about MLMs (i.e., multi-level or network marketing, or what I have labeled “product-based pyramid schemes” - or whatever you choose to call them) – as a business model that applies to all MLMs. And I have yet to find any exceptions to these generalizations, in spite of 20 years of research and worldwide feedback.

This is not to boast, just a statement of fact: I DO know what I am talking about - if anyone does. And I DO have the background to test and evaluate MLM as a business model, as well as specific MLM programs - if anyone does.

This is not to boast, just a statement of fact: I DO know what I am talking about – if anyone does. And I DO have the background to test and evaluate MLM as a business model, as well as specific MLM programs – if anyone does.

Sour grapes – or moral imperative?

Other critics see my analysis of the MLM industry as merely the 'sour grapes' attitude of a disgruntled ex-distributor who failed at MLM. I can only respond that I was successful at becoming one of the company's top 1% in the hierarchy of distributors – only a small percentage of all recruits reach even “Executive” level. In Nu Skin’s reporting, dropouts are not counted, as these people “never intended to do the business.” This is a convenient falsehood.

However, such success was not reflected in any profits, but instead in substantial losses, after all purchases and operating expenses were subtracted, to say nothing of \$50,000-\$100,000 lost from not working at a profitable sales-oriented business during that year. Also, I was fulfilling my initial pledge to myself to make public what my experiment with MLM taught me, and I feel a moral imperative to help others avoid the pitfalls inherent in this "industry.”

Shortly after I began posting my findings to educate and warn consumers against MLMs like Nu Skin, I also reported on the FTC's Order for Nu Skin to discontinue its misrepresentations about distributor earnings. This information can be downloaded from a page on my web site titled "Nu Skin's Naughty Numbers at – <http://mlm-thetruth.com/research/mlm-statistics/nuskins-numbers/>

I share my findings with regulators, the media, attorneys, academia, and consumer advocates – as well as with victims and potential victims.

To reach out to a broader audience of consumers, I initiated a website and cooperated with other consumer advocates and top experts who were reporting their findings and experiences with MLM. These included Robert FitzPatrick¹⁷, President of Pyramid Scheme Alert; Bruce Craig, former assistant Attorney General in Wisconsin; Kristine Lanning, (former) Assistant Attorney General of North Carolina; Doug Brooks¹⁸, plaintiff attorney dealing with MLM cases; Susanna Perkins, author and sponsor of mlmsurvivor.com, and Eric Schiebeler, author of *Merchants of Deception*.

With the cooperation of these extremely knowledgeable and capable experts, I organized seminars on product-based pyramid schemes for state and federal regulators in Washington, D.C., and at the National White Collar Crime Center in Richmond, Virginia. I also cooperated with sponsors of other web sites offering useful information on MLM.

My research was also presented at other national and state anti-fraud conferences. Robert Fitz-Patrick and I have been called upon as expert witnesses in several legal cases against MLM companies. However, the most gratifying rewards from all this research have been the thousands of emails and responses to my web site from persons all over the world

who express their thanks for saving them from potential losses.¹⁹

Finally – multi-level marketing, or product-based pyramid schemes, defined - based on extensive research. I spent months analyzing features of MLM and classic pyramid schemes and comparing them with features of legitimate direct selling and other home businesses. With my extensive background in sales and entrepreneurship, I was able to make some clear distinctions missed by other analysts.

In fact, I had not only done direct selling (which MLM adherents claim to be doing), but had recruited, hired, and trained sales persons and telemarketers. I knew what characterized legitimate direct selling – and even legitimate recruiting. After months of comparative analysis and discussions with top experts, five “red flags” or characteristics became apparent that clearly distinguished chain or pyramid selling schemes (MLMs) from legitimate direct selling businesses. The first four applied to all MLMs, the fifth to most.

These features, which could be identified in MLM's compensation plans, resulted in extremely high loss rates and helped to identify MLMs that could be considered in violation of laws in most states, as well as FTC guidelines. In fact, wherever I could get the earnings reports of participants in MLMs with these “5 Red Flags” in their pay plan, approximately 99.7% of all participants (including dropouts) lost money, after subtracting all expenses. In fact, with a more strict interpretation of the data (and eliminating TOPPs, or top-of-the-pyramid promoters from the calculation), the loss rate for new recruits is closer to 99.9%.²⁰

These expenses included minimal operating expenses and “incentivized purchases” of goods and services from the company (necessary to qualify for commissions or rank advancement).²¹ MLMs even make obviously illegal cash-based pyramid schemes look profitable in comparison – *with the likelihood of profiting 10-100 times as great.*

¹⁷ Sponsor of pyramidschemealert.org

¹⁸ Sole practitioner in Concord, Mass..

¹⁹ For sample feedback, see Appendix for Chapter 9.

²⁰ See Chapter 7.

²¹ See Chapters 5 and 7

The “5 Red Flags.” These five red flags were then presented in the form of a “5-step do-it-yourself MLM Evaluation” quiz. It soon caught hold, and thousands of MLM prospects have used it to keep themselves out of MLMs that could have caused considerable financial loss.

I also published for presentation *THE 5 RED FLAGS: Five Causal and Defining Characteristics of Product-Based Pyramid Schemes, or Recruiting MLMs* at the 2002 and 2004 Economic Crime Summit Conference, co-sponsored by the National White Collar Crime Center.



Over the past several years, I have used this “5 Red Flags”²² model to analyze the compensation plans of over 600 MLMs – and correlated them with average income data of participants (where such data was available). All of this has enabled me to make generalizable observations of consistent structures and practices of MLM as an industry – and losses suffered by participants – that would not otherwise have been possible. These observations and the research underlying them will be explained in subsequent chapters.

It should be noted that I now include only four causative and defining characteristics of a recruitment-driven MLM. The fifth (five or more levels in the pay plan) does not always apply because in rare cases, some MLMs have only four or five levels. They make up for it by increasing the payout to TOPPs. However, the added levels definitely enhance this unfair payout.

Roulette or Craps – or MLM? The numbers don’t lie. Other critics see me as biased against MLM in my research and reporting. This can be answered with a gambling analogy to explain my position. If the owner of a gambling casino in Las Vegas were to post a “Business Opportunity” sign at his craps or Roulette tables, the Nevada gaming authorities would take action against him. And no one would argue that a writer covering the issue should be impartial in

²² The first four causative and defining characteristics apply to all MLMs, the fifth to all but a few.

reporting on whether or not gambling is a legitimate business opportunity. It is gambling.

In fact, I called Las Vegas gambling casinos and learned that the odds of profiting from craps or Roulette are far better than the likelihood of profiting from MLM²³. Please don’t misunderstand me. I am not promoting gambling; I never gamble. But I am all for honest and ethical business practices in any endeavor. At least gambling casinos are honest enough not to claim that those who play at their gaming tables are investing in a “business opportunity.”

Business opportunity?



One can do better in Las Vegas – than in MLM!

MLM is not the only game in town.

From feedback all over the world it became apparent that many people are drawn into MLM because they are unaware of the many self-employment alternatives open to them. So using my past research and experience, I wrote the report *1,357 Ways to Make More Money than in MLM*. I began posting on my web site the research making up this book, along with suggestions for successful self-employment and links to websites that provide additional information and point to helpful resources.

Legislators and regulators yield to DSA/MLM lobbying, creating a vacuum in consumer protection.

Utah and other states duped by DSA.

In 2006, the DSA and local MLM companies lobbied



**DIRECT SELLING
ASSOCIATION**

²³ See Chapter 7.

intensely for a bill weakening Utah's Pyramid Scheme Act. I testified at hearings on behalf of consumers who were being victimized by what I dubbed "product-based pyramid schemes," or MLMs. But with well-placed political donations and the implication of a powerful voting block of MLM participants, the bill was passed in 2006, exempting MLMs with consumable products from prosecution as pyramid schemes. Even the Attorney General testified in favor of the bill, but without disclosing that MLMs were his chief political donors. Several other states have been similarly affected by DSA-initiated legislation.

The FTC's flawed Business Opportunity Rule. In 2006, the FTC proposed a Business Opportunity Rule that would require sellers of business opportunities to disclose average incomes, references, and other information crucial to a decision on whether or not to participate. Comments were invited, and the DSA and its members issued appeals to millions of MLM participants to use their form letters to write in objections to including MLM in the Rule. Some 17,000 offered comments following their company's suggested form letters. I wrote comments rebutting the comments of participants and spokesmen for over 30 MLMs.

Also, the DSA influenced 86 Congressmen to object to including MLM in the Rule. The FTC gave in to the pressure, and in 2008 a Revised Rule was proposed, exempting MLM. Commenting for consumers, I objected to this exemption with additional comments, and in 2009 participated in a workshop at the FTC offices on the proposed final version of the Rule – again objecting to the FTC's exemption of MLM from having to provide transparency needed to protect consumers from unfair and deceptive practices, which protection is a core mission of the FTC. However, in 2011, the FTC announced its final Business Opportunity Rule – exempting MLM! The details of how this happened are provided in my report titled "REGULATORY CAPTURE: The FTC's Flawed Business Opportunity Rule"



My resolve to do something

Something to get passionate about.

Knowing my grasshopper approach to career decisions in the past, hopping from one startup business to another, friends have asked me what has driven me to stay with my consumer advocacy, focusing so intently on this one business model for 20 years.

My answer is that when I discovered how deceptive, unfair, viral, and predatory this industry is, and how few people – including regulators – understand the consequences of MLM participation – to individuals, to families, and to society, it seemed appropriate to stand up and use my unique background and skills to challenge the industry and to provide guidance to prevent consumers from being victimized by fraudulent MLM schemes. It is both the outrage I feel at the unchecked growth of this deeply flawed practice, as well as letters of deep appreciation from persons around the world who used my information to remain solvent by refusing MLM recruiters, that keeps me going.

I go where the facts take me. The abysmal average income (losses) for new MLM recruits confirms the fundamental flaws in MLM as a business model, depending as it does on the unlimited recruitment of endless chains of participants as primary customers. MLM is built on the same endless chain concept as the clearly illegal chain letters of the past, where each person sends \$5 to all the persons on a list and is asked to add his name at the end and forward it on to all his/her friends, asking them to do the same. So I have no hesitation in gathering the evidence and arguments on both sides and then showing the flaws in the arguments justifying MLM as a "business opportunity." All of this has been posted on my web site – mlm-thetruth.com.

Appendix 1A

NU SKIN ATTEMPTS TO DISCREDIT ITS WHISTLEBLOWER

Nu Skin response to inquiries about Jon Taylor, the whistleblower – and Taylor’s rebuttal

Statement by Nu Skin in response to inquiries about Jon Taylor, the primary whistleblower for Nu Skin Enterprises, Inc.	Rebuttal by Jon Taylor, including references for further information. (“MLM” is the acronym for multi-level marketing, or network marketing. “Recruiting MLM’s” are MLM companies that reward recruiting far more than selling to non-network customers.)
<p>NOTE: Unable to refute Taylor’s charges that Nu Skin has continued its misrepresentations since the 1994 FTC Order for Nu Skin to stop misrepresenting earnings of its distributors, NS officials have chosen to attempt to discredit the company’s primary whistleblower. Comments from an official company statement follows (<i>in italics</i>) in this column:</p> <p><i>Nu Skin Enterprises believes that Dr. Taylor fails to make the distinction between legitimate network marketing and illegal pyramid schemes.</i></p>	<p>I performed extensive comparative analyses of alternate business models to which MLM is often compared, and found five defining characteristics which clearly distinguish legitimate business operations from recruiting MLM’s, or product-based pyramid schemes. Please read carefully my report entitled <i>The 5 Red Flags: Five Causal and Defining Characteristics of Product-Based Pyramid Schemes, or Recruiting MLM’s</i>. A more valid and thorough analysis of such distinctions has not been done elsewhere, certainly not by Nu Skin or the DSA (Direct Selling Assn.), the public relations and lobbying arm for the MLM industry.</p>
<p><i>Contrary to Dr. Taylor’s statements, credible network marketing companies are committed to protecting consumers, not preying on them.</i></p>	<p>While most participants in a recruiting MLM’s do not see themselves as victimizing or “preying” on those they recruit, a careful reading of my report on product-based pyramid schemes should help in assessing their extensive harm to consumers. Based on available data, the five defining characteristics result in an approximate loss rate of 99.9% (at least 99.94% for Nu Skin).</p>
<p><i>Nu Skin charges a low sign-up fee, requires no initial purchase of product,</i></p>	<p>The sign-up fee is irrelevant. It is the “pay to play” or incentivized purchases that constitute disguised pyramid investments and the aggregate losses of billions of dollars to millions of unsuspecting consumers. NS promoters sell “pay to play” purchases aggressively.</p>
<p><i>will refund 90% of the cost of unused product returned within a year,</i></p>	<p>Few understand within a year that they have been scammed without deprogramming. It took me several years of donated research to fully decipher all the deceptions – even with an MBA, a Ph.D., and over 30 years marketing and direct selling experience.</p>
<p><i>and is a NYSE-listed publicly traded and audited company.</i></p>	<p>Responsible SEC and the NYSE officials would be concerned if they understood that a highly leveraged pyramid scheme was listed and sold to investors under the guise of a direct selling company. And after Enron, Worldcom, and Arthur Anderson, does anyone seriously believe that a company’s reports are automatically to be trusted just because they have been audited using “GAAP” – generally accepted accounting principles?</p>
<p><i>The company is a responsible corporate citizen that employs thousands of people from every walk of life and shares its resources generously in every market where it does business.</i></p>	<p>That they do – and by so doing buy credibility among unwitting consumers and government officials. If organized crime organizes soup kitchens in ghettos or the Columbian drug cartel assists cocaine farmers, does that make them legitimate? (See section J-3 in the <i>Complaint of Violations</i> report on</p>

	Nu Skin's non-compliance with the FTC Order). The fact that NS "employs thousands" should not obscure the source of the money used to do so. Do the ends (employment and charity) justify the means (defrauding millions of unsuspecting consumers worldwide)?
Undoubtedly there are former distributors like Dr. Taylor who have become disenchanted with the business opportunity, just as there are in many industries.	A 99.94% loss rate is not normal for a legitimate "business opportunity," but is for MLM. As well might a "business opportunity" sign be posted above gambling tables in Las Vegas. See <i>Report of Violations of the 1994 [FTC] Order for Nu Skin to Stop Misrepresenting Earnings of Distributors . . .</i>
However, there are hundreds of thousands of others who continue to appreciate the opportunity to achieve their goals, whether they be earning a little extra pocket money each month or they seek the freedom to quit the traditional corporate world and own their own business.	Those who do "achieve their goals" do so at the expense of a multitude of unwitting downline victims. And the notion of a part-time income for Nu Skin's highly leveraged compensation system is a huge misrepresentation, especially if all expenses are subtracted from revenues – for a net (loss) figure. See Appendix A in the <i>Report of Violations</i> report and my own story below.
Background: Jon M. Taylor is a self-appointed crusader opposed to the network marketing industry, particularly Nu Skin Enterprises	No one appoints a genuine crusader to anything, much less a whistleblower. Does the writer expect that Nu Skin would appoint a crusader against its own program or against the MLM industry?
He has formed a non-profit corporation in Kaysville, Utah called the Consumer Awareness Institute. Dr. Taylor was an Interior Design Nutritionals (IDN, the precursor of Pharmanex) distributor for a short time. He claims to have been "very successful" during his year with Nu Skin. However, in the forward of one of his books he writes of changing from an "outspoken critic of network marketing to an enthusiastic convert" before his dream soured and his wife persuaded him to give up the pursuit of wealth.	My "conversion" and subsequent disillusionment is an important part my story – which follows. In fact, it would not have been possible to fully decipher the deceptions in the Nu Skin program without having at one time been a committed participant. It became apparent after having made it to the top 1% of all distributors, while receiving checks of only \$246 a month against expenses exceeding \$1500 a month, the "opportunity" was very different from what was represented. Extensive research showed that it was rare for anyone to make a profit. The more I researched the topic, the more my conclusions were confirmed.
Dr. Taylor is fond of acquiring public data about Nu Skin and then "torturing" it until it suits his purposes.	One attorney with years of MLM litigation experience laughed at the idea of my "torturing" the data. Who tortured the data? Nu Skin was given at least four opportunities to rebut my analyses with valid numbers. They failed to do so all four times.
He has challenged the way the company reports average distributor incomes – despite its being in the prescribed format required by the Federal Trade Commission	The "prescribed format" allowed by the FTC has been challenged in correspondence with the Enforcement Division officials, who now have better format input. The FTC has been petitioned by numerous petitioners for better disclosure by MLM companies. And if the format is "required by the FTC," why did NuSkin cease publishing the report – about the time I challenged its validity?
– as well as the structure of the network marketing model, the pricing of products, the ethics of the industry,	Read <i>The 5 Red Flags (cited above)</i> , and then evaluate the structure, product pricing, and ethics of the typical network marketing model. We see shades of Enron – except that it is small investors that are being stiffed by recruiting MLM's like Nu Skin.
and even the company's philanthropy.	There they go again on the philanthropy-credibility connection. Would anyone who read the <i>Report of Violations</i> still buy into that?

<p><i>Dr. Taylor forgets that salespersons in any organization have the same motivation: to earn money. He labels that desire "greed" and condemns it in network marketing. In traditional businesses national sales managers motivate regional ones, who motivate district ones, who motivate the salesmen, etc. The same is true in retail where the store manager motivates the assistant store manager, who motivates the department managers, who motivate the salesmen because they all get bonuses from the sales of those below them in the organization.</i></p>	<p>It is safe to say that the writer of this statement (most likely someone on staff who has neither been a distributor nor a direct sales person) has not had a fraction of the sales and marketing experience I have had – nor a wall full of awards for successful performance. I know the difference between legitimate selling and a scam. See Section D-3 and Appendix D in the above-mentioned <i>Complaint of Violations</i> report – and my more extensive report on defining characteristics of recruiting MLM's [op cit]. The latter makes a clear distinction between compensation systems in a recruiting MLM and legitimate retail or direct sales operations.</p>
<p><i>He says that network marketing companies claim distributors can make millions. Laws prohibit network marketing companies and distributors from making earnings claims. In Nu Skin, distributors are penalized or terminated if found violating this stricture.</i></p>	<p>The writer of this statement should attend some Nu Skin recruitment or opportunity meetings. And it would be good if while he was there he would open his eyes and ears to observe what goes on.</p>

When I discovered how unfair and deceptive, and how viral and predatory this industry is and how few people – including regulators – understand the consequences of MLM participation, it seemed appropriate to use my unique background and skills to challenge the industry, to inform regulators, the media, and academia – and to provide guidance to help prevent consumers from being victimized.

Chapter 2: MLM DEFINITIONS AND LEGITIMACY: what MLM is and is not, and the difference – if any – between MLM and pyramid schemes

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Introduction and summary

One of the biggest problems with multi-level marketing (a.k.a., "network marketing", or "MLM" for short) is the wide variety of definitions of what is – and what is not – multi-level marketing. We will consider a sampling of definitions and then discuss a much more objective definition based on comparative research on structural characteristics and confirmations of its validity in over 600 MLMs (MLM programs).

This research has yielded four (and in most cases five) causative and defining characteristics ("red flags") that can be recognized in the compensation plans of all MLMs – which motivates the behavior of participants. This definitional model makes possible a clear distinction between (1) legitimate direct selling or home-based businesses, (2) classic no-product (cash-based) pyramid schemes, and (3) MLMs – or what I call "product-based pyramid schemes."

As I shall explain, there are inherent flaws in any MLM, since all assume unlimited recruitment of endless chains of participants – and a pay plan that is recruitment-driven, top-weighted, and financed primarily by incentivized purchases of the participants themselves. I have looked for exceptions to this generalization in the 600 MLMs I have analyzed, but have found none.

As a business model, MLM operates on the same principle as a chain letter, in which a person receives a letter with a list of names on it, mails a \$5 bill to everyone on the list, adds his/her name to the bottom, and then forwards it to friends and relatives to do the same – in an endless chain of

such letters. In such schemes, the vast majority are mathematically doomed to lose money. "Pay to play" chain letters are illegal. (For the history of how chain letters evolved into MLMs, see Chapter 10.

Just like the chain letter, MLM founders assume an infinite market, which does not exist in the real world. They also assume a virgin market, which cannot exist for long – which necessitates that an MLM expand –

or “re-pyramid” (my term) – into new markets. Thus, MLM with its endless chains of recruitment, is inherently flawed, unfair, and deceptive.

Twenty years of worldwide feedback tells me that MLM is also extremely viral and predatory. This is advantageous for the founders, TOPPs (top-of-the-pyramid promoters), and the MLM company itself, but works to the detriment of new recruits – who are being sold a ticket on a flight that has already left the ground. MLM is an unfair and deceptive practice, if there ever was one. MLM takes new recruits from the real world into a world of make-believe “business opportunities” – and in the process fattens the coffers of the company, its founders, and TOPPs.

When discussing the legitimacy of MLM in this book, I use the word “legitimate” in the broadest sense; i.e., “conforming to recognized principles or accepted rules or standards,”²⁴ as opposed to narrow legal definitions, which may or may not conform to accepted standards in business practices.

This chapter concludes with likely the only accurate real-world, research-based, and consumer friendly, definition of the business model termed “multi-level marketing,” or “MLM.” In my opinion, a good definition would accomplish the following criteria:

1. Distinguish MLM from all other forms of business activity.
2. Distinguish MLM, or product-based pyramid schemes from Ponzi schemes (although there are some similarities)
3. Address the question of legitimacy – or lack thereof – of the business model.
4. Address fundamental flaws of all MLMs.
5. Explain the problem of incentivizing purchases by participants.
6. Point to the litany of misrepresentations characteristic of MLM recruitment.
7. Highlight the industry-wide high loss rates experienced by participants.
8. Emphasize the high attrition rate among MLM participants.

A problem of definitions. Much confusion exists on the subject of what is –

and is not – multi-level marketing and whether and how it can be distinguished from illegal pyramid schemes. All of the definitions by industry defenders as well as government agencies focus primarily on the behavior of participants and the existence of two or more levels for payout purposes, rather than on the fundamental structural characteristics that clearly distinguish MLM from all other forms of business activities. We will begin by looking at how others define it and then bring together what light can be shed on the subject from legal and regulatory sources and from recent research.

We will first look at the definitions of multi-level marketing offered by others before advancing a set of causative and defining characteristics of a “recruitment-driven MLM,” or “product-based pyramid scheme.” Then I will offer a definition of MLM that satisfies all of the above criteria.

Examples of Definitions of MLM by others – with commentary

From Wikipedia (March 2010):

Multi-level marketing (MLM), (also called network marketing, direct selling, referral marketing, and pyramid selling) is a term that describes a marketing structure



used by some companies as part of their overall marketing strategy. *The structure is designed to create a marketing and sales force by compensating promoters of company products not only for sales they personally generate, but also for the sales of other promoters they introduce to the company, creating a downline of distributors and a hierarchy of multiple levels of compensation in the form of a pyramid.*

The products and company are usually marketed directly to consumers and potential business partners by means of relationship referrals and word of mouth marketing.

“Independent, unsalaried salespeople of multi-level marketing, referred to as distributors (or associates, independent business owners, dealers, franchise owners, sales consultants, consultants, independent agents, etc.), represent the company that produces the products or provides the services they sell. They are awarded a commission based upon the volume of product sold through their own sales efforts as well as that of their downline organization.

²⁴The New Merriam Webster Dictionary, Springfield, MA, 2008

Independent distributors develop their organizations by either building an active customer base, who buy direct from the company, or by recruiting a *downline* of independent distributors who also build a customer base, thereby expanding the overall organization. Additionally, distributors can also earn a profit by retailing products they purchased from the company at wholesale price.

MLM spokesmen clearly crafted this definition, which Wikipedia uncritically accepted in lieu of definitions of consumer advocates that would highlight the inherent flaws in MLM. For example, no mention is made of the endless chains of recruitment and a pay plan that is recruitment-driven, top-weighted, and financed primarily by incentivized purchases of the participants themselves. These critical features will be explained later in this chapter.

From author Richard Poe:

Network marketing is not defined in any standard dictionary of business terms. Nor do network marketers themselves agree on what it means. For lack of any clear standard, I suggest the following definition: "Any method of marketing that allows independent sales representatives to recruit other sales representatives and to draw commissions from the sales of those recruits."²⁵

This overbroad definition would take in many sales organizations that are not considered MLM, such as some insurance and real estate agencies. And as with the Wikipedia definition, no mention is made of the inherent flaws in any MLM system – the endless chain of recruitment and a pay plan that is recruitment-driven, top-weighted, and financed primarily by incentivized purchases of the participants themselves.

Zig Ziglar (with Dr. John Hayes) offers his "technical definition" of what he claims network marketing (MLM) is – and is not. Below is an interesting definition put forth by Dr. John Hayes, in cooperation with prominent salesmanship author Zig



Zig Ziglar

Ziglar,²⁶ *who incidentally makes no mention of MLM or network marketing in his books directed to professional salesmen:*

Would you like a technical definition? Network marketing is a system for distributing goods and services through networks of thousands of independent salespeople, or distributors. The distributors earn money by selling goods and services and also by recruiting and sponsoring other salespeople who become part of their downline, or sales organization. Distributors earn monthly commissions or bonuses on the sales revenues generated by their downline.

Here's what network marketing is and is *not*:

- Network marketing, or multi-level marketing (MLM), isn't illegal, fraudulent, or unethical.
- Network marketing isn't an opportunity to get rich quick off the payments of others who join the organization. That's a pyramid scheme.
- Network marketing isn't a pyramid scheme, which *is* illegal and unethical.
- Network marketing isn't an opportunity to get rich quick. Period.
- Network marketing isn't built on simple mathematics where many losers pay a few winners. That's also a pyramid scheme.
- Network marketing isn't just for salespeople.
- Network marketing isn't expensive. Unlike most other business opportunities, the start-up costs are low, almost always less than \$500 and often under \$100.
- Network marketing isn't a way for companies to sell huge amounts of inventory to distributors. Network marketing isn't a way for distributors to sell stuff that nobody wants or uses.
- Network marketing isn't a license to sell products and services at inflated prices.
- Network marketing isn't for people who aren't willing to work hard.
- Network marketing isn't for anyone who can't or won't follow a proven system that leads to business success.

25 *Wave 3: The New Era in Network Marketing*, by Richard Poe (Prima Publishing: New York, 1995), p. 7-8

26 *Network Marketing for Dummies*, by Zig Ziglar with John P. Hayes, Ph.D. (Hungry Minds, Inc.: New York, NY, 2001), p. 2

While the first paragraph is quite descriptive and somewhat accurate, as is the Wikipedia definition, no mention is made of the inherent flaws in MLM – the endless chains of recruitment and a pay plan that is recruitment-driven, top-weighted, and financed primarily by incentivized purchases of the participants themselves. These critical features will be explained later.

Also, most of the items on the list of what network marketing is not would be vigorously challenged by knowledgeable experts advocating for consumers, based on extensive research as reported in this book.

Other authors on multi-level marketing offer weak definitions – or don't even attempt to define MLM. Another prominent MLM author, Dr. Charles King, professor of marketing at the University of Illinois at Chicago (with James Robinson), offers an even weaker – and I would suggest misleading – definition that would be almost useless in making the distinctions discussed above:



Dr. Charles King

Network marketing is the low-cost, and now high-tech, industry that invites you to build your own business and earn a potentially high income while working from home on your own schedule. You earn immediate income and serious long-term residual income by selling products and services directly to consumers and convincing others to do the same.²⁷

Again, as with the Wikipedia definition, no mention is made of the fundamental flaws inherent in any MLM system – endless chains of recruitment and a pay plan that is recruitment-driven, top-weighted, and financed primarily by incentivized purchases of the participants themselves.

As an example of other authors who have made weak attempts to define multi-level marketing, MLM author David Roller²⁸ suggests a definition that is rosy and descriptive, but not very helpful in making clear distinctions between MLM and other home-based businesses:

²⁷ King, Charles W. and Robinson, James W., *The New Professionals: The Rise of Network Marketing as the Next Major Profession*, Three Rivers Press, 2000

²⁸ Roller, David, *How to Make Big Money in Multi-level Marketing*, Prentice Hall, 1989

Multi-level marketing or network marketing is a system by which a parent company distributes its services or products through a network of independent business people, not only in the United States but throughout the world. These independent business people or entrepreneurs then sponsor other people to help them distribute the product or service. This people-helping-people process may be continued through one or more levels of earnings.

A search of the business section of a local bookstore store reveals that other authors have written on how to be successful at MLM²⁹, but without offering any substantive definition of what they are talking about, apparently assuming readers all know precisely what they are talking about. This may be true of MLM veterans, but feedback I have received tells me this assumption may not always be correct, especially for those being recruited for the first time.

The FTC chooses a definition of MLM that only creates confusion. In its 2008 announcement by the FTC of its Revised Proposed Business Opportunity Rule, exempting MLM from having to comply with the Rule, the FTC quoted an article in which the following definition was advanced:



Multi-level marketing is one form of direct selling, and refers to a business model in which a company distributes products through a network of distributors who earn income from their own retail sales of the product and from retail sales made by the distributors' direct and indirect recruits. Because they earn a commission from the sales their recruits make, each member in the MLM network has an incentive to continue recruiting additional sales representatives into their "downlines."³⁰

²⁹ One example is *The Ultimate Guide to Network Marketing: 37 Top Network Marketing Income Earners Share their Most Preciously Guarded Secrets to Building Extreme Wealth*, edited by Joe Rubino. John Wiley & Sons, Inc., 2006. Another book is by MLM promoters Yarnell, Mark, and Reid, Rene, *Your First Year in Network Marketing: Overcome Your Fears, Experience Success, and Achieve Your Dreams!* Three Rivers Press, 1998.

³⁰ Peter J. Vander Nat and William W. Keep, "Marketing Fraud: An Approach to Differentiating Multilevel Marketing from Pyramid Schemes." *Journal of Public Policy & Marketing* (Spring 2002), p. 140. (Cited in Footnote 34 at bottom of page 15 of RPBOR)

At a workshop hearing on the form for the final Business Opportunity Rule, I pointed out that almost any direct selling company could circumvent the Rule by paying commissions to two or more levels of sales persons, who would have in some way been involved in recruiting new sales persons. In fact, many sales organizations do this, but do not consider themselves "multi-level marketing."

With this definition, together with the MLM exemption, the Rule was rendered almost totally ineffective in curbing abuse. It is a tacit admission by the FTC that it is giving up on its mission to protect consumers against "unfair and deceptive practices" in this very important arena. As will be seen from further analysis, it would be difficult to conceive of a more unfair and deceptive practice than MLM, to say nothing of its extremely viral and predatory nature.

Again, in this FTC definition, as with the Wikipedia definition, no mention is made of the inherent flaws in any MLM system – endless chains of recruitment and a pay plan that is recruitment-driven, top-weighted, and financed primarily by incentivized purchases of the participants themselves.

The DSA re-brands MLM as "direct selling." The DSA (Direct Selling Association) was once dedicated to advancing the interests of what were then legitimate direct selling companies like Fuller Brush and World Book Encyclopedia. But what has happened in recent decades could be illustrated by a farmer who has pigs and horses for sale. He gets more money for horses, so he attaches horse hairs on the buttocks of the pigs and marches them into the horse corral and proclaims, "See there, they are no longer pigs, but horses - because they are in the horse corral."



Pigs are not horses!

Similarly, since "multi-level marketing" sounded too much like a pyramid scheme,

MLM promoters coined the term "network marketing." Then, since it would sound even less pyramid-like, they sought to be called "direct selling" companies. So one by one, MLMs joined the Direct Selling Association and now boldly declare that they are "direct selling companies," since they are members of the DSA.³¹ The DSA now divides its membership into "single level" and "multi-level" pay plans. *MLM is no more legitimate direct selling than pigs are horses, no matter how much money is spent positioning pigs as horses!*

The Direct Selling Association, has in recent years lobbied aggressively on behalf of the MLM industry to stop or water down proposed or existing legislation that protects consumers against what I call "product-based pyramid schemes"; i.e., MLMs. They also work to defeat efforts of consumer advocates to warn against product-based pyramid schemes, and to convince the public and the media of the legitimacy of MLM and of their stated intent to protect the public from unethical practices.



In 2006, the FTC proposed its Initial Business Opportunity Rule, which would require sellers of business opportunities to disclose certain information to protect consumers. The excerpt below is taken from comments the DSA submitted, objecting to including MLMs in the Rule. The DSA's efforts to equate MLM with legitimate direct selling and to justify its exclusion from the Rule are spelled out, as is their definition of MLM:

DSA defines direct selling as: The sale of a consumer product or service, in a face-to-face manner, away from a fixed retail location. . . Multilevel marketing, also known as network marketing, is a compensation structure, not a sales strategy. In a multilevel compensation plan, independent consultants are compensated based not only on one's own product sales, but on the product sales of one's downline (those individuals the direct sales-person has recruited, or recruits of recruits.)

In contrast, in a single level compensation plan, independent consultants are compensated based solely on one's own product sales. Companies using a multilevel compensation structure may use either a person-to-

³¹ See the section "The DSA/MLM lobby" in Chapter 10

person or party plan sales strategy. Eighty-four percent of direct selling firms use some form of multilevel compensation, and *virtually all new companies entering direct selling are using some form of multilevel compensation.*³²

It should be noted that the DSA definition of direct selling as “the sale of a consumer product or service, in a face-to-face manner, away from a fixed retail location” could apply to MLMs that do much direct selling. But *what the DSA definition fails to do is to state what legitimate direct selling is not; i.e., unlimited recruitment of endless chains of participants as primary customers.*

Another statement in the DSA comments is remarkable: “Recruiting is the lifeblood of the industry.” This is a startling admission of the focus on recruitment, which is true of all product-based pyramid schemes. My analysis of the compensation plans of over 600 MLMs, including DSA firms, confirms this. Slight rewards for retailing, together with overpriced products, make the effort to sell products to non-participants a comparative waste of time. Recruiting must be the focus for anyone seeking to profit from MLM.

The suggestion that “the vast majority of salespeople work only a few hours per week, with modest financial goals in mind” will be found in subsequent chapters to be totally misleading because one cannot build and maintain a large downline working part-time, seasonally, or with modest financial goals. And without a large downline, it is very unlikely that an MLM participant will profit. (See Chapter 7.) *Virtually all who work part-time in MLM lose money, after subtracting all expenses, including purchase of products necessary to qualify for commissions.*

And again, as with the Wikipedia definition, no mention is made of the inherent flaws in any MLM system – endless chains of recruitment and a pay plan that is recruitment-driven, top-weighted, and financed primarily by incentivized purchases of the participants themselves. These critical features will be explained later in this chapter.

Needed: A more accurate, research-based definition of MLM that addresses structural flaws in the model – and harm to participants

This book uses the terms “Recruitment-driven MLM” (implying an emphasis of recruitment over selling) and “Product-based Pyramid Scheme”³³ as interchangeable terms. And as discussed previously, these programs have also been called “Multi-level Marketing,” “Network Marketing,” even “direct selling” – though little selling to the public may take place.

More negative sounding titles include “pyramid selling,” “entrepreneurial chains,” “chain selling,” “multi-level selling,” etc. In this book, a “recruitment-driven MLM” uses a compensation plan that rewards recruiting so much more than selling that there is little incentive to sell products. “MLM” is a generic acronym for any type of multi-level or endless chain selling program, so for brevity, we will use ‘MLM’ most of the time.

No-product (cash-based) pyramid schemes are fairly easy to identify, and they seldom last long without law enforcement shutting them down. But when products are offered, and when consumers are presented with an income “opportunity” with multiple levels of “distributors,” it is not easy for some to decide whether or not it is in fact an exploitive pyramid scheme. Unfortunately, some of the most damaging MLM programs manage to escape legal action.

After processing extensive data and posting analytical reports on a web site, I found myself interacting with the top experts in the field. I began offering research and training through the non-profit Consumer Awareness Institute that I had formed years earlier for other projects – all financed out of my own pocket.

FTC rationale for considering pyramid schemes unlawful. The Federal Trade Commission Act states that “Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are

³² #178 FTC Matter No.: R11953 16 CFT Part 437 Notice of Proposed Rulemaking: Business Opportunity Rule, Comments #522418-12055, -58, -61, -66, -70, -74, -79, -83,-87, -92, and -96

³³ For a brief history of classic, no-product pyramid schemes, and MLM, or product-based pyramid schemes, see Chapter 10.

hereby declared unlawful.”³⁴ While the FTC Act does not specifically address pyramid schemes, such schemes have been deemed unlawful under the above clause in the Federal Trade Commission Act.³⁵

As will be demonstrated in subsequent chapters, using the same rationale, MLM should likewise be declared unlawful, as it is even more unfair and deceptive – and more viral and predatory – than are classic, no-product (cash-based) pyramid schemes.

For example, in a 1-2-4-8 no-product pyramid scheme, 14 persons lose their investment which goes to one person at the top. But in a typical MLM, or product-based pyramid, a handful of participants profit at the expense of thousands beneath them who lose money after paying for products, sales “tools,” and other business expenses. The average loss rate for MLMs is approximately 99.7%.

In fact, it can be demonstrated that the chances of profiting from a no-product (cash-based) pyramid scheme is at least 10-50 times as great as the odds of profiting from an MLM, or product-based pyramid scheme.³⁶ And over 100 typical misrepresentations have been identified that are used in MLM recruitment campaigns.³⁷

“. . . unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.” While the FTC does not specifically address pyramid schemes, such schemes have been deemed unlawful under the above clause in the Federal Trade Commission Act (FTC Act, Section 5). Using the same rationale, MLM should likewise be deemed unlawful, as it is even more unfair and deceptive, and more viral and predatory, than classic, no-product pyramid schemes.

MLMs are recruitment-driven. I refer to MLMs which recruit aggressively as “recruitment-driven MLMs,” as opposed to hypothetical “retail-focused MLMs,” which would allow a person to earn significant profits from retailing products to end users. Understanding the difference is the key to identifying the features in MLM that cause harm to participants – which will be explained in later chapters. Actually, retail MLMs would be extremely rare. In fact, I found no retail-focused MLM compensation plans out of hundreds that I have reviewed. So I feel justified in concluding they do not exist. Such a retail focus would contradict the basic nature of MLM as a business model.



Party plans do some retailing. The closest to a retail-focused MLM would be an “in-home demonstration” program, or “party plan,” which features sales at parties sponsored by demonstrators. But determining whether or not the party plan is still recruitment-driven and financed primarily through *In-home demonstrations* would require (“party plans”) on plans and average earnings data, which most such companies have not as yet been willing to provide to the general public. So they remain in somewhat of a grey area in my research.

Confusing comparisons. MLM is often compared to legitimate alternative business models, such as franchising, direct sales, insurance, and product distributorships. This adds confusion in the minds of consumers and law enforcement officials. However, my research suggests that clear differences can be seen.

As explained above, one common strategy for MLM companies to build credibility is to go to great lengths to be

³⁴ Section 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. 45(a)(1)

³⁵ In re Koscot Interplanetary, Inc., 86 F.T.C. 1106 (1975)

³⁶ See Chapter 7.

³⁷ See Chapter 8: “MLM – a Litany of Misrepresentations.”

identified as “direct sales” organizations. However, after rigorous comparisons of legitimate business models with compensation plans of “recruitment-driven MLMs”, when the four characteristics described below are taken together, clear distinctions between legitimate and illegitimate (using the FTC standard of “unfair and deceptive practices”) can be seen.

Interestingly, the four characteristics, which when taken together differentiate these programs from legitimate businesses, are the same features that cause an extremely high loss rate and other problems for participants. I call them “causal and defining characteristics of product-based pyramid schemes” because they both *cause* the harm and also serve to *define* MLMs as product-based pyramid selling schemes, or recruitment-driven MLMs. Properly applied, they can also be highly effective in identifying programs that violate federal and state laws against pyramid schemes.

Inadequate legal definitions. Most of the laws and statutes were crafted before the structure, dynamics, and effects of product-based pyramid schemes were fully understood, so the definitions within anti-pyramid statutes do not accurately reflect the root causes of the problems. They tend to focus on *behavior of participants*, rather than on *underlying structural features*.

However, there is enough validity in the present legal definitions of pyramid schemes in most jurisdictions that enforcement against such schemes can be effective if the principles in this paper are understood and applied. This is true regardless of the complexity of the compensation plan of any given MLM.

FTC guidelines and most state statutes include a *key element in defining pyramid schemes* – the payment of money by the company in return for the right to recruit other participants into the scheme. *If the primary emphasis is compensation from recruiting, rather than from the sale of products to end users, it is considered a pyramid scheme.* How such primary emphasis is to be determined has until now been a formidable challenge for investigators.

For some of the relevant terms used in discussions about MLM, go to Appendix 2A.

Persons investigating MLM must understand compensation plans and why they are so important. Decades ago, psychologists experimenting with both animals and people learned that *you get the behavior you reward*. For example, if you place a dog in a room with two bowls, the first containing a pound of beef, and the second an ounce of dry dog food, invariably the dog will choose to eat from the first bowl.



You get the behavior you reward.

Similarly, since an MLM compensation plan specifies how participants are rewarded, it reveals whether the primary income emphasis is on recruiting or on retailing – and therefore, whether or not a given MLM is a disguised pyramid scheme.

MLM spokesmen maneuver to divert authorities from examining how participants are rewarded. They speak of the validity of a company’s products, the integrity of its leaders, and the company’s solid financial condition. *It seems that the one thing MLM leaders do not want regulators to understand – the compensation plan – is the one thing investigators must grasp in order to answer the question of where the emphasis is – on company payout resulting primarily from recruiting (usually from commissions for product sales to downline recruits), or primarily from retailing to consumers outside of the MLM’s network of participants.* To dramatize the importance of concentrating on the compensation plan, rather than people or products, read and enjoy “The Parable of the Missing Children” in Appendix 9A (Chapter 9).

The problem of evaluating MLM programs is further complicated by a wide array of complex MLM payout formulas, or compensation plans. The problem of identifying emphasis on recruiting vs. retailing in a compensation plan, as well as consumer harm, can be greatly simplified by understanding the four characteristics discussed below – commonalities which are

generic to all MLMs, or product-based pyramid schemes. (There is also a fifth characteristic that appears in almost all MLMs which amplifies the fourth characteristic.) For explanations of various types of MLM compensation plans, go to Appendix 2B.

It is vital that we understand the commonalities and distinguishing features that separate MLM from all other forms of business activity.

MLM compensation plans can get quite complex. Appendix 2C illustrates just two examples out of hundreds of MLM compensation plans, showing the complexity of only a portion of a typical MLM compensation plan. Many of the plans are far more extensive and complex than these. This makes it difficult to compare plans from different MLMs. *These widely varying plans also illustrate the need for an understanding of the commonalities and distinguishing features that separate MLM from all other forms of business activity.*

What is the difference between recruitment-driven MLMs and (hypothetical) retail-focused MLMs? Companies with all four of the following characteristics of a product-based pyramid scheme can be classified as *recruitment-driven MLMs*, as differentiated from *hypothetical retail-focused MLMs*, which would primarily reward those who sell products. In reality, MLMs (with the possible exception of some party plans) are essentially closed systems, which sell products at retail primarily to program participants and cooperating family members – seldom to the general public.

These product purchases could be considered disguised or laundered investments in a product-based pyramid scheme. TOPPs (top-of-the-pyramid promoters), founders, and company executives are rewarded in commissions for the sale of products to a revolving door of unwitting downline recruits.

How these defining characteristics were derived. Early in my research, after comparative analysis, I was able to identify a list of characteristics that are common to all MLMs, including the 600 MLMs I have since analyzed. These were compared to characteristics of no-product pyramid schemes, as well as to legitimate businesses to which MLM is often compared, such as direct sales, franchises, distributorships, etc. (See Appendix 2D for details of this analysis.)

From this comparative analysis, a trained eye can see that when one focuses on the causes of the problems with MLMs, which are compensation plans with perverse reward features (enriching a few at the top at the expense of a huge downline who lose money), certain characteristics, or “red flags,” become apparent. Four key *characteristics* are both *causative* (causing high loss rates) and *defining* (clearly distinguishing pyramid schemes from legitimate businesses). I’ll refer to these causative and defining characteristics as “CDCs.”

The four characteristics (CDCs) of recruitment-driven MLMs are causal, defining, and legally significant. The set of four characteristics below were found to be exclusive to recruitment-driven MLMs (which included all MLMs in my sample of 600 programs). Based on careful analysis of available data, *MLM programs with all of these characteristics have a shocking loss rate – approximately 99.7%³⁸ of ALL participants lose money (after subtracting ALL expenses)! And if you eliminate TOPPs (top-of-the-pyramid promoters) from the calculation, the loss rate is closer to 99.9%. This is not a legitimate business by any reasonable measure.*

In the light of these odds, typical promises made by MLM promoters of lucrative incomes are misleading, except for a few at the top of the pyramid who got in early.

Again, it is important to recognize that –

- These four characteristics are *causal* because they identify the cause of the harm or consumer losses.
- They are *defining* because they clearly separate MLMs, or product-based

³⁸ See Chapter 7: “MLMs Abysmal Numbers”

pyramid schemes, from all other forms of commercial activity.

- And they are *legally significant* because they answer the question that law enforcement has not answered in cases before; i.e., how the *primary emphasis on income from recruiting* (as opposed to selling direct to consumers at retail prices) can be determined from the reward system (compensation plan) – rather than from complaints, which simply are too cumbersome and unreliable in this arena. Besides, as will be discussed in Chapter 9, victims of endless chains rarely file complaints with law enforcement.

It is the synergistic effects of these four CDCs working together in an MLM that cause the extraordinary loss rates characteristic of these schemes. Interestingly, *most of the laws that might implicate MLMs as pyramid schemes are based on one or more behavioral effects of the scheme (such as whether or not sales are made to non-participants) or behavior of participants, and not the essential causes of the problems; i.e., the underlying structure, or compensation plan. As explained already, rewards drive behavior.*

No wonder law enforcement has been so confused and inconsistent in this arena. Even so, using this analysis, law enforcement agencies can work within existing laws. Attempting to change the laws is risky, since the MLM lobby (Direct Selling Association) could then influence legislators to pass deceptive “anti-pyramid” laws that are actually favorable to MLM, as they have already done in several states.

Twenty years of research and feedback confirm this analysis, including a one-year experiential test, direct observations of numerous MLM opportunity meetings; communications with thousands of participants (and ex-participants and family members), executives from a variety of MLMs, and with consumers as MLM prospects; consultations with top MLM experts and attorneys; the collection and processing of available data (including official company reports); analysis of over 600 MLMs with all types of compensation plans; and surveys of consumers and tax professionals.

Four CDCs of recruitment-driven MLMs, or product-based pyramid schemes, cause the harm and clearly distinguish between MLM and legitimate direct selling and all other businesses:

1. Each person recruited is empowered and incentivized to recruit other participants, who are likewise empowered and motivated to recruit still other participants, etc. – in endless chains of empowered and motivated recruiters recruiting recruiters – without regard to market saturation.

When analyzing a program, prospects could ask: Is unlimited recruiting allowed, and are those who are recruited empowered and spurred on by incentives (such as overrides from downline purchases, rank advancement, etc.) to recruit additional participants, etc. – so that the effect is unlimited recruiting of empowered and motivated recruiters in an endless chain of recruitment?

This unlimited recruitment of endless chains of participants is the great underlying flaw in MLM. In fact, all pyramid schemes, chain letters, and MLMs have this unlimited recruitment characteristic in common. They also assume virgin markets, which don't exist for long – which means they either collapse or expand (“re-pyramid”³⁹) into new markets.

Since MLM depends on unlimited recruitment of endless chains of participants, it is fundamentally flawed, unfair, and deceptive. It is deceptive because prospects are sold on an income opportunity that is primarily an opportunity for those placed at the beginning of the endless chains of recruitment – usually those at or near the top of the pyramid of participants. New recruits are being sold a ticket to a flight that has already left the ground.

For important background information on the endless chain feature of MLMs, read the letters to FTC officials by Bruce Craig, former assistant to the Wisconsin Attorney General in Appendixes 2E and 2F.

³⁹ “Re-pyramid” will be explained in Chapter 3.

Exhibit 2a



CDC* (“Red Flag”) #1: Every MLM incentivizes unlimited recruitment of a network of endless chains of participants. This dependence on recruitment is not the case with legitimate direct selling, which focuses on sales to customers, not to the network of participants.



The endless chains of recruiters recruiting recruiters – works on the same principle as illegal “pay to play” chain letters or classic, no-product pyramid schemes.

***NOTE:** These CDCs (or “red flags”) are causative and defining characteristics of recruitment-driven MLMs, or product-based pyramid schemes. They are causative in that – taken together – they cause the extremely high loss rates suffered by participants, and they are defining in that they clearly define product-based pyramid schemes as differentiated from legitimate direct selling and other packaged business opportunities. **All 600 MLMs I studied demonstrated this characteristic in their compensation plans.**

MLM is also viral and predatory – rapidly expanding chains of recruitment from state to state and from country to country as it targets and defrauds the most vulnerable in the population. But it is sufficiently deceptive that even some people who should know better are victimized.

These features should have been sufficient grounds for the FTC to consider MLMs as unfair and deceptive practices, and therefore illegal. However, that opportunity was missed in the 1979 ruling that Amway was not a pyramid scheme, assuming certain “retail rules” were followed.

It is interesting to note that in the earlier Koscot case⁴⁰, the court noted, “*The Commission has previously condemned so-called “entrepreneurial chains” as possessing an intolerable capacity to mislead.*”⁴¹ This capacity has been demonstrated in literally thousands of MLMs (many now defunct) fashioned after the model of entrepreneurial chains which the FTC has allowed following the 1979 Amway decision. Unfortunately, this prophetic warning of an “intolerable capacity to mislead” was set aside, and the deceptions continued unabated. (See Chapter 8 for lists of at least 111 typical MLM misrepresentations.)

MLM promoters often argue that all organizations are organized as pyramids, with a few at the top and many at the bottom and with those at the top being paid the most. If this were the only distinguishing characteristic of a pyramid scheme, they would be right. But the endless chains of recruitment of participants as primary customers – with money to those at the top coming from purchases (amounting to losses) of those at the bottom – is far more accurate and discriminating.

So the stacking of recruits into a pyramid of participants for the purposes of payout is secondary to the chaining aspects. However, it should be noted that *in corporations and government organizations, even those at the very bottom at least earn a minimum wage – as opposed to all those on the bottom of a*

pyramid scheme actually losing money. A more apt analogy for MLM as an income opportunity would be that of an iceberg, instead of a pyramid. Those few who profit from MLM stick out like an iceberg, with the vast majority under water, or in a losing position, after subtracting expenses.

Had all forms of endless chain marketing schemes been declared illegal (as happened in Wisconsin in 1970, but seldom enforced since⁴²), this confusion over definitions would be minimal. Based on DSA data on worldwide sales by MLMs (which represent losses to 99% of participants) I estimate that *since 1979, aggregate losses totaling hundreds of billions of dollars by hundreds of millions of unwitting victims worldwide could have been prevented.* MLM in its present form would not have existed, and you would not be reading this.

The ill-fated Amway decision – and the “retail rules.” In 1979, FTC attorneys were outfoxed and outgunned by Amway attorneys. FTC Administrative Law Judge James Timony ruled that Amway was “not a pyramid scheme,” assuming the implementation of its “retail rules” that Amway claimed it would voluntarily enforce. These rules can be summarized as follows: (1) distributors were to sell or consume 70% of the products they purchased each month (refined in later court cases to mean sales to non-participants⁴³), (2) they must be able to prove a sale to each of ten customers each month, and (3) reasonable buy-back provisions would be permitted.⁴⁴ Though not enforced by the FTC or by the MLMs, these retail rules have been used as a benchmark in other MLM cases.

The rules were merely given lip service. In practice, the first two of these rules are unenforceable (in the present regulatory environment) and are generally ignored by MLMs. The Amway decision opened the floodgates for thousands of the most unfair, deceptive, viral, and predatory MLMs ever devised. Tens of millions of consumers

⁴⁰ In re Koscot Interplanetary Inc., 86 F.T.C. 1106, 1181 (1975), aff'd., Turner F.T.C., 580 F. 2d 701 (D.C. Cir. 1978)

⁴¹ Holiday Magic, Inc., Docket No. 8834, slip op. pp. 11-14 [84 F.T.C. 748 at pp. 1036-1039] (Oct. 15, 1974); Ger-Ro-Mar, Inc., Docket No. 8872, slip op. pp. 8-12 [84 F.T.C. 95, at pp. 145-149] (July 23, 1974), rev'd in part 518 F.2d 33 (2d Cir. 1975).

⁴² *Tax Returns of the Top Amway Direct Distributors in Wisconsin*, Bruce Craig, op cit

⁴³ Webster v. Omnitrition, IIB, filed in the Appeals court for the U.S. District Court for the Northern District of California, March 4, 1996. Also statements by FTC officials James Kohm and Debra Valentine – referred to later in this report.

⁴⁴ See 93 F.T.C. 618, 716-17 (1979).

recruited into MLMs worldwide will continue to pay heavy prices for that decision – unless FTC and/or state legislators and law enforcement officials muster the will to address the issue of widespread MLM abuse.

In spite of the confusion over definitions of what constitutes a pyramid scheme, much can still be accomplished within the present legal framework. This chapter focuses on clarifying those definitions and on identifying the combination of features in the compensation plan that cause the greatest harm.

Market collapse happens quickly.

MLM defenders argue that saturation never happens, which proves an MLM is not a pyramid scheme. But *total saturation* is absurd. Why would McDonald's need 100,000 fast food outlets in a city of 100,000 people? One or two may be adequate. So with MLM. *Market saturation* may be reached when a city has only five or ten distributors, with new ones finding it more and more difficult to recruit more participants.

Re-pyramiding to avoid market saturation and collapse. When pyramid promoters introduced product purchases as the means for financing their schemes (then dubbed “multi-level marketing”), some found ways to avoid ultimate collapse. First, MLM recruiters used a hard-sell approach to focus attention on the quality of the products, and away from endless chain recruiting.

As a second strategy, major MLMs introduce new product lines or divisions, enter new demographic markets or countries, or change the name of the company and introduce the package as a whole new company with a “different” product or service emphasis – as Amway did when it morphed into “Quixtar” in the U.S., while keeping the “Amway” name in overseas markets. Nu Skin shifted its recruiting to Asia to the point that 85% of its revenues came from Asia. And Nu Skin developed new product divisions, such as Interior Design Nutritionals (IDN), Big Planet (internet services), and Pharmanex, and Photo-Max – through which it could cycle new recruits. *This is a process I call “re-pyramiding,” i.e., opening new markets in other countries and/or by starting new product divisions and repeating the cycle all over again.*

Third, MLMs engage in aggressive and unlimited recruitment campaigns and use the DSA to influence public opinion to accept and define their recruitment schemes as legitimate direct selling opportunities.

And fourth, there is a revolving door of newly recruited participants who are constantly replacing those who quit. Thus, in MLM there is a continuous collapse of the base of the pyramid, involving the churning of newly recruited participants. This allows those at or near the top of the pyramid to maintain their positions and their high income levels.

It is through actions like this, indicative of continuous collapse, that MLMs, or product-based pyramid schemes, can survive longer without total collapse than no-product pyramid schemes. Losses from the continuous collapse of the pyramid are borne by the new recruits cycling through. Furthermore, because of the prolonged saturation and collapse, many more participants are adversely affected in product-based schemes than in no-product schemes.

Strategies used by MLMs to compensate for market saturation and to avoid market collapse will be discussed further in Chapter 3.

Are participants buyers or sellers?

Unlimited recruiting in MLMs also changes the marketing nature of the system from one of a network of “distributors” to a network of buyers. The normal distinction between buyers and sellers is blurred – even evaporated. The sellers are the buyers, and the buyers are the sellers – to themselves and their families. Also, we see the fallacy of the claim that MLM is removing the “middle man” in their marketing. Actually, in an MLM, middlemen may number in the thousands in multiplying downlines.

New MLM recruits buy products mainly to qualify for profits from recruiting others, rather than from any real need for the products or from any expectation of profit from retailing. And as people tire of being solicited, the perceived opportunity to find willing buyers eventually diminishes to a trickle. Since the retail market is a phantom one, in order to increase the base of recruiting prospects who will pay retail to “play the game,” we see promoters introducing new product divisions or opening up new markets to recruit in other areas.

Recruitment-driven MLMs engage in re-pyramiding to continue growing – and can become like Ponzi schemes. When MLM promoters re-pyramid into other areas to make it possible for the first investing participants to earn commissions from purchases of new recruits, the MLM can be said to have evolved from a pyramid scheme into a type of Ponzi scheme – which is illegal in almost all jurisdictions. Ponzi schemes are programs in which new investors are repaid, from the investments of new investors.⁴⁵ (The persons doing the selling remain the same.) In MLM, without re-pyramiding, into new markets, collapse is inevitable as market saturation makes future prospects resistant to participation.

MLM proponents argue that replacement of continual dropouts by ongoing recruitment is like other direct sales businesses. But this is a fallacy. Later recruits never have the same opportunity as earlier entrants due to market saturation.

Why is recruiting emphasized over retailing? Unlimited recruiting of recruiters, combined with the other factors explained here, creates enormous leverage. Rewards for recruiting a large downline are so much greater than for retailing products that participants see no point in spending time and effort retailing, except for token sales (often purchases in the names of relatives who become “counterfeit customers”) to satisfy “retail rules.” Again, “you get the behavior you reward.” The “primary emphasis on income from recruiting” test of a pyramid scheme is thus satisfied.

The following items summarize the evidence that recruitment-driven MLMs do not engender any significant retail market:

1. The compensation plan rewards the recruitment of a downline so well that there is little incentive to sell directly to consumers.

2. An analyst can subtract all incentivized purchases by new distributors and their families from total revenues from that area on the company’s financial report. If the volume left over is minimal, direct selling is not the major thrust of the company.

⁴⁵ *Ponzi Schemes, Invaders from Mars, & More Extraordinary Popular Delusions and the Madness of Crowds*, by Joseph Bulgatz, (New York: Harmony Books, 192), pages 11-45

3. Surveys of ex-distributors reveal that few continue buying the products after quitting. They recall that little if any direct selling occurred outside of the network of distributors and their own families. (Surveys of ex-distributors are more valid than those of current distributors, who may have contracted to do a limited amount of selling to non-participants to keep their distributor license.)

4. We know from surveys conducted in areas of intense MLM activity that few sales are made directly to consumers who are not in the network of participants.⁴⁶

5. Little if any direct selling continues in an area two or three years after an MLM finishes its recruitment blitz through the area.

6. To counter dwindling sales due to a drop-off in recruiting, the MLM engages in re-pyramiding; i.e., recruiting in other areas or shifting to new product divisions. MLM promoters can then sell to new recruits.

6. Signs of reporting inconsistencies can reveal a lack of direct sales. In the case of Nu Skin, sharp discrepancies appeared between U.S. revenues reported to the SEC and those reported to the FTC and to recruits in the amount of sales that were occurring at retail prices. This was blatant evidence of misrepresentation.⁴⁷

7. In my test of Nu Skin’s program, I saw over 400 Nu Skin distributors over a one-year period, but I can recall only one who made a serious effort to sell very many of Nu Skin’s expensive supplements directly to non-distributors. She sold to rich neighbors who were sympathetic to her desire to “succeed.”

For an excellent analysis of the problems resulting from the FTC’s allowing endless chain recruitment schemes (MLMs) to continue, read the letters written by Bruce Craig, former Wisconsin Assistant AG, to FTC Chairman Robert Pitofski⁴⁸ in Appendix 2F and to FTC economist Dr. Peter J. Vander Nat⁴⁹ in Appendix 2G.

⁴⁶ “Survey of Tax Preparers”, by Jon M. Taylor, (posted in 2004 on website for mlm-thetruth.com)

⁴⁷ *REPORT OF VIOLATIONS of the FTC Order for Nu Skin to Stop Misrepresenting Earnings of Distributors*, by Jon M. Taylor, filed with the FTC November 20, 2002 Since that time, Nu Skin has not reported retail sales that they could not prove had occurred.

⁴⁸ Dated February 20, 2000

⁴⁹ Dated April 24, 2001

Exhibit 2b



CDC* (“Red Flag”) #2: Advancement in a hierarchy of multiple levels of participants (“distributors,” “associates,” etc.) is achieved by recruitment and/or by purchase amounts, rather than by appointment.



MLM is all about getting in early - or climbing to the top of the pyramid - where the big money is made – just like any other pyramid scheme.

***NOTE:** These CDCs (or “red flags”) are causative and defining characteristics of recruitment-driven MLMs, or product-based pyramid schemes. They are causative in that – taken together – they cause the extremely high loss rates suffered by participants, and they are defining in that they clearly define product-based pyramid schemes as differentiated from legitimate direct selling and other packaged business opportunities. **All 600 MLMs I studied demonstrated this characteristic in their compensation plans.**

2. Advancement in a hierarchy of multiple levels of participants is achieved by recruitment and/or by purchases, rather than by appointment.

Ask: Does a participating “distributor” advance one’s position or rank (and potential income) in a hierarchy of multiple levels of participants by recruiting other “distributors” under him/her, who in turn advance by recruiting distributors under them, etc.? Or by buying products to qualify at certain levels in the compensation plan?

Rank advancement in the pyramid is determined not by appointment, but by time of entrance into the program, by recruiting success, and by volume of products purchased by one’s group. When recruited into such a program and then given incentives to buy products, participants are being “leveraged” for the profit of those above them. They may think they are advancing, when in fact they are often being manipulated into buying more products and recruiting more people to benefit those above them.

Are MLM “distributors” really distributors? When the pay plan rewards recruits far more for recruiting others than for selling products or services, and when purchases are “incentivized,” or tied more to advancement in the scheme than to the sale of products and services to non-participants, it is a misnomer to refer to them as “distributors.” (or “representatives,” “associates,” etc.) It is more correct to refer to them as “investing participants.”

Correctly viewed, an accumulation of such incentivized purchases over a period of time constitutes a substantial investment in a pyramid scheme. (See #3 below)

Participants are typically not wise business managers so the customary subtraction of all costs from revenues to figure profits is ignored – including products and services from the company. Such purchases would be made from less expensive sources if serious comparison shopping were done.

Close examination reveals that *both advancement and income are dependent primarily on downline recruiting and on “internal consumption”* (sales to participants in the scheme). If participants must recruit and buy products to be successful, and if

the pay plan’s primary rewards are for building a downline, it should be considered an illegal pyramid scheme.

Exception – Selected distributors given priority. Often during the startup of a new MLM, or when an MLM enters a new country, selected distributors, or TOPPs (top-of-the-pyramid promoters), are assigned top positions arbitrarily by the founders. Nepotism sometimes appears, such as when favored positions are extended to family members of the founders. This is unfair to those who come in later, who must aggressively recruit and buy products to have any hope of advancing to the top where the money is made.

3. “Pay to play” requirements are met by ongoing “incentivized purchases” and/or recruitment minimums, with participants the primary buyers.

Ask: Are “distributors” who are recruited presented with significant “pay to play” options; i.e., are they encouraged to make initial or ongoing investments in “incentivized purchases” and/or to satisfy recruitment minimums, in order to take advantage of the “business opportunity,” and to continue qualifying for advancement in – or overrides and bonuses from – the MLM company?

What are “incentivized purchases?” – or “pay-to play”⁵⁰ purchases – or “pay for your paycheck”? I coined the term “incentivized purchases” to refer to the practice of tying purchases of products from an MLM company with requirements to enter the “business opportunity” option, to qualify for commissions, and to qualify for rank advancement in the hierarchy of “distributors” – who are in effect merely participants making pyramid scheme investments disguised (or laundered) as purchases. They are also called “pay to play” purchases. (See Appendix 2A for definitions of relevant terms.)

Incidentally, William Ackman in his attack on Herbalife used very descriptive term for this feature – “pay for your paycheck.”

⁵⁰ This insight resulted from discussions with Kristine Lanning, former assistant to the Attorney General for North Carolina.

Exhibit 2c



CDC* (“Red Flag”) #3: “Pay to play” requirements are met by ongoing “incentivized purchases,” with participants the primary buyers.



MLM participants subscribe to minimum product purchases in order to "play the game" – to qualify for commissions and to gain or maintain advancement in the scheme.

***NOTE:** These CDCs (or “red flags”) are causative and defining characteristics of recruitment-driven MLMs, or product-based pyramid schemes. They are causative in that – taken together – they cause the extremely high loss rates suffered by participants, and they are defining in that they clearly define product-based pyramid schemes as differentiated from legitimate direct selling and other packaged business opportunities. **All 600 MLMs I studied demonstrated this characteristic in their compensation plans.**

Percentage of revenues accounted for by internal consumption – a key legal issue. In pyramid scheme cases, the percentage of purchases accounted for by participants' personal consumption – as opposed to sales to non-participants – has become a litmus test for determining if an MLM is an illegal pyramid scheme. MLM executives may attempt to excuse lack of evidence of retail sales by pointing to company rules that require sales to non-participants as proof of such sales. However, the existence of “rules” aimed at encouraging retail sales and discouraging inventory loading will not protect a company from being an illegal pyramid scheme if not properly incentivized and adequately enforced.⁵¹

Investing in the form of incentivized and ongoing product purchases could be considered a device for disguising or laundering pyramid scheme investments.

How much is actually invested in the scheme? MLMs typically charge a nominal fee to be licensed as a distributor. This is usually less than \$100 to avoid raising the eyebrows of law enforcement officials – and to escape subjecting the MLM program to more strict guidelines as a franchise, security, or “business opportunity.”

However, in the typical scenario, the fee for initial registration is merely the beginning of the total MLM investment. One must add incentivized ongoing purchases, which may total hundreds, or even thousands of dollars a year.⁵² They

⁵¹ *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181 (1975), *aff'd.*, *Turner v. F.T.C.*, 580 F.2d 701 (D.C. Cir. 1978); *In the Matter of Amway Corp.*, 93 F.T.C. 618 (1979); *Webster v. Omnitrition*, 79 F.3d 776, 781 (9th Cir. 1996); *United States v. Gold Unlimited, Inc.*, 177 F.3d 472, 480-81 (6th Cir. 1999); *F.T.C. v. Equinox, Int'l. Corp.*, 1999 U.S. Dist. LEXIS 19866, *15 (D. Nev. Sept. 14, 1999); *People v. Cooper*, 166 Mich. App. 638, 651-52; 421 N.W.2d 177 (1987); *Koscot Interplanetary, Inc. v. Draney*, 90 Nev. 450, 530 P.2d 108 (1974); Section 5 of the FTC Act; M.C.L. 750.372; N.R.S. 598.100, et. seq.

⁵² The minimum 100 PV (personal volume) for Quixtar (Amway) participants was “roughly equal to \$260/mo.” (\$3,120 per year) . . . and “because Quixtar’s overpriced products are not sellable to anyone except through distributors who are buying to qualify for bonuses, Quixtar distributors’ earnings are a direct function of how much product they and their downline consume. The more internal

constitute a substantial portion of the cost of participating in the “business opportunity.” Whether they are used, sold, given away, or stored, is irrelevant to the analysis.

Escalating incentives to continue purchasing products to qualify for higher commissions rates and/or ever-higher levels in the hierarchy of participants often lead “distributors” to hyper-consume products or to give away a lot of samples. Many fill their garages with products they don’t need. The argument that they would have purchased the products anyway, and that these purchases should not be considered an expense of doing business, does not hold water. Upon quitting, most cancel product subscriptions.

So when participants are expected to make product investments to get into an MLM – and then to continue purchasing products (by subscription), training, etc., in order to achieve rank advancement, *they are paying pyramid investment fees to “play the game,” one of the earmarks of a product-based pyramid scheme.*⁵³

If participants subtracted purchases and the operating costs of recruiting from commissions, they would find a high breakeven bar rarely exceeded by revenues. In other words, almost all participants below the TOPPs lose money.

Why are incentivized MLM product purchases not widely recognized as investments in a pyramid scheme? Most MLMs offer lucrative incentives for recruiting an increasing number of “distributors” (or other term for participants) and for revenues from product sales. So many participants recruit “dummy distributors” from friends and relatives and buy products in their names – or simply buy products for them as “counterfeit customers.” They believe this will qualify them for “the really big bucks.” Few realize that they have in effect paid a very large fee for participation in a pyramid scheme. Through a variety of misrepresentations about the “opportunity,” large sums of money may thus be extorted from them.

consumption and the larger the downline, the higher the bonus.” (Complaint and demand for jury trial, US Dist. Ct., Central District of Calif., Western Div., Case No. CV 07-05194), § 97)

⁵³ *In FTC v. Amway* (1979 – 142-145), *Webster v. Omnitrition* (Discussion on “Pyramid”), and *FTC v. Skybiz* (29)

Such an amount paid in cash at the start into a no-product pyramid scheme would immediately arouse suspicions of its' being an illegal pyramid scheme. But since the money paid into an MLM is paid for legitimate products and over a period of time, most participants and investigators fail to see it as an investment in a pyramid scheme. In reality, this means of investing in the form of incentivized and ongoing product purchases could be considered a device for disguising or laundering pyramid scheme investments.

MLMs typically sell overpriced potions and lotions touted to prevent or cure a wide range of maladies. This could be compared to a bushel of apples selling for \$20 a bushel. The seller paints blue stripes on them and sells them for \$80 – \$60 more because of the “magical properties” attributed to the blue stripes – the old “snake oil” pitch.

Many MLM products are sold at a premium so that commissions can be paid to many levels of distributors. If an MLM product were sold for \$20 more than a comparable one sold through other outlets, this \$20 premium could be considered the pyramid investment portion of the price, which would flow to the top of the hierarchy of participants in typical pyramid fashion.

Do MLM participants sell products at listed retail prices to non-participants? MLM promoters have convinced many regulators that MLM distributors sell a significant amount of products to persons not participating in the scheme. In most MLMs, this is patently false. We know from surveys conducted in areas where intense MLM activity is occurring that few sales are made directly to consumers who are not connected to the recruitment scheme. As discussed earlier, in a randomized survey of households in Utah County, Utah,⁵⁴ where many MLMs are located, *we found four MLM distributors for every one non-participating customer.*

It is generally motivated participants who are induced into paying for overpriced “pills, potions, and lotions” typically sold by MLMs.

We know from surveys that few sales are made directly to consumers who are not connected to the recruitment scheme. It is generally motivated participants who are induced into paying for overpriced “pills, potions, and lotions” typically sold by MLMs.

A startling admission. We usually see a “wink-wink, nod-nod” attitude of MLM promoters on how they get participants to purchase most of the products from the company. “Pay-to-play” or incentivized purchases play a bigger role than most are willing to admit. But occasionally the truth leaks out. Consider this quote from Advocare’s “Policy and Procedures” manual regarding its compensation plan:

You may choose any method you like to achieve Advisor status. These examples point out the practical reasons you always want to track your volume if you think you’re close to qualifying Advisor status – and *if necessary, cover the \$500 Personal Volume with your own purchases.*⁵⁵

“ . . . if necessary, cover the \$500 Personal Volume with your own purchases.”
– *Advocare P&P manual*

MLM not recognized as legitimate selling. Additional evidence that little actual direct selling takes place in MLM can be found on the business shelves of any bookstore. I searched the contents of books on salesmanship of major bookstores and found no mention of MLM or multi-level or network marketing as an arena for professional salespersons. The only exceptions were when networking (not MLM) was discussed, and only when a professional sales person mentioned a bad experience with MLM on his way to becoming a real

⁵⁴ Randomized survey conducted in Utah County, Utah, by Consumer Awareness Institute, 2004

⁵⁵ (Advocare) “Policies, Procedure, and the Compensation Plan” (Rev. 10/21/08), “Section II: The Compensation Plan,” Chapter 4: “Advancing to Advisor,” p. 20.

salesperson⁵⁶. And even in the books that Zig Ziglar (who has written on MLM⁵⁷) has written on salesmanship, he is careful not to include MLM as a form of selling. Apparently, MLM is only respectable to those doing it.

When as a young man I sold encyclopedias to help pay my way through college, it was not a requirement that I buy a set for myself or to meet a certain quota in order to qualify for commissions. And later, as an insurance agent, I was not required to buy the insurance I was selling. This would not be true in an MLM, which depends for much of its revenues on minimum purchases by participants who buy to qualify for commissions and/or rank advancement.

For a list of criteria to distinguish between MLM and legitimate direct selling, see Exhibit 2f: *“Does Multi-level Marketing” Qualify as a Form of Direct Selling? – a 7-Point Checklist.”*

How recruitment-driven MLMs kill their own retail market. In many MLMs, purchases at inflated retail prices are primarily made by new recruits as a form of entry fee – after which they pay wholesale for products. Recruiters at MLM opportunity meetings often kill their own retail market. Why would anyone pay full retail price when there are plenty of “distributors” who would gladly sell at wholesale prices to meet their “pay to play” quota of purchases?

Most ex-distributors of MLMs I have interviewed have said they cancelled automatic bank draft payments for monthly product shipments or sharply reduced purchases from the company following their quitting an MLM. This supports the conclusion that the retail market for the products is more contrived than real. “Pay to play” purchases usually cease upon termination.

What about the refund policy of MLMs? Many MLMs have a 30-day or one-year return policy, allowing for a refund for unused and unopened merchandise, minus a small re-stocking fee. While this sounds acceptable to recruits and regulators, hundreds of interviews with ex-distributors lead to the conclusion that this offers little actual protection to participants. It is extremely rare for MLM

victims to recognize the fraud in an MLM without intensive de-programming by a knowledgeable consumer advocate. They have been told by their upline that anyone can succeed and are conditioned to blame themselves – not the MLM program – for their “failure.” And many have opened their product packages to sample or share the contents, so they don’t “qualify” for a refund. Or they may fail to qualify on other technicalities.

“Tools for success” – or just more money down the drain. Top distributors may sell “tools” (books, audio/video training, etc.) to aid recruits in “building their business.” Their message to participants is that if they are not succeeding in selling products or recruiting a downline, it is because they are not doing it right – not because the program itself is inherently flawed. If they want to be successful, they need the proper “tools.”

The sellers of these tools may make more money on them than on the sale of products to or through their downline. While not required “pay to play” items, some upline promoters will not provide training and other support to downline participants who do not buy the tools. So these tools become in fact a necessary cost to “play the game” – further reducing the likelihood that these hapless recruits will realize a profit.

Incentivized purchases are typical of a pyramid scheme. On the FTC web site is an article entitled *“The Bottom Line about Multi-level Marketing Plans.”*⁵⁸ Under the heading “Evaluating a Plan,” the following advice is given: *“Beware of plans that ask new distributors to purchase expensive products and marketing materials. These plans may be pyramids in disguise.”*

The FTC ruling that Amway was not a pyramid scheme was conditioned on the assumption that its “retail rules” would be enforced. Yet it was disclosed in a recent California case involving Quixtar’s (Amway’s) “top guns” that **only 3.4% of sales were to non-participants!**⁵⁹

⁵⁶ *The Sales Bible: The Ultimate Sales Resource*, by Jefferey Gitomer (John Wiley & Sons, Inc., N.J., 2003)

⁵⁷ Ziglar, op cit

⁵⁸ www.ftc.gov

⁵⁹ Notice of Errata re exhibits E, F and G to Affidavit of Billy Florence submitted with complaint, US Dist. Ct., Central District of Calif., Western Div., Case No. CV 07-05194), § 97) p. 13

It was disclosed in a recent California case involving Quixtar's (Amway's) "top guns" that only 3.4% of sales were to non-participants!

In summary, MLMs typically require significant purchases in order to participate in the financial rewards outlined in the compensation plan. While the actual enrollment fee may be small, the cost to qualify for commissions and rank advancement can be substantial. This is one of the earmarks of a pyramid scheme, as opposed to legitimate direct selling.⁶⁰

CAUTION: Many MLMs are now claiming they have no "pay-to-play" requirement, or that there is little or no cost to join. However, there is always a requirement for full participation that leads to more money for the company and for TOPPs. It may be a requirement for a certain number of recruits, some of whom will do the same and eventually buy products to advance in the scheme. In these cases, we could call them "play to pay" schemes, but the effect is the same.

If participants must recruit and buy products to be successful, or if the pay plan's primary rewards are for building a downline, it should be considered an illegal pyramid scheme

4. Company payout (in commissions & bonuses) per sale for the total of all upline participants equals or exceeds that for the person selling the product – resulting in inadequate incentive to retail and excessive incentive to recruit. This is what is meant by a "top-weighted" pay plan.

Ask: Would a "distributor" purchasing products for resale receive less in total payout (in commissions, bonuses, etc.) from the company as would the total of all upline participants? In other words, does most of the money paid to distributors go to those at the higher or lower levels in the pyramid of participants?

While the previous three features are fairly easy to identify, this one requires understanding of alternative distribution models and complex incentives in the MLM pay plan. Group bonuses and other incentives must be factored in to determine actual payout per sale. Sometimes the bonuses come in the form of larger discounts or higher commissions per sale at higher levels.

Why does this "top-weighted" feature of recruitment-driven MLMs discourage retailing of products to end-users? MLMs offer small rewards to front line "distributors" for selling products, which are usually overpriced to support the large network of participants. So to achieve significant income one must recruit a large downline from which to draw commissions from their combined purchases.

This "top weighted" characteristic, more than any other, determines whether a program is biased towards recruitment or towards retailing (direct selling to end users). It is also an important red flag signaling an illegal pyramid scheme in most jurisdictions because it shows a primary emphasis on compensation from recruitment rather than from sales to end users who are not participating in the scheme.

For a more complete discussion of why MLM compensation plans are so top-weighted, read "My explanation for the extremely unfair income distribution in MLM" in Chapter 7. Note especially Exhibits 5a&b).

⁶⁰ In *FTC v. Amway* (1979 – 142-145), *Webster v. Omnitrition* (Discussion on "Pyramid"), and *FTC v. Skybiz* (29)

Why is this top-weighted feature one of the main problems with MLMs? MLM compensation plans of recruitment-driven MLMs lead to extreme inequality in company payout to participants. There are a few “winners” who profit at the expense of a multitude of “losers.” When plotted on an income distribution chart, the graph resembles a candlestick, with a handful on the left receiving huge earnings, and a multitude of participants to the right losing money.

For example, Nu Skin has published average income figures of its distributors, having been ordered by the FTC to cease its misrepresentations of distributor earnings. Based on its own report entitled “2011 Nu Skin Enterprises, Inc. Distributor Compensation Summary,” on discussions with top executives and high level ex-distributors, and on my one-year experiential test of their system, I concluded the following:

At best, one out of about 3,000 distributors profited; i.e., received more in commissions than they spent on products and minimum operating expenses. But of those few who profited, only a few netted anywhere near the average incomes that promoters at opportunity meetings stated were earned by “Blue Diamond” distributors. It is likely *that less than one in 10,000 new recruits received the potential Blue Diamond incomes held out to them!* All others just “didn’t try hard enough.”

Often these “losers” will invest considerable amounts of time and money and then quit, blaming themselves. But their “failure” is due not so much to their lack of effort, as to an exploitive and unfair system, which dooms approximately 99.7% of all participants⁶¹ (including dropouts) to losses – after subtracting “pay to play” purchases and minimal operating expenses. A 99% loss rate would not be so serious, except that in MLM opportunity meetings, the program is typically touted as the path to financial freedom, or “time freedom,” and the earnings of top distributors is posted – but with no mention of the abysmal odds of getting there.

In legitimate direct sales programs, it is typical for successful commissioned sales persons to receive more income than their sales managers. This is because the person doing the selling usually makes more in

commissions per sale (often 20-40%) than managers two or three management levels above him or her. But the distribution of commissions in MLM programs is upside-down from legitimate direct selling. Upline distributors several layers removed from the actual sale may receive as much or more in commissions and bonuses per sale from the company as the person who actually sold the product. The latter may only get a sales commission of 5-15% from the company⁶² – not enough to make selling profitable, even if the products were priced competitively.

Since the total payout per sale is limited, when upline participants receive substantial income in overrides from downline purchases, this tightens any resale margin and limits the percentage of commissions to any participants selling products to actual customers. So the potential income of front line “distributors” is extremely limited, forcing him or her to recruit a large downline in order to realize a significant income from commissions on downline purchases. Powerful incentives are at work to recruit a downline of hundreds, even thousands, of participants.⁶³

This “top-weighted” characteristic is an important red flag signaling an illegal pyramid scheme in most jurisdictions because it shows a primary emphasis on compensation from recruitment rather than from sales to end users who are not participating in the scheme.

⁶¹ To see how this was calculated, see Chapter 7.

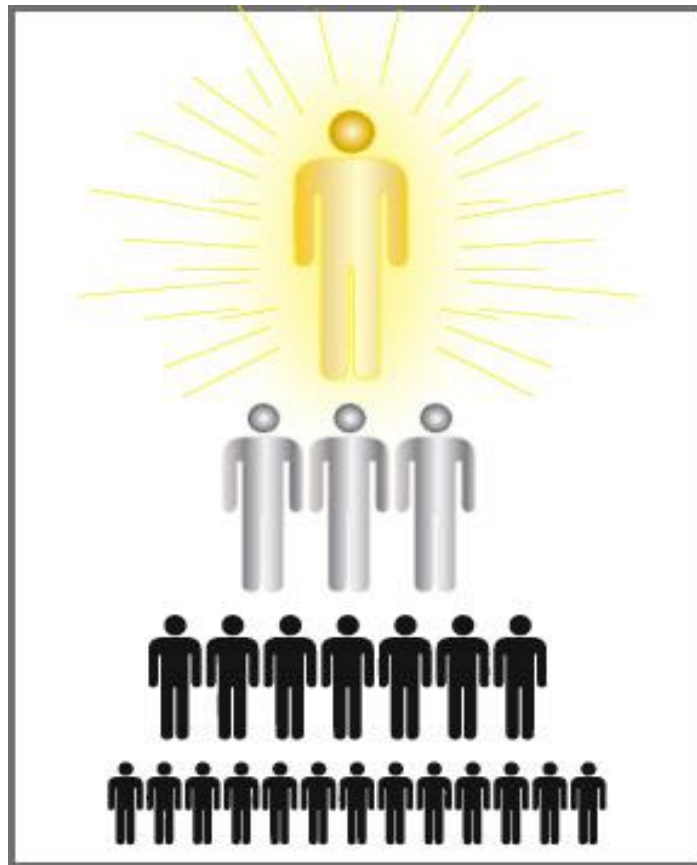
⁶² Again, read “My explanation for the extremely unfair income distribution in MLM” in Chapter 7, noting especially Exhibits 5a and 5b.

⁶³ For examples of complex top-weighted compensation plans, see Appendix 2C. Nu Skin is one of the most top weighted of MLMs.

Exhibit 2d



CDC* (“Red Flag”) #4: Company payout (in commissions & bonuses) per sale for the total of all upline participants equals or exceeds that for the person selling the product – resulting in inadequate incentive to retail and excessive incentive to recruit. This is what is meant by a “top-weighted” pay plan.



MLM’s typically top-weighted compensation plans disproportionately reward founders and TOPPs (top-of-the-pyramid promoters – at the expense of those at the bottom levels.

***NOTE:** These CDCs (“red flags”) are causative and defining characteristics of recruitment-driven MLMs, or product-based pyramid schemes. They are causative in that – taken together – they cause the extremely high loss rates suffered by participants, and they are defining in that they clearly define product-based pyramid schemes as differentiated from legitimate direct selling and other packaged business opportunities. **All 600 MLMs I studied demonstrated this characteristic in their compensation plans.**

Can't low commissions to front-line distributors be offset by retailing products at marked up retail prices? MLM promoters claim “distributors” who buy MLM products at wholesale prices can then sell them at a higher retail price, such as in conventional retail outlets, which allow for a retail profit margin. MLM communicators then go to great lengths to assure regulators that they are legitimate direct sales operations and that participants can make money buying wholesale and selling products at retail prices. They also tout the unique qualities of their products to justify the high prices they must charge to pay commissions on huge pyramids of participants.

The problem is that suggested retail prices for MLM products are generally too high to be competitive with other outlets. So MLM “distributors” purchase large quantities for themselves and their families and/or sell products at wholesale prices to downline participants and others in order to meet volume requirements for bonuses or discounts at different levels. Again, the payment of full retail listed price generally occurs with new recruits who are “buying into” the system. This is how they “pay to play” (the game).

How does this feature distinguish recruitment MLMs from (hypothetical) retail-focused MLMs? *This “top weighted” characteristic is primarily what would separate recruitment-driven MLMs from “retail-focused MLMs” – if such were to exist. Retail-focused MLMs would make it possible for participants to make money from the sale of products with only a small downline of participants, or with none at all – by assigning the majority of commission payments to front-line distributors for actual sales, as is the case in legitimate direct selling or retail settings.*

However, out of over 600 MLM programs I have analyzed, I did not find any that could clearly be classified as retail-focused MLMs. Possible exceptions are the party plans that emphasize income from the sale of products at in-home parties, though they may allow for recruitment of a downline. But even then, one must look at the compensation plan to see if the program is so top-weighted as to encourage recruitment and self-consumption over selling to the general public.

In summary, this “top-weighting” of MLM compensation plans is what drives

TOPPs to feverishly build their downlines; i.e., to recruit a revolving door of new recruits who buy products in order to participate in the “opportunity.”

5. In addition to the four CDCs above, nearly all MLMs also have a fifth CDC, making it even more top-weighted. The MLM company pays commissions and bonuses on more “distributor” levels than are functionally justified; i.e., five or more levels, which only further enriches those at the top of the pyramid.

Ask: Does the company pay overrides (commissions and bonuses) to distributors in a hierarchy of more levels than are functionally justified; i.e., five or more levels?”⁶⁴

For even the largest of conventional distributor arrangements, the entire U.S. can be covered by four supervisory levels in the sales hierarchy; e.g., branch managers, district managers, regional managers, and national sales manager. More than that is superfluous and bloated, driving up prices and making sales at a competitive retail markup unrealistic and unprofitable.

Why do five or more levels signal a recruitment-driven MLM? There is seldom any functional justification for five or more levels in an MLM hierarchy of participants. other than to encourage recruiting and the illusion of very large potential incomes – which only a few enjoy.

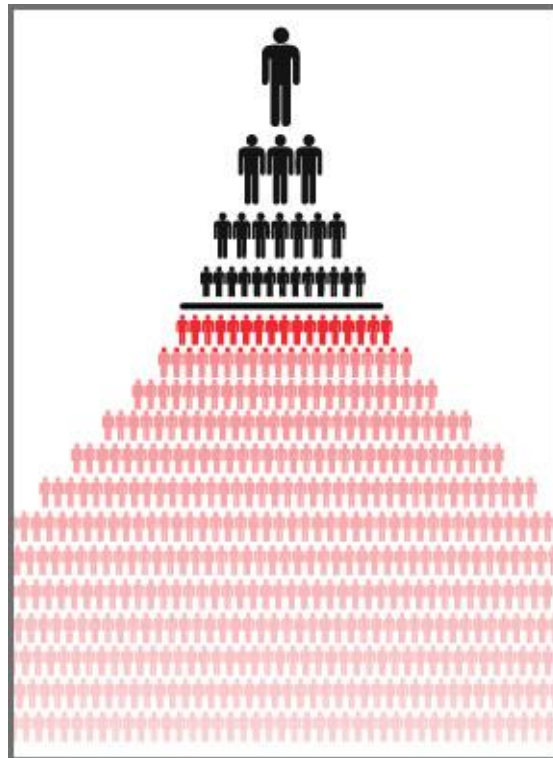
Combined with other factors, this feature hugely enriches those participants at the top of the pyramid at the expense of those beneath them, 99% of whom lose money. Such exorbitant incomes result from the reaping of huge overrides from the combined product investments of as many as thousands of downline participants, which increase exponentially with each added level. It is a money transfer scheme – transferring money from those at the bottom to those at the top.

⁶⁴ For this insight, I am indebted to Douglas M. Brooks, a Boston attorney, who has for many years worked on cases related to franchises and MLMs.

Exhibit 2e



CDC* (“Red Flag”) #5: In addition to the four CDCs above, nearly all MLMs also have a fifth CDC, making it even more top-weighted. The MLM company pays commissions and bonuses on more “distributor” levels than are functionally justified; i.e., five or more levels, which only further enriches those at the top of the pyramid.



More than four levels in the compensation plan exponentially enriches those at the top with the addition of each additional level – at the expense of those who invest at the bottom. The primary customers are those in the downline, making the MLM merely a money transfer, or product-based pyramid scheme.

***NOTE:** These CDCs (“red flags”) are causative and defining characteristics of recruitment-driven MLMs, or product-based pyramid schemes. They are causative in that – taken together – they cause the extremely high loss rates suffered by participants, and they are defining in that they clearly define product-based pyramid schemes as differentiated from legitimate direct selling and other packaged business opportunities. All 600 MLMs I studied demonstrated the prior four characteristics in their compensation plans, and most included this fifth characteristic. Those that did not make up for it by extra rewards paid to those at the top levels.

It should be noted that in the aforementioned 1979 FTC v. Amway ruling, the prosecution had argued that *as the number of levels in an MLM compensation plan increased, so did the opportunity for fraud*. It is interesting that in 1979, Amway had ten payout levels. By 2008, the number of levels had increased to an astonishing 22 levels! But no one at the FTC noticed this worsening of Amway's highly leveraged compensation plan.

Generally, but not always, this characteristic of excessive payout levels is a key feature (other than products for sale) separating many recruitment-driven MLMs from classic, no-product pyramid schemes. The latter typically pay on only four or five levels before the person atop the pyramid collects and moves on to start a new pyramid. It also helps explain why the loss rate for MLMs is much higher than for classic, no-product pyramid schemes.

How does extreme leverage result from excessive payout levels? MLM promoters refer to such residuals as "leverage" – large company payouts, disproportionate to effort expended, to top-level participants. The effects of leverage can be illustrated in a downline of six levels of participants. For example, assume that a "distributor" recruits five "active distributors," each of whom recruits five more, and so on through six levels of distributors.

We see the pyramid grow exponentially:

Level 1: 5 distributors
x \$5 in commissions & bonuses = \$25/month

Level 2: (5x5=) 25 + 5 = 30 total distributors
x \$5 " " " " = \$150/month

Level 3: (25x5=) 125 + 30 = 155 total distributors
x \$5 " " " " = \$775/month

Level 4: (125x5=) 625 + 155 = 780 total distributors
x \$5 " " " " = \$3,900/month

Level 5: (625x5=) 3,125 + 780 = 3,905 total distributors
x \$5 " " " " = \$19,525/month

Level 6: (3,125x5=) 15,625 + 3,905 = 19,530 total distributors
x \$5 " " " " = **\$97,650/month!**

If each "distributor" were to buy enough products each month to yield an override of \$5 in commissions and bonuses to the

original upline distributor, then with a five-level downline, the upline distributor gets \$19,525 per month, while with a six-level downline the same distributor can get \$97,650 per month – five times as much as for five levels. The incentive to recruit to get to the sixth level becomes enormous. Of course, it seldom works out that way, but this illustrates why recruiting is emphasized over selling products to persons outside the pyramid. An income of \$97,650 is far more appealing to a Level 1 participant than \$100 that might be earned by selling the products at the full retail price (assuming \$20 markup on products sold to each of five customers).

The FTC prosecution argued that as the number of levels in an MLM compensation plan increased, so did the opportunity for fraud (FTC v. Amway). But no one at the FTC noticed that the number of levels since that time has more than doubled at Amway.

Compared to recruiting, selling products at full retail price becomes a waste of time in such a system. The incentive to recruit to move up a level becomes very great. Again, one can see that the legal requirement of "primary emphasis" on income from recruiting fees (in the form of downline purchases) is satisfied.

In legitimate direct selling or retailing operations, management looks at what value each link in the distribution chain contributes to a profitable operation. They are always on the lookout to streamline operations, not to cut profits by adding more levels of sales management. Rational corporate behavior in this scenario would be to quickly jettison passive commission recipients in their distribution chains, not recruit more. But with a MLM, the opposite is true – the more levels, the better, thus exponentially enriching those at the top, who recruit aggressively to maximize their gains. Also, company revenues are enhanced by recruitment more than by sales to end users.

Exploitive breakaway compensation plans – legal or not? One category of compensation plans, the “breakaway” deserves mention, as it is so highly leveraged that the losses of participants are staggering.

In a breakaway system, the levels in the hierarchy are made up, of “breakaway organizations” (or pyramids) – groups of participants who have met requirements to “break away,” allowing a small commission override from all participants in the breakaway unit. So a hierarchy of six levels is actually six levels of *groups* of participants, which makes it a constellation of pyramids within a giant mega-pyramid – with most of the payout going to TOPPs.

The extreme loss rate results from each profitable top-level “distributor” being supported by a downline of many groups of participants (often totaling thousands), almost all of them victims who lose money – after subtracting purchases and other expenses. In my opinion, MLMs with breakaway compensation plans are the most extreme and exploitive type of pyramid scheme and therefore should be illegal.

“Australian two-up,” and other schemes that limit the number of levels for payout, make up for it in other ways. The fact that an MLM compensation plan limits the number of levels upon which any distributor can be paid overrides from the company does not negate the “endless chain” feature of the scheme. For example, in “Australian two-up” plans, new recruits must forfeit commissions for the first two sales to an upline sponsor before qualifying for commissions. The mathematical impossibility of later recruits enjoying the same financial benefit as earlier participants is apparent. It should be noted that 2-up recruits who fail to recruit two others become in effect the downline of someone above them. This could continue for several levels.

These four CDC’s confirmed by industry-wide research

In 100% of the compensation plans of over 600 MLMs I have analyzed, I found at least the first four of the five causal and defining characteristics (CDCs) discussed above, and the fifth CDC exists for the vast

majority of them. These pay plans are clearly recruitment-driven and top-weighted, meaning they are driven by incentives to recruit, with company payout of commissions (after “skimming” by founders) going primarily to a select few “TOPPs” (top-of-the pyramid promoters) who are often those who were positioned at or near the beginning of the recruitment chain.

Where data was available, I found loss rates averaging about 99.7%.⁶⁵ A list of the MLMs for which I have analyzed the compensation plans and which displayed at least the four of the five causative and defining characteristics of recruitment-driven MLMs is found in Appendix 2E.

The same four CDC’s are found in all no-product (cash-based) pyramid schemes as in all MLMs. It is important to recognize that *the structural elements CDCs of both no-product and product-based pyramid schemes are identical. To ask if an MLM is a pyramid scheme is like asking if a hybrid vehicle is a car. It may have advanced features, but it’s still a car. So with MLM, which is merely an elaborate form of a pyramid scheme.*

MLM not legitimate direct selling.

Based on the above CDCs, of the over 600 MLMs we analyzed, none qualified as legitimate direct selling. (To clearly separate MLM from legitimate direct selling, review again the 7-point checklist in Exhibit 2f.) I should also note that these four CDCs exist in none of the hundreds of alternative income options I have reviewed over many years of teaching and researching in the field of income or business opportunities.

Harmful effects of MLMs

MLM compensation plans with all of the characteristics discussed above inevitably lead to the following negative effects:

1. *Loss rates are extremely high – far worse than for legitimate direct selling. See comparison in Exhibit 2g, which is based on*

⁶⁵ Chapter 7, Exhibit 7d

data from Nu Skin's reports – and similar to those in other MLMs analyzed in Chapter 7. To those who understand the numbers, this is the harm that is most objectionable – especially in light of the MLM being presented as a profitable income opportunity.



For nearly all MLM participants, money paid out exceeds money coming in.

Because of the extreme leverage in the compensation plan, the founders, early entrants into the program, and a few TOPPs get huge gains – who are held up as examples for all to see. But for the vast majority of participants, actual profits are rare.

When discussing average income of MLM participants, it should be noted that there are three statistical measures used to indicate “average” – the mean, median, and mode. The most talked about is the arithmetic mean, or the aggregate income of all divided by the number of participants – which is negative if all recruits are counted and minimal expenses (including incentivized purchases) are subtracted.

The median, or middle measure, for all MLMs I have studied is zero or less. And the mode, or most common measure, is also zero or less. Also, if TOPPs – whose disproportionately large incomes skew the averages – are removed from the calculation, the average will nearly always be a significant minus figure.

By any measure, MLM is a losing proposition. This explains why the DSA and MLM spokespersons and statisticians do everything they can to skew the numbers in their favor. A more detailed analysis of the abysmal statistics on average earnings will be presented in Chapter 7.

2. *Since the compensation and marketing system is weighted towards recruitment, instead of retailing of products, MLMs are technically illegal in many jurisdictions. This one effect is the basis of*

most statutes against pyramid schemes. MLM promoters often go to great lengths to make it appear that revenues of participants come from (unreported) direct selling of products, which is simply not the case.

3. *Misrepresentations abound.* Deception is essential for MLM to survive and grow. If the truth were told about the abysmal odds of success, only the numerically challenged would join.

Some MLM promoters make exaggerated product claims to draw in new recruits. I have concluded that success in a recruiting MLM requires one first to be deceived, then to maintain a high level of self-deception, and finally to go about deceiving others.

Chapter 8 lists at least 111 typical misrepresentations used in MLM recruitment campaigns. With MLMs dependent on so many falsehoods, it would not be an exaggeration to consider the income earned by MLM sponsors as “theft by deception,” and certainly as ill-gotten gain.

4. *MLMs become somewhat like Ponzi schemes, with promoters moving from one location to another, as each area is increasingly perceived to be saturated. What happens is that the MLM grows rapidly until it reaches market saturation in a given area. All later entrants are severely disadvantaged in their recruiting efforts and lose money. MLMs sometimes get around this by starting new product divisions or entering new geographic regions to start new pyramids, a process I have labelled “re-pyramiding.”*

So investing participants recover their investments by recruiting in other areas – in Ponzi fashion – to get new participants to invest. If they don't do this, they can lose their income stream and the rank they achieved. Company officials cooperate – or the company may collapse, along with their jobs.

5. *The distinction between seller and buyer becomes confused and blurred. The seller becomes the buyer, and the buyer becomes the seller – to themselves and their families.*

6. *When most of the buyers are participants, MLM is simply a money transfer scheme, transferring money from those at the bottom to those at the top – through the infrastructure of the MLM company.*

Exhibit 2f: Does MLM (multi-level or network marketing) qualify as a legitimate form of direct selling? — a 7-point checklist

Much confusion exists on whether or not MLM can qualify as direct selling. Since the MLM industry has much to gain by being classed as direct selling, MLM promoters and the industry's lobbying arm, the Direct Selling Association, work hard to convince legislators, regulators, and the public that they are direct selling companies. Since few officials have much experience in direct sales, they are often misled on this key point.

Based on several years of experience, observation and research related to both direct sales and MLM, I can safely conclude that **the typical MLM business model constitutes what I call a “product-based pyramid scheme” and NOT a form of legitimate direct selling.** They should be considered “recruitment-driven MLMs”; i.e., MLMs that require aggressive recruiting of a large downline to earn a significant income. However, it is true that selling – mostly in the form of recruiting – is involved in building an MLM downline.

Based on this analysis, below is a comparison of two marketing models – direct sales, as represented by traditional Fuller Brush sales persons (or any non-MLM

direct sales company, including life insurance) – with prominent MLM programs, such as Amway and Nu Skin.

CONCLUSION: The typical MLM company is no more a direct sales company than a pig is a horse. MLM companies use highly leveraged compensation systems (rewarding top distributors at the expense of a large downline of recruits who invest in products to “play the game” – almost all of whom lose money), its participants are primarily recruiting to build downlines, not to sell products directly to end users.

When was the last time you were approached by an Amway or Nu Skin “distributor” to buy products without some mention of the “business opportunity”? With millions of “distributors” recruited over the last twenty years, if they were primarily selling direct to customers, you would expect by now to have been inundated with requests to buy products from them – without being asked to join up. No, the sellers are the buyers, and the buyers are the sellers – generally to themselves and their immediate families.

CHARACTERISTICS OF LEGITIMATE DIRECT SALES COMPANIES	LEGIT. DIRECT SALES⁶⁶	MLMs (that reward participants for recruiting large downlines, which is virtually all MLMs)
1. The number of agents/sales persons recruited for a given area is somewhat limited to prevent market saturation and resulting dissatisfaction of existing sales persons or agents.	YES	NO – MLMs use an endless chain of recruiters recruiting still more recruiters, ad infinitum. And each participant must recruit others to make his/her investment profitable.
2. Advancement to various levels of sales management is by appointment.	YES	NO – Advancement in the sales hierarchy is achieved by recruiting a downline who purchase products
3. Little or no purchases are required to begin and to continue selling the program profitably. The company, rather than the sales person, assumes the burden of financing and stocking inventory. When I sold encyclopedias as a young man, it was not a requirement that I buy a set for myself or meet a certain quota in order to qualify for commissions. And as an insurance agent, I was not required to buy the insurance I was selling	YES	NO – Sizable initial and ongoing purchases are tied to qualification to get commissions and/or to advance through higher distributor payout levels. Thus, many participants stock up on inventory. The burden of inventory cost is thereby transferred from the company to the distributor – who finds that the easiest way to sell the products is to sell the “opportunity.” Most actual buyers are recruits.
4. A maximum of four levels of sales managers is sufficient– for example: branch manager, district manager, regional manager, & national sales mgr.	YES	NO – An MLM downline may include 6, 8, 10, or even an infinite number of levels of distributors – which, of course, is absurd.
5. Commissions <u>per sale</u> paid by the company to the person selling products and services to end users are typically greater than the total override commissions for ALL those above him/her in sales management.	YES	NO – A distributor several levels above the person selling the product may get as much or more commission <u>per sale</u> from the company as the person doing the selling.
6. The primary focus in compensation systems, at sales meetings, and in actual effort by sales persons is on selling products and services to legitimate customers, or “end users.”	YES	NO – Marking up and reselling products bought at high wholesale prices is unrealistic. The primary focus is on recruiting more participants, so persons are seldom approached to buy the products without considering the “business opportunity.” Top-level recruiters are often held up as examples for their huge pay checks.
7. Sales persons can make a reasonable income (in commissions and bonuses) from selling the products or services – without recruiting a downline.	YES	NO – Commissions paid by the company for direct sales pale in comparison with potential rewards for recruiting a downline. In MLMs, it is extremely rare for participants (except for those at or near the top of the pyramid), to report profits on their tax returns.

⁶⁶ Including insurance, real estate, investments, fire alarm systems, and other products and services that are sold person-to-person away from a fixed location (but without the first four of five CDCs of a product-based pyramid scheme)

7. *Stockpiling of products is common, a fact seldom admitted by MLM participants. Many wind up making excessive purchases in order to advance up the hierarchy of participants, so they can reap large residual incomes off the efforts of others – which seldom happens. Most participants are left with unsold products, broken promises, and unrealized dreams. Return privileges for refunds are not used as much as one would expect for the reasons mentioned above.*



Stockpiling is common in MLM

8. *The regulatory process – essential in a democracy – is compromised when pyramid fraud is allowed by regulatory agencies. Victims of all types of pyramid or chain selling schemes rarely file complaints, fearing consequences from or to those they recruited (often relatives or friends) – and having been taught that failure is “their fault.” Lacking such complaints, law enforcement seldom acts against them. This complacency on the part of consumer protection officials creates, in effect, a “license to steal.”*

8. *MLM observers have noticed cultish and even compulsive behavior from MLM participation. Some MLMs adopt cultist patterns in recruitment and retention of members, becoming a rather closed society. Also, the devolution of “MLM junkies” has been observed, with traits of addiction similar to those with other addictions.*

10. *A perverse risk-reward relationship develops with MLMs. In legitimate businesses,*

the more time and money one invests in the business, the more likely it is that success will be achieved. But with MLMs (except for TOPPs), the more one invests, the more one loses. The luckiest participants are those who invest the least time and money. The most fortunate are usually prospects who refuse to join at all.

11. *Extreme leverage results, meaning the majority of company payout goes to TOPPs. Cases of downline distributors receiving large commission checks are rare, but are held up as examples for all prospective recruits to see (without disclosing costs incurred). However, for the vast majority of MLM participants, actual profits are rare – and losses are the rule, not the exception. Again, study Exhibit 2g.*

12. *The program becomes a closed market system, in which products are sold primarily through (and to) a downline of participants (and sympathetic family members) and seldom to legitimate customers at retail prices. This alone should qualify it as an illegal pyramid scheme.*

13. *Personal losses can be substantial, including psychological, social, and spiritual harm⁶⁷ – far outside of the norm for legitimate businesses. Some MLM participants lose more than money. We often hear of marriages and families broken up, credit cards maxed out, bankruptcies, long-term friendships ruined, religious and other groups stressed or broken up, even suicides – all from single-minded dedication to an MLM program. In fact, the more committed a person is to an MLM, the greater the likelihood that he/she will suffer at least some of these consequences.*

Also, disturbing tendencies to move away from ethical and charitable motivations to a more materialistic and greedy persona often becomes apparent from MLM participation. These personality changes help explain why some see MLM as an unethical business model.⁶⁸

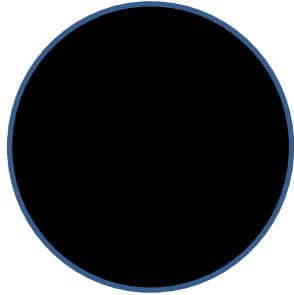
⁶⁷ For examples, go to feedback in ch. 9 Appendix.

⁶⁸ Jon M. Taylor, *The Network Marketing Game*. op cit. See also *False Profits*, by Robert FitzPatrick. (Herald Press: Charlotte, N.C., 1997).

Exhibit 2g: Legitimate direct selling vs. MLMs

Legitimate direct selling

Direct sales persons who sell directly to customers seldom lose money, since most supplies and training are provided by the company. And the sales persons do not have to buy the products in order to qualify for commissions. Most of the commissions are paid to the person doing the selling. With the growth of the Internet and discount stores, little direct selling is done any more.



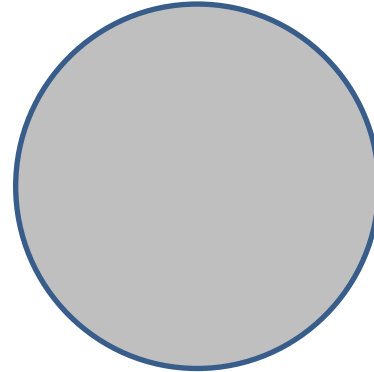
Majority make money



Few lose money

MLMs, or product-based pyramid schemes

An extremely high loss rate explains MLM's high attrition rates, churning of new recruits, and need to aggressively "re-pyramid" through new markets and/or with new products



00.3% make money in the typical MLM⁶⁹

Only a few of the participants in a typical MLM earn significant profits – after purchases and operating expenses are subtracted. To correctly represent these persons would require a circle so small that it would be barely visible in this visual.

99.7% lose money in the typical MLM

It is very expensive to build a profitable MLM downline. Significant purchases are required to qualify for and to maintain "pin levels" (pay rank). And the cost of mounting a recruitment campaign effective enough to "succeed" in an MLM can be very high. For these reasons, the dropout rate is also extremely high. In any MLM, the first ones into a given market have a huge advantage. Those coming in later are buying a ticket on a flight that has already left the ground.

⁶⁹ See Chapter 7. Calculations are based on reports of average income of participants for 50 MLM companies that have released such data by 2013. See methodology and calculations in Chapter 7.

Considering all the harmful effects of MLM, it is easy to see why MLMs are far more harmful than no-product (cash-based) pyramid schemes. They have a higher loss rate, cause far greater losses in the aggregate, and affect far more victims. They also have a much lower payout ratio for distributors, since most of the proceeds go to products and infrastructure, and some to the founders.

Conversely, in cash-based pyramid schemes, all the money goes to the person at the top, but the downline consists of only a few persons, who strive to move up to take their turn at the top.

See Exhibit 2h for a summary of some of the effects stemming from the CDCs (“red flags”) of MLMs, both individually and in combination.

Exhibit 2h: Characteristics and effects of MLMs, or product-based pyramid schemes

CHARACTERISTICS	EFFECTS
1. Each person recruited is empowered & given incentives to recruit other participants, who are empowered and motivated to recruit still other participants, etc. – in endless chains of empowered and motivated recruiters recruiting recruiters – without regard to market saturation.	Demonstrates primary income is from recruiting, especially with the features of unlimited recruitment and such powerful incentives to recruit – vs. meager profits from retailing over-priced products. Hyper growth inevitably leads to perceived saturation, which often is followed by expanding (“re-pyramiding”) to other markets – or to introducing new product divisions and cycling through the same markets.
2. Rank advancement in a hierarchy of multiple levels of “distributors” is achieved by recruitment, rather than by appointment.	Demonstrates primary income is from recruiting, since that is the only way to advance in the scheme and to realize major profits. In virtually any MLM, 99% of recruits are doomed to financial loss.
3. “Pay to play” requirements (to qualify for commissions and/or for rank advancement) are met by quotas of “incentivized purchases”.	Raises breakeven bar, assuring losses for 99% of participants. May technically place MLM in category of a franchise, security, business opportunity – or a de facto pyramid scheme. Encourages hyper-consumption of products by participants, who are the primary buyers.
4. Company payout per sale for the total of all upline participants equals or exceeds that for the person selling the product	Removes incentive to do direct selling, since recruiting is potentially many times more profitable.
5. (typical, but optional) The company pays commissions and bonuses on five or more “distributor” levels – more than are functionally justified; i.e., more than needed to manage the sales function.	Demonstrates primary income is from recruiting. Enhances leverage for top participants who profit hugely, while assuring high loss rate for lower levels. Virtually eliminates retail option, due to high wholesale prices (to pay commissions on many levels) that make direct sales with retail markup very difficult. Primary retail target is new recruits – which are making de facto pyramid investments.
1-5: Combining all (or at least the first four) of the above characteristics	Results in high loss rates (99.7% average) – much higher than for no-product pyramid schemes (87.5% to 93.3%). Strong emphasis on recruiting as the primary source of income, satisfying most statutory definitions of a pyramid scheme. Demonstrates extreme leverage, necessitating deceptive income promises to succeed at recruitment.

MLM's unsavory reputation among the general public in the U.S.

Twenty years of feedback from all over the world confirms what most consumer advocates have observed – that the MLM industry generally has an unfavorable reputation among the general public. This has certainly been evident in consumer surveys.⁷⁰

When I did an advanced (exact) Google search of the term “scam” (using quotation marks) with standard brands of nutritional supplements (such as Centrum, Bayer One-a-Day, etc.) sold in retail stores, I got 0 (zero) results. But in sharp contrast, when “scam” was paired with the names of leading MLM companies that sell supplements (Amway, Herbalife, Nu Skin, USANA, etc.), I got several hundred results for each of them!

The typical answer by promoters of specific MLMs to the unsavory reputation of MLM is that the reputation is deserved by most MLMs, but not their MLM. Their MLM is somehow different. This is another reason why defining and understanding the underlying MLM model is important.

MLM's problem with legal identity

MLM promoters and defenders have a recurring problem whenever they have to present MLM as a class of business activity. This is because MLM is like a chameleon; it can – and often must – change colors to suit the situation. Consider the following examples:

- *Are MLM participants employees of the company?* MLM executives often try to exercise the control of an employer, but don't want to be classified as such because of the costs and legal liabilities. Yet, their contracts have been challenged as exercising too much control for participants to be considered independent contractors.⁷¹

⁷⁰ “Network Marketing Survey” Conducted in three Utah counties in 2004. Similar results were found in “Herbalife Online Fraud: A Web Analyst's Perspective.” (Jonathan Brand's Instablog at www.SeekingAlpha.com)

⁷¹ For a thorough discussion of bad legislation (IRC § 3582) pushed by lobbyists in 1982 to reclassify

For example, they may not be allowed to sell competitors' products along with those of the particular MLM they signed with.

- *Are MLM promoters selling investment securities?* They talk to prospects about the “residual income,” or “passive income” potential of signing up in their MLM – as an investment that was not dependent so much on their own efforts as on the efforts of those in their downline. But they do not register as securities with the state or federal securities agencies.
- *Are MLMs franchises?* Though many promoters refer to their MLMs as “like a franchise,” as an “un-franchise,” or even as a “personal franchise,” the last thing MLM executives want is to have to comply with franchise disclosure requirements, including a franchise disclosure document that could be hundreds of pages long with financial data, background of founders, etc. The MLM industry spent \$4 million lobbying for an exemption from the Business Opportunity Rule so they would not be required to provide even a one-page document disclosing information to help prospects make a wise decision about participation.
- *Are MLMs a form of gambling or a lottery?* Some promoters present MLM as an opportunity for the chance of unlimited income: “You never know how much money you will make if you sign up now,” or “You may get lucky and recruit someone in your downline who is a ‘business builder’ who will make you a lot of money,” etc. New MLMs will sell a “pre-launch” opportunity, implying that one could profit handsomely by being one of the lucky first ones in.
- *Are MLMs a form of direct selling?* Of course, the Direct Selling Association says it satisfies the criteria of person-to-person selling away from a fixed location, etc. The problem is that the DSA does not specify what legitimate direct selling is not – endless chains of recruitment of participants as primary customers.⁷²

employees as independent contractors to those contractors' detriment, go to the following web site (“All you need to know about MLM”) – <http://www.armydiller.com/financial-scam/mlm.htm#dsalegislation>

⁷² Again, See Exhibit 2f for a 7-point checklist for determining if MLM is a form of legitimate direct selling

- *Are MLMs buyers' clubs? Some MLM promoters present their programs as ways to buy from your own business rather than from others – like a buyers' club. The problem is that products from MLMs are almost always far more expensive than those purchased from alternative outlets, so they can't qualify as discount buyers' clubs. It might be all right if an MLM was sold as a "pay more" buyers' club, and not as a business opportunity.*
- *Are MLMs business opportunities? If so, they may need to register as such with the applicable state agencies, which may require disclosure of information they don't want to disclose and other requirements with which they would not want to comply. So while MLM promoters often refer to their particular program as a "business opportunity" to prospects, they are careful to refer to it as "direct selling" to law enforcement officials.*
- *Are MLMs income opportunities? If they were, they should provide a good likelihood a person could earn a significant income from them. However, the opposite is true. As carefully demonstrated in Chapter 7, almost all participants in MLMs – approximately 99.7% of them (where data is available), lose money. *And if you eliminate TOPPs (top-of-the-pyramid-promoters) from the calculation, the loss rate is about 99.9% for new recruits – with approximately zero chance of profiting. It would be more honest to call MLMs money traps that lead to almost certain loss, except for those at the top of the pyramid.**
- *And finally, are MLMs cleverly disguised pyramid schemes? If you are not already convinced, re-read this chapter and read the rest of the chapters in this book with an open mind and decide for yourself. But I can attest that *after analyzing the compensation plans of over 600 MLM schemes, I feel more comfortable than ever labeling them recruitment-driven MLMs, or product-based pyramid schemes.**

What is the difference between Ponzi schemes and (no-product or product-based) pyramid schemes?

Both pyramid schemes (whether or not product-based) and Ponzi schemes⁷³ are money transfer schemes, meaning that they involve a transfer of money between participants, rather than offering either legitimate investments or the production or sale of actual goods or services to those outside of the participants themselves. In the case of Ponzi schemes, new investors are recruited to provide revenues, but little real investment occurs. Instead, earlier investors are paid dividends or "profits" from the investments of new investors. Of course, since the supply of new investors is limited, eventually the scheme collapses when new investors cannot be found, or the demand for refunds of original investment principal by earlier investors exceeds available funds. This is what happened to cause the collapse of the Bernie Madoff scheme in 2008 when the financial markets imploded.

No-product pyramid schemes offer no products, merely the transfer of investors' money from those at the bottom to those at the top. In contrast, MLMs, or product-based pyramid schemes, deceive participants into thinking that they are legitimate businesses by offering consumable products. But few are sold outside the network of participants, so they wind up also being transfer schemes, at least indirectly – transferring money from product purchases of a continuing stream of new recruits to the company to pay for products, infrastructure costs, and distributors. Usually less than half the money from purchases of recruits is rebated back to the network of distributors, with a disproportionate amount going to founders and TOPPs.

Since MLMs are dependent on the recruitment of an endless chain of recruitment, recruiters soon find their local market saturated and must recruit elsewhere. As will be discussed in Chapter 3, this saturation of markets happens rather quickly, so MLMs are extremely viral in spreading like

⁷³ The history of pyramid and Ponzi schemes will be discussed in Chapter 10.

a fast-growing cancer from state to state and eventually to vulnerable foreign markets to keep the chain of recruitment going. Both Ponzi and pyramid schemes are similar in that timing of entry into the program is critical. In Ponzi schemes, the person who initiates the scheme usually profits the most, failing to use the investors' money to fulfill his promises to them and instead chooses to pay them out of funds received from future investors. In pyramid schemes, the timing of entry affects rank position in the pyramid (and resultant level of pay) of participants, and each person recruited is incentivized to recruit others in an endless chain of recruitment.

Unlike Ponzi schemes and no-product pyramid schemes, some of the more successful MLMs are able to continue almost indefinitely, not only by expanding to other markets (often overseas), but by introducing new "product divisions" or name brands and starting the whole recruitment process all over again. And after enough years have gone by, a new generation of prospects can be targeted under a new name or focus, as Amway has done with Quixtar and Nu Skin has done with several product divisions. Again, *this is a process I call "re-pyramiding."*

Are all MLMs pyramid schemes?

As the following chapters will demonstrate, MLMs are merely product-based pyramid schemes disguised as "direct selling companies." But even when confronted with overwhelming evidence of this, MLM defenders – especially the Direct Selling Association – will likely protest: "Wait a minute. You're not suggesting that *all* MLMs are (illegal) pyramid schemes, are you?"

As if all of the foregoing were not sufficient to answer that question, an appropriate response would be –

***If it looks like a duck,
walks like a duck,
swims like a duck,
and quacks like a duck,
then it's probably a duck!***



Few would question the underlying flaws in chain letters where you pay ten dollars to everyone on a list, add your name at the bottom, and forward it to all your friends – and they to their friends, ad infinitum. Most consumers see the flaws in this concept, so that it requires little explaining. But when MLMs (built upon endless chains of recruitment) came along and introduced unique and exotic products with complicated pay plans, charismatic leaders, palatial home offices, and donations to charitable causes and influential political candidates; promoters were able to dupe regulators, legislators, and many in the media into believing they were legitimate.

The underlying motivations that seem to drive MLM development and recruitment are greed and the desire for easy money, even at the expense of a multitude of victims. Though not articulated by founders, they seem to understand that it is much easier to facilitate a scheme that promotes product purchases by selling a bogus opportunity than by selling the products without the attached opportunity.

In fact, as will be shown in later chapters, ***MLM is the most harmful of the two classes of pyramid schemes (no-product and product-based), by any measure*** – loss rates, aggregate losses, total number of victims, low payout percentage, and degree of leverage enjoyed by TOPPs (the degree to which they profit from the purchases of those beneath them). For an interesting analogy and explanation of the relative harm of no-product and product-based pyramid schemes, go to Appendix 2i: "Are all MLMs pyramid schemes"

Definitions and terms for pyramid schemes vary among the states. Those who expect to find uniform definitions of pyramid schemes across jurisdictions will be disappointed. Statutory definitions of what is and what is not a pyramid scheme vary from state to state, and many show lack of recognition of the fundamental flaws in all endless chain recruitment programs, including MLMs. This is not surprising, as many attorneys, legislators, academicians, and so-called experts are not clear on these issues.

As will be explained in Chapter 10, the structural difference between pyramid schemes and MLMs – aside from the existence of products for sale – may represent a distinction without a difference. (The only substantive difference is that one accepts cash – and the other payments for products (usually over time) as investments in the scheme.] Definitions and terms designating pyramid schemes used in state statutes are compiled in Appendix 2H. One can see from reviewing these that it is no wonder there is so much confusion over terminology.

Emphasis on “internal consumption” in labeling MLMs “pyramid schemes.” In recent MLM cases, efforts have been made to determine the percentage of sales that were made to participants versus non-participants. The former are considered internal to the system, or “internal consumption.” The latter are “external sales.” Unless it can be proven that the majority of sales were to end users outside the network, it may be considered a pyramid scheme. However, this data is not easy to obtain, as the companies are loathe to seek or to disclose such information. As explained in this chapter, this emphasis can more readily be discovered by analysis of the compensation plan.

The question of whether or not a given MLM is a pyramid scheme has become a red herring to mislead anyone investigating the company. Defining what is a pyramid scheme has become so obfuscated by the MLM industry that it thwarts efforts to prosecute cases against MLMs. But one thing is certain – MLM is an unfair and deceptive practice – making it illegal under Section 5 of the FTC Act, and based on statutes in many states.

What about MLMs whose promoters claim they are “not MLM?”

Some MLM communicators claim that their program is “not MLM” – or “not like the others,”⁷⁴ but a careful study of their

compensation plan reveals the first four of the five CDCs listed above. They may have only three or four levels in their pay plan, but that is offset by greater commission percentages to the top levels – which accomplishes the same concentration of income to TOPPs. Or they may have a “play-to-pay” alternative to “pay to play,” as discussed above.

A more descriptive term for MLMs, or product-based pyramid schemes: “pancake schemes”

I owe this insight to a man whose loved one’s life was turned upside-down by MLM addiction. Others have calculated that in “doubling” 33 times with a simple binary MLM progression, you exceed the population of the earth. In plotting the positions on a graph, this man found that the downline organization looks more like a flat line or pancake with a bump in the middle than a triangular-shaped pyramid. This is illustrated in Appendix 2j.

Of course, if you have more than a doubling of recruits at each level, the line flattens out even more quickly. For example, with Nu Skin a person must be an “Executive” with five active distributors beneath him or her to qualify for “breakaway” commissions or for rank advancement. While a “Blue Diamond” may only be paid on six levels, the mathematical progression of endless chain recruitment continues. The progression (with the line of victims getting longer at each level) proceeds as follows:

1x5 =5
 X5= 25
 X5= 125
 X5= 3,125 (a very long flat line of victims)
 X5= 15,625
 X5= 78,125
 X5= 390,625
 X5= 1,953,125, or 1.9 million victims (A line of that many persons standing next to each other could be 800 miles long!)

By only the 15th level, the progression approximates the population of the entire earth! (See Appendix 2j which shows that even a binary system is shaped more like pancake than a pyramid.)

In contrast, with a classic 1-2-4-8 pyramid scheme, the progression matures at the fourth level, with the person at the top cashing in from

⁷⁴ An article about claims of some MLMs to be “different” titled “What about this One?” by Robert FlitzPatrick can be found at his web site – www.pyramidschemealert.org

the investments of those at the bottom. There are no product or infrastructure costs to recoup, so all the money goes to the person at the top. So one person wins at the expense of 14 who lose their investment – as opposed to a massive “flat line” MLM scheme in which thousands in a downline lose money to enrich a few at the top.

The point I am making is that the “flat line” downline is another way of illustrating that MLM is far more damaging than classic 1-2-4-8 no-product schemes by any measure – loss rate, aggregate losses, and number of victims.

Compensation plans designed to benefit the company and TOPPs, not downline participants

A recent statement⁷⁵ by a leading designer of compensation plans reveals the real motivation behind the plans:

A critical component of your new MLM or party plan company is the compensation plan. This is one of their earliest concerns for many startup company entrepreneurs. Often the role and requirements or the compensation plan are widely misunderstood. Therefore on this page we'll expose some misconceptions:

Misconception #1: *The purpose of the compensation plan is to compensate distributors.*

Reality: *The purpose of the compensation plan is to motivate behaviors that will grow your company.*

Here is another example of the unfairness of MLM. Newly recruited distributors are misled to believe that the compensation plan is designed to benefit them, when in fact, it benefits TOPPs (top-of-the-pyramid promoters), founders, and the sponsoring MLM company.

Then skip to misconception #7:

Misconception #7: *I can buy an off-the-shelf plan for now and change it later.*

Reality: *The plan you launch with will have enormous impact on your early success. Some refinements will be possible later, but a major change can destroy your business.*

[NOTE: This latter reality explains why – once established, compensation plans are not altered, except for minor modifications.]

Some MLM players game the system.

Some “players” regularly “game the system.” They are extremely successful MLM recruiters who are continually on the lookout for new MLMs. Because of their reputation for aggressive recruiting, they are given entry positions at or near the top of a pyramid of distributors yet to be developed. They may bring hundreds of downline distributors with them from another MLM. This practice – called “cross recruiting” – has led to lawsuits. Some even work more than one MLM at a time.

These players often choose to work fast-paying binary compensation plans in which they can be earning tens of thousands of dollars a week before they move their downline to the next deal. This may happen when a new market is opened up in another country or when a new product division is introduced. We have learned of a top “player’s” position determined by nepotism, by a telephone call, or even by a toss of the dice. This is not fair to others in the MLM, but as this and subsequent chapters prove, MLM is fundamentally an unfair and deceptive practice.

What would a good MLM look like?

Many have asked if it is possible to have a fair and equitable “retail-focused MLM” program. In other words, what would a “good MLM” look like? Considering the inherent flaws in MLM as a business model, the established precedents, and the motivations that drive the industry, one might wonder if such an MLM is possible. Some insist that a “good MLM” is an oxymoron.

However, for anyone willing to try, here are some consumer protections that should mitigate some of the harm done by endless chain recruitment schemes. Assuming

⁷⁵ “A Winning Compensation Plan – like a goose laying golden eggs”: The Sheffield Group– www.sheffieldnet.com

honest execution, they could help to assure an MLM would be both legal and ethical.

1. Commissions or bonuses would be paid only for sales to non-participants – not for “internal consumption” (sales to participants). This would minimize losses from buying what is not needed and would put the emphasis squarely on selling to legitimate customers, as opposed to recruiting a downline and incentivizing them to buy and stockpile products.⁷⁶

2. An MLM could reward selling of products more than recruiting by paying at least half of the total company payout of commissions to “front line distributors” actually selling products to end use consumers; i.e., persons not in the network of participants. So if a company’s total payout of commissions to participants was 50% of total sales revenues, commissions (not retail markup) paid by the company to frontline distributors would be at least 25%. The other 25% would be split among the upline.

3. There would be limits to the number of participants allowed to recruit in any given area.

4. There would be no “pay-to-play” purchase requirements to qualify for commissions or rank advancement. Participants would not lose their status or their commissions if they have a bad month and fail to meet a monthly quota. This could minimize losses.

5. The number of levels in the pay plan would be no more than are functionally justified. Even sales programs of major corporations can cover the country with four levels of sales management – branch, division, regional, and national sales managers. Thus, if MLM is a legitimate direct sales program, it should be capped at a maximum of four levels of supervisors. (More than that serves only to enrich founders and TOPPs at the expense of their downlines). And by limiting the number of levels on which commissions are paid, prices could be more competitive – and distributors could profit from retailing products, not just from recruiting and selling to their downlines at inflated prices.

6. Ideally, no commission payments would be paid in perpetuity, except for sales by those on the first level (“front line”) in one’s downline of participants. For example, downline commissions might be paid for one or two years to give time for the upline to profit from training recruits until they are competent. This would minimize the mathematical absurdity of a program that expands endlessly not only in space (area-by-area market saturation), but also in time, and it would limit the motivation to build a downline for “residual income,” or the dream of sitting back and profiting forever from the efforts of others.

7. Breakaway compensation plans – essentially pyramids within mega-pyramids – would be banned, and other complex plans (matrix, binary, etc.), would be replaced with simpler unilevel plans. This would help to limit the obfuscation that hides misrepresentations and makes comparisons difficult. The irony of this is that such an MLM compensation plan would be fashioned after classic no-product pyramid schemes – which are illegal, though not usually as harmful as MLMs.

8. The MLM would disclose average NET payout to ALL participants at all levels in the pay plan, meaning money paid by the company to participants, less money paid in to the company by these same participants, including purchases, training, and “sales tools.”

9. In reports of average income of participants, ALL participants who joined would be included in these averages, not just those who are “active.” Attrition rates and total refunds (“buybacks”) as a percentage of total revenues would also be disclosed. Such transparency would discourage many typical MLM misrepresentations.

10. Prospects would have to be told that market saturation could inevitably occur, leading to a diminishing opportunity for new recruits. Such protections would remove the underlying “easy money” motivation (“residual income,” “time freedom,” etc.) and the complex maze of deceptions, upon which MLM is dependent.

11. Any major legal actions against the company would be disclosed, whether or not resolved successfully.

⁷⁶ See Koscot and Omnitrition cases in Chapter 10.

12. And finally, a list of at least five names drawn randomly from the total population of participants in a given region who had been with the company for at least a year would be provided with telephone numbers as references, whether or not they are still active.

I have tried in vain to visualize an MLM program with such consumer protections succeeding. The driving force of huge incomes for TOPPs would be absent, and founders may find it more difficult to skim from revenues. In fact, I have run these suggestions by several persons who were interested in starting a "good MLM," but they each decided on a more standard MLM compensation plan – probably because no one would make obscene profits with such strict protections against abuse.

Conclusions – definition and effects of multi-level marketing

An accurate, research-based, and consumer-friendly definition of multi-level marketing. Persons honestly seeking a good understanding of multi-level marketing (MLM) find that MLM does not yield itself to a short and simple definition. However, based on 20 years' research and worldwide feedback on this topic, I can articulate what I believe to be the only accurate, research-based, and consumer-friendly definition of multi-level marketing. Although lengthy, it incorporates the four causal and defining factors of a recruitment-driven MLM, as discussed above. I am confident this definition is the most useful for analytical purposes, as it holds true for all of over 600 MLMs I have analyzed.

Unlike other definitions cited earlier, *this definition recognizes the inherent flaws of any MLM, or product-based pyramid scheme; viz., an endless chain of recruitment and a pay plan that is recruitment-driven, top-weighted, and financed primarily by incentivized purchases of the participants.* Also, it clearly separates MLM from all other income activities, which definitions articulated by others have not accomplished.

So I conclude with what I believe to be the only accurate, research-based definition of the business model labeled "multi-level marketing":

Multi-level marketing (MLM) is a purported income opportunity, in which persons in company-sponsored pyramids of participants qualify for commissions and for rank advancement primarily by meeting "pay-to-play" purchase quotas and by recruiting others in endless chains of recruitment, and in which rewards are stacked in favor of participants at the top of the pyramid.

Taken together, the following distinguishing characteristics separate MLM from all other forms of business activity:

(1) Endless chains of participants are recruited without limit into the bottom level of company-sponsored pyramids of participants.

(2) Rank advancement up the levels in the pyramid is achieved by recruitment and/or purchases, not by appointment. It should also be noted that compared to the incentives for recruiting a large and active downline, rewards for selling to non-participants is insignificant.

(3) Minimum "pay-to-play" purchases, or quotas, are required to qualify for commissions and/or to attain or maintain ranks or levels in the pyramid.

(4) The bulk of rewards are paid to those at the top levels of the pyramid, whose positions are usually established early in the formation of the pyramid. Also, most MLMs have five or more levels in their compensation plan, with additional levels exponentially increasing rewards to those at the top of the pyramid at the expense of those at the bottom levels.

NOTE: This set of four distinct characteristics is not found in any other type of business – except pyramid schemes. In fact, the fundamental structure of MLMs is virtually

identical to that of classic, cash-based (no-product) pyramid schemes, except that in lieu of cash exchanged directly between participants, products are purchased and commissions processed through an MLM company sponsor. Such commissions are drawn chiefly from purchases of their “downline” (those recruited beneath them). It is appropriate to refer to MLMs as “product-based pyramid schemes.”

The above definition is further clarified by noting (1) the assumptions upon which MLM is based and (2) MLM's powerful effects on participants.

Assumptions and effects of MLM: The above definition requires some explanation of its assumptions and effects, which have been identified through 20 years of research and worldwide feedback. Both the above definition and the effects described below provide a true and complete picture of multi-level marketing as a business model and as an industry, which has been confirmed in analyses of the compensation plans and practices of over 600 MLMs evaluated:

As a business model incentivizing unlimited recruitment, creators of MLMs (MLM programs) assume an infinite market, which does not exist in the real world. They also assume virgin markets, which cannot exist for long. Since MLM compensation plans are heavily weighted towards recruitment, rather than sales to the general public (non-participants), stable retail markets never materialize. Consequently, MLMs must “re-pyramid” (expand) into new markets to compensate for saturation of existing markets. And with its high attrition rate, constant recruitment is necessary to replace dropouts. This re-pyramiding and constant churning of new recruits is necessary to prevent total market saturation and collapse, as is true of any pyramid scheme.

The distinction between buyer and seller evaporates, as participants are incentivized to subscribe to ongoing purchases of “pills, potions, and lotions” – or other products or services offered by some MLMs. In addition, fees are paid for training meetings and “opportunity” extravaganzas, some of which require expensive travel. And MLM recruiters

often sell motivational books, lead generation systems, web sites, and other “sales tools” to assure success, but which – combined with normal business expenses – wind up further increasing costs and eventual losses.

MLMs depend on a myriad of misrepresentations to survive and grow and to defend against regulatory action. Prospects are typically lured into MLM with exaggerated product and income claims. Since approximately 99% of participants lose money, the vast majority eventually drop out, to be replaced by a continual stream of new recruits, who are likewise destined for loss and disappointment.

MLMs are therefore inherently flawed and have been proven likely to be the most unfair and deceptive of all purported “business opportunities.” Technically, as extremely unfair and deceptive acts or practices (UDAP), all MLMs in the U.S. violate Section 5 of the FTC Act, as well as statutes against UDAP in many states. Properly understood, MLMs are therefore technically illegal in most jurisdictions whether or not they are classified as illegal pyramid schemes.

As recruitment-driven systems, MLMs can also be extremely viral and predatory. MLMs, or product-based pyramid schemes, do far more damage than cash-based (no-product) pyramid schemes by any measure – loss rates, aggregate losses, and number of victims. Tens of millions of MLM victims suffer tens of billions of dollars in losses every year.

MLM may be the most successful consumer fraud in history. However, the fraud is systemic, meaning that it is not so much a problem of perpetrators deliberately scamming people, but it is the underlying MLM system that is fraudulent. This is why it is safe to state that a “good MLM” is an oxymoron.

While financial losses can be significant, adverse effects are also often seen in bizarre or cultish behavior, high divorce rates, loss of “social capital” or ruined relationships with family and friends who feel exploited, and even addiction to MLM's empty promises. Some sacrifice careers or education to pursue MLM's vaporous promises of easy money (“time freedom” or “residual income”) and a mystique of personal and spiritual fulfillment.

We should also note that society suffers from the proliferation of MLM schemes because the money could have instead been invested in legitimate enterprises. Such failed investments and wasted energy also spoil the initiative of would-be entrepreneurs.

Finally, MLM expenses written off as losses result in a shortfall of tens of billions of dollars in IRS revenues, which should not be allowed for an illegitimate business. MLM losses should be treated the the same as gambling losses, which can only be subtracted against winnings.

A testable hypothesis for the legitimacy of MLM

If the legitimacy of MLM were approached scientifically, the scientific method of proposing a testable hypothesis could be applied, at least in the examination of major effects of MLM on its participants.

Some regulators made decisions on the theory (promulgated by MLM promoters) that if MLMs were pyramid schemes, they would be destined for saturation and collapse. Amway defenders used this theory while arguing that Amway had already been operating for many years without coming even close to saturation and collapse. Obviously the prosecutors did not understand the difference between total saturation and market saturation. As will be explained in Chapter 3, MLM promoters have found ways to overcome market saturation and to transfer losses to a revolving door of new recruits. So MLMs continue to survive and grow.

Because MLM is presented as an income opportunity, and income claims are what is most often challenged by critics, the bogus income claims issue is an excellent place to start. Given available data, the most relevant strategy for testing MLM as a business model would be to take a broad sample of MLM companies and analyze their compensation plans and resulting average income figures for participants. So a testable hypothesis might be framed like this:

Assuming MLM's unlimited and incentivized recruitment of endless chains of participants, average income data for

participants in a broad sample of MLMs will show that participation in MLM is profitable primarily for those at the top of the pyramid of participants. And given the costs of recruiting a downline, it would be rare for new participants to realize profits above expenses – meaning the vast majority lose money.

This hypothesis will be tested in upcoming chapters. In fact, in Chapter 7 I show that MLMs are the most harmful of the two classes of pyramid schemes (product and no-product), by any measure – loss rates, aggregate losses, payout ratios, and number of victims. So read on.

Appendix 2A

Definitions of Relevant Terms

Compensation plan – the method of compensating participants in a program, which can be very elaborate in MLMs. Often ignored by regulatory officials, it is the position of this author that analysis of compensation plans is essential in identifying the programs likely to cause the greatest consumer losses. See above for types of MLM compensation plans.

De facto (market) saturation – an area where recruiting opportunities are perceived to have diminished to the point that recruiting becomes unprofitable. (Same as “market saturation.”)

Direct selling. This is a term that MLM companies, with help from the Direct Selling Association, have worked hard to adopt for their business model. According to them direct selling is marketing and selling products, direct to consumers away from a fixed retail location. However, what the DSA/MLM lobby fails to recognize is what legitimate direct selling is not – an endless chain of recruitment of participants as primary customers.

Downline – all of the MLM distributors who are recruited under a given distributor and from whom are generated overrides on product sales

Incentivized (or “pay to play”) purchases – the practice of tying purchases of products from an MLM company with requirements to enter the “business opportunity” option and to advance in the hierarchy of “distributors” – who are in effect merely participants making pyramid scheme investments disguised (or laundered) as purchases.

Leverage – a concept often used by MLM promoters to convey the idea that by drawing income from a large downline of distributors, a person can leverage his/her time and investment in the scheme by drawing on the time and resources of their downline. A related concept is “residual income,” a form of passive income often received by authors, artists, insurance agents, and others who have made a contribution and thereafter get royalties from work performed earlier. The ideal presented is that a successful MLM recruiter can work hard for a period of time and never have to work again, thanks to his/her downline.

Market saturation – an area where recruiting opportunities are perceived to have diminished to the point that recruiting becomes unprofitable. Promoters of an MLM program must then find other areas or create other product divisions in which to recruit. Market saturation is reached far sooner than actual saturation, a point often overlooked when MLM apologists defend their programs by saying that saturation has never actually happened, and that replacement is an ongoing process like many other businesses. Also called “de facto saturation”

Multi-level marketing (MLM), as defined by the Federal Trade Commission is “any marketing program in which participants pay money to the program promoter in return for which the participants obtain the right to –

1. recruit additional participants, or to have additional participants placed by the promoter or any other person into the program participant’s downline, tree, cooperative, income center, or other similar program grouping;
2. sell goods or services; and
3. receive payment or other compensation; provided that:

(a) the payments received by each program participant are derived primarily from retail sales of goods or services, and not from recruiting additional participants nor having additional participants placed into the program participant’s downline, tree, cooperative, income center, or other similar program grouping, and

(b) the marketing program has instituted and enforces rules to ensure that it is not a plan in which participants earn profits primarily by the recruiting of additional participants rather than retail sales.”³⁶

As this book will make clear, this definition has some problems with it, most notably:

(1) Until this analysis, it has never been made clear how it was to be determined that payments to participants came primarily from the retail sales of goods or services and not from recruiting of additional participants. Hopefully, after reading this book, the question can be answered.

(2) the fact that the institution of “rules” [in (b) above], is insufficient to correct the problems with product-based pyramid schemes. The compensation plans must be addressed, along the lines of this analysis, if the problems with MLM are to be corrected.

The following definition, (explained in this chapter) is the only one based on extensive independent research:

Multi-level marketing (MLM) is a purported income opportunity, in which products are sold by recruitment of persons who are incentivized to buy products and to recruit others in endless chains of participants, who must buy products to qualify for commissions and to advance upward through multiple levels in company-sponsored pyramids of participants.

Further – With unlimited recruitment, MLM assumes both infinite and virgin markets, neither of which exists in the real world. MLM is therefore inherently flawed, unfair and deceptive. It can also be extremely viral and predatory.

Prospects are typically lured into MLM with exaggerated product and income claims. Rewards are stacked in favor of those at or near the top of the pyramid, who are often the first ones to join. Since approximately 99% of participants lose money, most of them eventually drop out, to be replaced by a continual stream of new recruits, who are likewise destined for loss and disappointment.

Network marketing – a term devised by MLM companies to get around the implications of “multi-level marketing” – which sounds too much like a chain distribution or pyramid form of marketing.

No-product (cash-based) pyramid scheme – a blatant pyramid scheme that is easy to detect because no products are offered, merely a participation fee or “investment.” Chain letters work on the same principle. A continuous chain of “participants” or “investors” is recruited, in which each pays a fee to participate and receives money by recruiting others into the program.

“Pay to Play” – a requirement common to all chain letters, no-product (cash-based) pyramid schemes, and product-based pyramid schemes, in which an investment – either in monies or in products purchased – is required in order to “play the game,” i.e., participate in and/or advance in the scheme. This need not be a substantial up-front fee to enroll in the MLM, but can be in the form of ongoing (usually monthly) volume purchase requirements for bonuses, advancement to “pin levels,” etc. These could be viewed as disguised or laundered investments in a product-based pyramid scheme. See “incentivized purchases.”

Ponzi scheme (in the final evolution of a MLM) – named after Charles Ponzi, an Italian-born swindler who cheated over 30,000 investors of over \$15 million in 1919-1920. Since that time, a Ponzi scheme refers to any investment swindle in which some early investors are paid off with money put up by later ones. Since MLMs use compensation plans that pay much greater rewards for recruiting than for direct sales to end users, they cannot sustain themselves from direct sales only. So when recruiting leads to saturation in a given market, they must recruit elsewhere. They thus eventually become like Ponzi schemes, seeking new investing participants elsewhere (in the form of incentivized product purchases) to pay off earlier investors.

Product-based pyramid scheme (MLMs) – a pyramid scheme that in most respects resembles a no-product pyramid scheme, except that products are purchased by distributors, ostensibly for resale, but actually for qualification or advancement in the scheme. Such product purchases, often combined with other incentives, qualify distributors for commissions and advancement in ascending levels in the distributor hierarchy. Such payments could be considered investments in a pyramid scheme laundered through product purchases.

Pyramid scheme – According to the FTC, these are plans which “concentrate on the commissions you could earn just for recruiting new distributors” and which “generally ignore the marketing and selling of products and services.”⁷⁷ The latter feature, of course, ignores the realities of product-based pyramid schemes, which this paper demonstrates do more aggregate damage to consumers than no-product (cash-based) schemes. The FTC has also described the essential features of an illegal pyramid scheme as follows:

Such schemes are characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users. . . . As is apparent, the presence of this second element, recruitment with rewards unrelated to product sales, is nothing more than an elaborate chain letter device in which individuals who pay a valuable consideration with the expectation of

⁷⁷ FTC Consumer Alert, December 1996

recouping it to some degree via recruitment are bound to be disappointed.⁷⁸

Recent court decisions have emphasized the need for the majority of sales to be to non-participants for an MLM program to avoid being classified as a pyramid scheme.

Unfortunately, the issue of whether or not a given MLM is a pyramid scheme has become a red herring to deflect attention away from its being determined to be an unfair and deceptive act or practice, which makes it clearly in violation of Section 5 of the FTC Act – and of many state statutes.

Recruitment-driven MLM (product-based pyramid schemes) – an MLM with a compensation plan that rewards primarily distributors who recruit huge downlines, and is therefore a product-based pyramid scheme. My research shows this applies to virtually all MLMs, or at least the 600 I have studied.

(hypothetical) Retail-focused MLM – an MLM which uses a compensation plan in which company remuneration to distributors is generous for front-line distributors who actually sell the products to consumers, but which does not allow huge and disproportionate fortunes to be made by upline distributors. Such companies may exist in theory, but I have not found any.

Saturation – the occurrence of reduced interest in an MLM as more and more people are recruited into the scheme. Note that although total saturation of a market may never be reached, saturation is perceived as a problem by new prospects as the percentage of prospects dwindles due to the perception of diminished opportunity. De facto or market saturation is the result.

Scheme - “a plan or program of action, especially a crafty or secret one; . . . a systematic or organized . . . design.”⁷⁹

Time freedom – another term bandied about by MLM promoters to appeal to those who want to be relieved from the requirement of having to spend their precious time to earn a living. They can live off the labor of others.

Unfair or deceptive act or practice – the very type of business activities that FTC was

established to protect against.⁸⁰ MLM is the epitome of such practices. Unfortunately, FTC officials have become sidetracked to determining whether or not an MLM is a pyramid scheme, using a definition that has been obfuscated to the point that MLM proponents are able to fend off efforts to stop such practices.

Upline – the direct line of distributors who are above a given distributor in the MLM distributor hierarchy or pyramid scheme and who receive overrides from sales or purchases. In a recruitment-driven MLM, top upline participants receive most of the payout in commissions and bonuses from the company and are the only ones to profit significantly.



⁷⁸ In *re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1180 (1975), gaff's mem, sub nom. *Turner v. FTC* 580 F.2d 701 (D.C. Cir. 1978).

⁷⁹ Merriam Webster's Collegiate Dictionary, Tenth Edition, 1993

⁸⁰ Section 5 of the FTC Act.

Appendix 2B

Explanations of Compensation Plans

MLM promoters frequently argue that while they know of problems in their industry, they have solved the problems with their new brand of MLM compensation plan, which is supposedly more fair, honest, generous, etc., than all the others.

Why are compensation plans so important to MLM promoters? Because they are at the heart of what MLM is about. As one promoter proudly stated in a meeting I attended, "Our compensation plan IS our product."

Here are the basic MLM compensation plan options:

Unilevel – There is no limit to the number of distributors that can be recruited on the first level (who "retail" products to end users). However, there is usually a limit on the number of levels deep that can qualify for commissions or overrides. It could be considered a "flat pyramid" and is probably the most fair of the compensation plans – though few would get rich. It is also the structure typically used by no-product pyramid schemes of the past.

Binary – Binary plans promote recruiting in a downline of two legs of distributors (left and right "profit centers"), with incentives to maintain matching sales volume between the two legs, since commissions are based on the lesser producing leg. Commissions are paid only on "matching volume," and this can sharply limit company payout. Seldom are high volume producers matched in the same leg of the downline. Binary plans could be considered "split pyramids."

Matrix – A limit is placed on the number of distributors wide in the first and succeeding levels and on the number of levels deep. Additional recruits "spill over" into the next level. Growth is limited (for example, $4 \times 12 = 48$ total downline). Can be played like a lottery – lazy participants can win. Matrix plans could be viewed as "block pyramids."

Stairstep/breakaway – A "distributor" ascends a staircase of groups of participants with escalating incentives to recruit more people to profit from more and more "pay to play" purchases. Commissions from one's personal group are replaced with overrides for volume of qualifying breakaway groups ("organizations") of "distributors." Extremely high leverage rewards hugely those at the top at the expense of a multitude of downline distributors who invest in "pay to play" purchases – their loss, but their upline's gain.

Each breakaway is a separate organization tied to one person who draws overrides from the entire breakaway organization, which may be one of many. It is important to recognize that six levels in a breakaway are not six levels of distributors, but of whole breakaway organizations of people.

Though breakaway plans are found in some of the most popular MLMs, those who understand breakaway plans agree that they are the most exploitive and extreme of all the pyramid schemes ever devised – and therefore have the greatest leverage and the highest loss rates. The author characterizes breakaways as "mega-pyramids" comprised of many nested "poly-pyramids."

Creative new plans. Though these are the basic compensation plans that have been used by MLM companies in the past, it should be noted that new forms of compensation are being developed by a never-ending supply of MLM schemers. These include a trinary plan, modifications of matrix and binary plans, and creative combinations of the above. Often, promoters of new MLMs claim they have come up with a revolutionary compensation plan that is superior to all others. However, I have found that the four (and usually five) causative and defining factors ("red flags") discussed in this paper can be found in all multi-level compensation plans.

Appendix 2C

Sample MLM Compensation Plans

What follows are examples of compensation plans for two MLM companies with names starting with the letter Z. You can nearly always view the company's compensation plan by doing an advanced Google search with the name of the company on one line and "compensation plan" on the other. Note the creative nomenclature for these plans. This is typical in the MLM industry. In fact, analyses of "proprietary density" of MLM compensation plans reveals the use of many proprietary words unique to the specific MLMs – which is not typical in legitimate direct selling programs. All of this suggests a tendency on the part of founders and promoters of MLM programs to obfuscate the nature of their programs to prospects.

Zija Compensation Plan

You can really drink life in when you know you have the resources to do all the things you need to do, and a lot of the things you want to do. And let's face it, the most important resource is a pay plan that works for the average and the aggressive business builder. At Zija, you don't need a computer or a mathematical degree to understand the Zija plan — just five minutes worth of common sense.

Think you've heard all this before? Think again. Say hello to Zija's Compensation Plan, which includes FastStart Commissions with Builders' Bonus Pool, Customer Commissions, Unilevel payout to nine levels, and three Executive Director Bonus Pools.

Zija FastStart Commissions

FASTSTART COMMISSION			
Each initial Product Order Paid on TWO LEVELS	Autoship Qualifications	Percent Paid	A Qua
Recruiter of New Member:	50 PSV	20%	1
First Upline Sponsor of Recruiter:	50 PSV	5%	1

We already know just how well the Zija beverage will jumpstart your lifestyle. Now let's talk about how the Zija FastStart Commissions can jumpstart your business. Because Zija is so easy to share, your friends and family will want to enjoy it like you do. Whenever someone becomes your customer, Zija will award up to 45% of their initial purchase made in the first month. You can even take advantage of the Builders' Bonus Pool, paid to the top new business builders every month from FastStart Commissions others left behind.

[Click here](#) for more details on just how fast Zija FastStart Commissions can move you.

Zija Unilevel Commissions

8

FABULOUS WAYS TO MAKE MONEY WITH ZIJA



RETAIL COMMISSION - PAID WEEKLY

1 **RETAIL COMMISSION** - Paid out when you sell Zija to other people who do not qualify for wholesale pricing. You'll either earn a \$5 or \$15 commission on each case of Zija you sell. Paid weekly.

FASTSTART COMMISSION - PAID WEEKLY

PAYS 45%

Each initial Product Order Paid on TWO LEVELS	Autoship Qualifications	Percent Paid	Autoship Qualifications	Percent Paid	FASTSTART COMMISSION - This commission is earned by Active Distributors of any rank and is based on the sales volume of the first order made within 30 days by new Customers or Distributors. Paid weekly.
Recruiter of New Member	50 PSV	20%	100 PSV	35%	
First Upline Sponsor of Recruiter	50 PSV	5%	100 PSV	10%	

UNILEVEL COMMISSION - PAID MONTHLY

PAYS 46%

	1 st Level	2 nd Level	3 rd Level	4 th Level	5 th Level	6 th Level	7 th Level	8 th Level	9 th Level	UNILEVEL COMMISSION - This commission is earned from the ongoing sales made by Customers and Distributors after the first FastStart purchase. The amount you are qualified to receive is based on your rank which dictates the number of levels for which you are paid. Paid monthly. RANK QUALIFICATIONS - Refer to the Volume and Organization Requirements on the back of this sheet.
Distributor	5%	✓	✓	✓	✓	✓	✓	✓	✓	
Associate Manager	5%	5%	12%	✓	✓	✓	✓	✓	✓	
Manager	5%	5%	12%	5%	✓	✓	✓	✓	✓	
Senior Manager	5%	5%	12%	5%	5%	4%	✓	✓	✓	
Director	5%	5%	12%	5%	5%	4%	4%	✓	✓	
Senior Director	5%	5%	12%	5%	5%	4%	4%	3%	✓	
Executive Director	5%	5%	12%	5%	5%	4%	4%	3%	3%	

BUILDERS' BONUS POOL - PAID MONTHLY

4 **BUILDERS' BONUS POOL** - This pool is divided on a pro-rata basis amongst the top ten Active Distributors, based upon their personal FastStart sales volume generated during that month. The pool is funded by the FastStart Commissions that were not earned by other Zija Distributors. Paid monthly.

RAPID GROWTH BONUS

Earned Rank	Month	Bonus	Paid Month	RAPID GROWTH BONUS Rewards Active Distributors with bonus checks for meeting specific rank qualifications within set periods of time. It's paid in the 4th, 6th, 9th, 13th, and 19th months after enrollment to qualified Directors, Senior Directors, and Executive Directors.
Director	3	\$ 2K	4	
Senior Director	5	\$ 4K	6	
Executive Director	8	\$ 8K	9	
Executive Director 200	12	\$ 15K	13	
Executive Director 400	18	\$ 25K	19	

LEADERSHIP BONUSES

EXECUTIVE DIRECTOR BONUS POOLS - PAID QUARTERLY				EXECUTIVE DIRECTOR BONUS POOLS Three pools of money—ED100, ED200, and ED400—are funded with up to 4% of Zija's gross product sales. It's paid out in a pro-rata basis to qualified Executive Directors (ED). Paid quarterly.
Executive Director 100K (ED100) Bonus Pool	100K GV	Pro Rata Share of 2% Gross Product Sales		
Executive Director 200K (ED200) Bonus Pool	200K GV	Pro Rata Share of 1% Gross Product Sales		
Executive Director 400K (ED400) Bonus Pool	400K GV	Pro Rata Share of 1% Gross Product Sales		
UNLIMITED LEADERSHIP BONUSES				UNLIMITED FASTSTART & UNILEVEL BONUSES We reward qualified EDs with either 1%, 2%, or 3% of the FastStart/UniLevel sales that have been generated in unlimited legs and levels within each EDs organization. Paid weekly and monthly respectively.
	ED100	ED200	ED400	
Unlimited FastStart Bonus (Paid weekly)	1%	2%	3%	
Unlimited UniLevel Bonus (Paid monthly)	1%	2%	3%	

For a more comprehensive explanation of the Zija Compensation Plan, go to drinkitfein.com and review the Zija Policies & Procedures.

The “Zrii™ Prosperity Plan™” Explained

By Douglas Schwartz (www.Amalaki-Drink.Blogspot.com)



Prosperity Plan™

Fast Start Training Bonus* (paid weekly)				
Enroll Level	1st Month	2nd Month	3rd Month	
	5			5%
4			5%	
3		5%	5%	
2		5%	5%	
Enroll: PV: 240+	40%	20%	20%	
Enroll: PV: 120+	30%	20%	10%	

5% Fast Start Bonus Pool (paid monthly)
5 personal enrollments per month with minimum 120 AS = 1 share in the pool

Unilevel Royalty Bonus – dynamically compressed* (paid monthly)											
Paid as Rank	Independent Executive	1-Star Executive	2-Star Executive	3-Star Executive	4-Star Executive	5-Star Executive	6-Star Executive	7-Star Executive	8-Star Executive	9-Star Executive	10-Star Executive
Minimum Monthly PV†	120	120	120	120	540	940	940	940	940	940	940
Minimum Monthly OV‡	N/A	1,000	2,500	5,000	10,000	20,000	50,000	100,000	200,000	500,000	1 million
Maximum % per leg	N/A	N/A	N/A	N/A	N/A	N/A	60%	60%	60%	60%	60%
Rank Qualifications	None	None	None	None	1,2-Star	2,3-Star	3,3-Star	3,3-Star	1,6-Star	2,6-Star*	3,6-Star
Leg Requirements	1	1	1	1	1	2	3	3	3	3	3
Placement Tier	1st	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%
	2nd	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%
	3rd		7%	7%	7%	7%	7%	7%	7%	7%	7%
	4th			5%	5%	5%	5%	5%	5%	5%	5%
	5th				5%	5%	5%	5%	5%	5%	5%
	6th					5%	5%	5%	5%	5%	5%
	7th						5%	5%	5%	5%	5%
	8th							5%	5%	5%	5%
	9th								5%	5%	5%



Matching Bonus* (paid monthly) *Must enroll 1 person on AS per month in order to earn the monthly Matching Bonus, through 6-Star Executive.											
	10%	10%	10%	15%	15%	15%	20%	20%	20%	20%	20%

3% All Star Bonus (paid quarterly)
3% of total commissionable sales paid to qualified 9-Star, 9-Star, and 10-Star Executives. 1% of the bonus is paid pro-rata at each rank.

8-Star Pool	9-Star Pool	10-Star Pool
1%	1%	1%

2% Founders Bonus (paid annually)
One share of 2% of new market commissionable sales will be paid as a royalty, to any independent Executive who attains the rank of 7-Star Executive or above, within 1 year of a country launch. This is 1% for each successive year. Note: Rank must be maintained 9 out of 12 months in a calendar year in order to continue to participate in the Founders Bonus.

BONUS DETAILS:
 *Fast Start Training Bonus: An independent Executive whose autochip is 240 PV or more will receive 40% on the product purchased by anyone they personally enroll during the first month of the new IE's enrollment. The sponsoring IE will receive 30% month 2 and 20% month 3 on purchases from the same new enrollee, so long as their own autochip is 240 PV or more. A sponsor whose autochip is under 240 PV will receive 30%, 20%, and 10% in months 1, 2, and 3, respectively. Fast Start volume in excess of 1200 PV in month one and 270 PV in months two and three will be paid out through the unilevel pay plan.
 †Minimum Monthly PV: Personal Volume (PV) requirements may be satisfied through personal autochip (AS) or retail customer orders.
 ‡Minimum Monthly OV: Organizational Volume (OV) = PV + all other volume in your organization.
 *Rank Qualifications: Rank qualifications must be in separate legs. Additionally, 6-Star must have at least 1 6-Star and at least 2 3-Stars or above, 9-Star must have at least 2 6-Stars and at least 1 3-Star or above.
 †Infinity Bonus: Pays infinitely deep beneath your lowest qualified compressed level, until another IE in your organization achieves the same rank or higher.
 *Matching Bonus: An IE must personally enroll at least one IE or Preferred Customer each month in order to earn Matching Bonus. Once an IE attains the rank of 7-Star Executive, there is no longer a monthly personal enrollment requirement to receive Matching Bonus. Matching Bonus is based on the unilevel check of personal enrollments.

Appendix 2D

Comparative Analysis of Direct Sales and other Legitimate Distribution Models with No-Product (cash-based) Pyramid Schemes (NPS) and MLMs*, or Product-based Pyramid Schemes (PPS)

Analysis by Jon M. Taylor, MBA, Ph.D., President, Consumer Awareness Institute, and Advisor, Pyramid Scheme Alert

What this analysis reveals

The table which follows shows that clear distinctions can be made between classic (1-2-4-8, etc.) no-product pyramid schemes, product-based MLMs (multi-level marketing) programs*, and all forms of legitimate businesses to which the latter are often compared. MLM programs are often referred to as “network marketing” (also “consumer direct marketing,” etc.) and can be separated into two categories:

1. Recruitment-driven MLMs use compensation systems that are so heavily weighted towards the top of the hierarchy of participants that it is necessary for participants to recruit aggressively to realize any significant profits. These are highly leveraged programs, enriching a few at the top of a pyramid of participants at the expense of the efforts and purchases of a multitude of downline distributors – whose contributions are “leveraged” for the benefit of those above them. In recruitment-driven MLMs, most of the payout in commissions and bonuses from the MLM go to top distributors and very little can be gained from efforts to sell products directly to consumers. Properly understood, such MLMs are illegal pyramid schemes. The vast majority of MLMs I have studied fall into this category.

2. Hypothetical retail-focused MLMs pay the bulk of their commissions to the person selling the products or services to end use consumers. In a retail MLM, there is enough incentive to sell directly to customers that it is not necessary to recruit a large downline to realize significant profits. In over 600 MLMs (to date), I could find no examples of true retail-focused MLMs. So I feel safe in concluding that retail-focused MLMs do not exist.

How these distinctions were derived

Fortunately, I was able to draw from an extremely broad background in home businesses to make these comparisons. Following my MBA degree, as an adjunct college instructor, I taught entrepreneurship and was involved in over 40 business startups. I had direct experience or performed consultation services in almost all forms of business to which MLMs are often compared. In addition, I spent a full year in an intensive one-year test of a leading MLM as a full-fledged distributor, carefully noting everything that went on. I then conducted interviews with hundreds of present and former participants in a variety of MLMs before arriving at the conclusion that most MLMs are in fact cleverly disguised pyramid schemes.

I knew enough from my direct experience to know that the major problems with MLMs resulted from the compensation systems, or pay plans, of the various MLM companies. Also, my Ph.D. studies in applied psychology gave me valuable insights into the influence of incentives on behavior. Decades ago, psychologists learned that “you get the behavior you reward.” Nowhere is this more evident than in multi-level marketing.

Combining the research and experience of myself and others, I itemized what characteristics in MLM and in no-product pyramid schemes are unique to them and clearly differentiate them from other types of business activity. Then I broke these down into those which were implicit within the compensation plan – which seemed to cause most of the problems – and those that could be considered merely effects growing out of the reward system. Items numbered 1 to 6 could be considered causal, while items numbered 7 to 17 could be considered effects. Number 6 applies to no-product pyramid schemes and is replaced by number 4 for product-based pyramid schemes.

Other useful findings:

What I found was strikingly clear. Five characteristics*** (especially the first four) clearly differentiated the MLMs, or product-based pyramid schemes from the rest. These factors were both defining and causal – defining the differences, as well as identifying the causes of the problems. No-product (cash-based) pyramid schemes have always been more easily recognized, both by law enforcement and by consumers. What this analysis shows is that traits can be singled out both to clarify differences and to predict high loss rates.

These same five “red flags” could have legal significance in court cases. In most jurisdictions, a key element is considered in defining pyramid schemes – the payment of money by the company in return for the right to recruit other participants into the scheme. If the primary emphasis is compensation from recruiting, rather than from the sale of products to end users, it is considered a pyramid scheme. How such primary emphasis is to be determined has until now been a formidable challenge for investigators. Hopefully, this challenge will be met with this analysis and my more complete analysis entitled “*THE 5 RED FLAGS: Five Causal and Defining Characteristics of Product-Based Pyramid Schemes*”***

In the spring of 1999, I mailed my conclusions to the presidents of 60 of the most prominent MLM companies and gave them a form to provide data to “prove me wrong.” At least five of them attempted to do so, but none were able or willing to do so. So I was left with the necessity of validating my conclusions using other resources. With the help of associates, careful research into public documents, and a lot of communications with key informants, I was finally able to locate the average incomes and percentages of “distributors” at various payout levels at 37 (by 2012) MLM companies. What I found was startling – far worse than expected. After eliminating typical deceptions in their reporting, the loss rate for the MLMs for which I was able to find average earnings data was approximately 99.7%. And if you eliminate TOPPs (top-of-the-pyramid-promoters) from the calculation, the loss rate is closer to 99.9% for new recruits.

That means that as few as one in 1,000 new recruits earn a profit – and only a tiny percentage of those earn the huge “residual income” promised them. No-product pyramid schemes, which are illegal because of the guarantee that the all of those on the bottom layers will lose money, have far better odds than that! Recent data shows that product-based pyramid schemes are far worse than no-product schemes by any measure – loss rate, aggregate losses, number of victims, etc.

The chart that follows is color-coded to help discern the differences between characteristics of the various business models. Defining and causal characteristics of -

No-product (cash-based) pyramid schemes are marked in **medium gray**.

Recruitment-driven MLMs are **dark gray**.

Retail-focused MLMs (if such were to exist) are **light gray**.

Significant effects that are not causal are marked in **very light gray**, the most important of which are listed first, as numbers 7 to 10.

* a.k.a. multi-level marketing, network marketing, consumer direct marketing, etc. Recruitment-driven MLMs can be distinguished from retail-focused MLMs, in which the company pays generously for retailing products without recruiting large downlines. For retail-focused MLMs, #5 (and preferably #4 as well) would be answered with a “NO.”

** “Incentivized purchases” are purchases of goods and services from the MLM company that are tied to qualification to participate in commissions or to advance through ascending levels in the distributor hierarchy. If they constitute a required cost of participating in the “business opportunity,” then whether they are used, sold, given away, or stored is irrelevant – they should be considered a cost of doing business.

*** **NOTE:** In 2003, I settled on the 5 CDCs (or “5 red flags”) for analytical purposes. However, analysis of over 600 MLMs has led me to reduce the number to four, since #4 occasionally does not apply. [#4 and #5 were later reversed in subsequent reports so that the first four could be easily identified as universal and #5 as applied to most, but not all, of them.] However, when the number of levels in the pay plan has been limited to four or less, this has been compensated for by extreme jumps in income at the top levels. All are top-weighted, though increasing the number of levels can greatly enhance the effect.

DEFINING AND CAUSAL CHARACTERISTICS in the compensation system that identify harmful pyramid schemes. The features on this page both define a pyramid scheme and cause the harm (extreme loss rate).	Franchises	Distributor-ship sales	Insurance agency sales	Recruiting business	Legitimate Direct selling	NPS (no-product schemes)	PPS- or recruitment-driven MLMs	Retail MLMs (hypothetical)	COMMENTS – and PROBLEMS resulting from these characteristics when applied to pyramid schemes (NPS and PPS)
<p>1. RECRUITING OF PARTICIPANTS IS UNLIMITED IN AN ENDLESS CHAIN OF EMPOWERED AND MOTIVATED RECRUITERS RECRUITING RECRUITERS. Is unlimited recruiting allowed, and are those who are recruited empowered and spurred on by incentives (overrides, advancement, etc.) to recruit additional recruiters, who are also empowered and motivated to recruit still more recruiters, etc. – so that the effect is an endless chain of recruiters recruiting recruiters?</p>	NO	NO	NO	NO	NO	YES	YES	YES	Income is dependent on downline recruiting, with the assumption of an unlimited market. Perceived or de facto saturation results in diminishing opportunity and guaranteed losses for participants at bottom levels. If all pyramid schemes were defined as illegal (and the laws were enforced) based on this one characteristic, we would not have the proliferation of schemes we see today.
<p>2. ADVANCEMENT IN A HIERARCHY OF MULTIPLE LEVELS OF “DISTRIBUTORS” IS ACHIEVED BY RECRUITMENT, RATHER THAN BY APPOINTMENT. Does a participant advance in position (and potential income) in a hierarchy of multiple levels of “distributors,” by recruiting other distributors under him/her, who in turn advance by recruiting other distributors under them, etc.?</p>	NO	NO	NO	NO	NO	YES	YES	YES	If a participant must recruit to advance to more profitable payout levels in the scheme, and if a program's emphasis is on building a downline, it as a de facto pyramid scheme, whether or not it has been declared illegal by authorities. Also, for PPS's, quality of products often becomes questionable when advancement and monetary incentives are tied to recruitment.
<p>3. “PAY TO PLAY” REQUIREMENTS ARE SATISFIED BY ONGOING “INCENTIVIZED PURCHASES” Are new “distributors” given “pay to play” options? That is, are they encouraged to make sizable investments in “incentivized purchases” (purchases tied to qualification for commissions or advancement in the scheme”) in order to take advantage of the “business opportunity,” and later to continue qualifying for advancement and payments from the company?</p>	NO – only initial investment	NO	NO	NO	NO	YES	YES	YES	Such cost of participation assures huge gains for top-level participants, but guarantees losses for those who fail to ascend to higher levels in the hierarchy of participants. The amount of initial investment for PPS's may be small, but total purchases over time can be very significant for those seeking promised rewards, such as advancement to higher “pin levels” or bonus categories.
<p>4. TOP WEIGHTED PAY PLAN – COMPANY PAYOUT PER SALE FOR EACH UPLINE PARTICIPANT EQUALS OR EXCEEDS THAT FOR THE PERSON SELLING THE PRODUCT, CREATING INADEQUATE INCENTIVE TO RETAIL AND EXCESSIVE INCENTIVE TO RECRUIT – AND AN EXTREME CONCENTRATION OF INCOME AT THE TOP. Would a “distributor” purchasing products “for resale” receive about the same total payout (in commissions, bonuses, etc.) from the MLM company as participants several levels above who had nothing to do with the sale? Those at the top of the hierarchy then profit hugely. NOTE: the program is still top-weighted if the total payout for all upline distributors exceeds that for the front-line person selling the product.</p>	NO	NO	NO	NO	NO	YES	YES	NO	This results in extreme inequality in payout to distributors and a high loss rate. Only a few participants at the top of the pyramid get enough in commissions from sales to a large downline to achieve a significant income. Conversely, those on lower levels seldom get enough payment from the MLM to cover their expenses, including purchases from the company. Thus the emphasis is on recruiting, not retailing or direct selling. If distributors on the front line receive over half of an MLM company's payout, the MLM would have more of a retail emphasis.
<p>5. COMPANY PAYS COMMISSIONS AND/OR BONUSES TO MORE THAN FIVE LEVELS OF “DISTRIBUTORS.” Does the company pay commissions and bonuses to distributors in a hierarchy of more levels than are functionally justified; i.e., more than five levels? Even in major corporations, the entire world marketplace can be covered in five levels of sales management – branch, district, regional, national, and international sales managers.</p>	NO	NO	NO	NO	NO	NO – not usually	Usually – if not, #5 is more extreme	4-level limit best	More than 4 levels in an MLM means huge payouts to top level participants, which come from overrides on purchases of a large downline. This more than compensates for the small payout per sale – vs. NPS's, where the top person gets it all. Paying bonuses on more than five levels in an MLM enriches those at the top at the expense of those at the bottom.
<p>6. ALL THE MONEY GOES TO THE TOP. Would participants who recruit other participants into the scheme receive nothing until advancing to the top level in the hierarchy? NOTE: This applies to NPS only – PPSs (MLMs) are still top-weighted without all the money going to one person at the top, but more money goes to the upline than to the front-line person selling the product.</p>	NO	NO	NO	NO	NO	YES	NO	NO	With NPS's, only participants at the top of the pyramid get paid. Those at the bottom levels will always be waiting to advance to the highest level to get paid. Approximately 90% end up losers when the pyramid collapses or is shut down.

DEFINING AND CAUSAL CHARACTERISTICS in the compensation system that identify harmful pyramid schemes. The features on this page both define a pyramid scheme and cause the harm (extreme loss rate).	Franchises	Distributor-ship sales	Insurance agency sales	Recruiting business	Legitimate Direct selling	NPS (no-product schemes)	PPS- or recruitment-driven MLMs	Retail MLMs (hypothetical)	COMMENTS – and PROBLEMS resulting from these characteristics when applied to pyramid schemes (NPS and PPS)
7. Emphasis is on payments for the rights to recruit as the primary source of income, rather than the sale of products and services	NO	NO	NO	NO	NO	YES	YES	NO	This EFFECT results from the system of rewards in the compensation system. Though not a CAUSE of the harm done by pyramid schemes, it is a key criterion in federal and state laws against pyramid schemes.
8. Loss rate is so dismal enough to disqualify them as legitimate businesses. It is rare for participants to report a net profit to the IRS.	NO	NO	NO	NO	NO	YES	YES	NO	Loss rates for recent NPS's have ranged from 87.5% to 93.3%. For PPS's or recruitment-driven MLMs the loss rates are about 99.9%. One can do better with a single roll of the dice in a game of craps in Las Vegas.
9. Misrepresentation and deceptive sales practices are commonplace, as they are essential for any pyramid scheme to survive and grow. If the truth were told about the abysmal odds of "success," few would join the program, and it would soon collapse.	NO	NO	NO	NO	NO	YES	YES	NO	Misrepresentation causes harm to consumers who invest on the basis of incorrect information. To be successful in a PPS or NPS, one must first be deceived, then maintain a high degree of self-deception, and finally go about deceiving others.
10. New pyramidal organizations are set up in other areas (or with new product divisions for PPS's) to maintain downline networks until the pyramid collapses or the scheme is stopped by legal action. By having to recruit new participants to repay earlier investors, NPS's and PPS's evolve into Ponzi schemes.	NO	NO	NO	NO	NO	YES	YES	NO	The more durable MLM companies avoid collapse by initiating new pyramids, which they label "growth opportunities." They then become like Ponzi schemes, moving to new areas or starting new divisions to get new recruits to buy products so that earlier investors can profit.
11. The distinction between buyer and seller becomes blurred. With multi-level schemes, the seller, buyer, and recruiter (and his/her immediate family) may be the same entity.	NO	NO	NO	NO	NO	YES	YES	NO	This creates confusion and a low level of trust in the minds of consumers – and contaminates the marketplace for legitimate enterprises.
12. The program displays a pattern of rapid growth, then a leveling off in sales, followed by a precipitous decline in volume, unless aggressive re-pyramiding occurs.	NO	NO	NO	NO	NO	YES	YES	NO	This pattern is common to all pyramid schemes due to empowerment and incentives given to each recruit to recruit other recruiters, as in #1 (above)
13. Duplication of one's efforts and investment is encouraged in order to build one's downline.	NO	NO	NO	NO	NO	YES	YES	YES	Recruits are taught that this process can lead to great leverage for one's time and investment – but not that they are only fattening the checks of their upline.
14. Continuous replacement of "losers" is supplied by continual recruiting of new participants.	NO	NO	Sometimes	NO	Sometimes	YES	YES	NO	Replacement also helps to maintain a pyramid scheme by creating a "body shop" of new victims to replace an inordinate percentage of dropouts.
15. Demand for the products is distributor-driven, not market-driven.	NO	NO	NO	Sometimes	Sometimes	NO	NO	YES	The need for and quality of products becomes secondary to participation in the scheme. "Pay to play" purchases become disguised (or laundered) pyramid investments. Some MLMs are notorious for hyper-consumption of products, filling garages, etc.
16. Promises are made of quick return on investment, huge residual ("permanent") income, time freedom, and other easy money appeals.	NO	NO	NO	NO	NO	YES	YES	NO	Pyramidal income appeals induce distributor investments, which ultimately become losses for the vast majority of participants—especially for PPS's.
17. Addition to pyramid scheme appeals can be seen in some participants.	NO	NO	NO	NO	NO	YES	YES	NO	"MLM junkies" have been observed cycling through one MLM after another, losing money each time. It is likely that these same people would fall for NPS's.

For more information, go to www.mlm-thetruth.com.

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Appendix 2E

List of MLMs for which compensation plans have been analyzed by Jon M. Taylor, MBA, Ph.D.

As of May 1, 2017, a total of over 600 MLMs have been evaluated by Dr. Taylor (usually by request). When at least the first four of the five causal and defining factors, or "red flags," identified by Dr. Taylor are found in an MLM, it can be considered a recruitment-driven MLM, or product-based pyramid scheme – and certainly an unfair and deceptive practice (UDAP). Such compensation plans have been found to result in loss rates of 99.1% to 99.9%, with an average loss rate of 99.7% in the 50 MLMs analyzed in Chapter 7.

When you eliminate TOPPs (top-of-the-pyramid promoters) from calculations of average incomes, the chances of new recruits profiting is approximately ZERO!

In addition to those listed below, Dr. Taylor also analyzed numerous MLM programs that are now defunct, shut down by authorities, or that did not provide sufficient detail in their compensation plans to do a complete evaluation. This was true of many party plans.

Those MLMs with the symbol ► by them have furnished average income statistics (See Appendix 7)

Disclaimer: Since each person is encouraged to do their own 5-step "do-it-yourself evaluation" on our web site, we will not be responsible for the decision any reader chooses to make about participation.

MLMs analyzed:

1Cellnet
 10 Level Riches
 124 Online
 3000 BC
 4 Corners Alliance Group
 4Life International
 4 the Good Life
 5Linx

A

A. L. Williams (now Primerica)
 Acai Plus
 Achievers Unlimited
 ACN
 Adcalls
 Advantage Marketing Systems
 Advantage Neutraceuticals
 ► Advocare
 Affordable Energy
 Agel
 Ageloc (product division of
 Nu Skin)

AIM

Alivemax
 All-star Entrepreneur
 AlpineV
 Altairia
 Amazon Herb
 Ambit Energy
 Amega Global
 American Longevity
 Ameriplan USA
 AMS - American Marketing
 Systems
 Amway
 APP - American Petroleum
 Prom's
 ► Ameriplan USA
 Amerisciences
 Amigo Health
 Amkey
 Amsoil
 ► Amway (was Quixtar in
 USA for a few years)

Annasa

Apeus
 Approval Warehouse

► Arbonne

Ardyss International
 Ariix

Ascend Technologies**Ascental Bioscience****Asea****At Home America****Ava Anderson Non-toxic****Avalla (distributes Nutrimetrics)****Aviance****Avon (now an MLM)****Awareness Life****B****Baby Crazy****Bamboo Park****► Beach Body****BeautiControl Cosmetics****Bel'Air****Bellamore****Better Universe****Beyond Freedom Evolution****bHIPGlobal****Big Planet (was a Nu Skin
 division)****Boceutical****Biogen****Biometrics****Bioperformance****BioPro****BioSolace (India)****BodHD****Bodywise****Bookwise Books****Boresha Int'l****Brain Abundance****Brain Garden****Business in Motion****Business Toolbox****C****Cabi****Cajun Country Candies****CCM -Consumer Choice****Marketing****Celebrating Home****Cell Tech****Cell Wireless****Ceres Living****Champion Communications****Cie Aura****Citizenre****Cleur****Coastal Vacations****Cognigen****Common Sense****Communications (Telex Free)****Conklin****Consumer Choice Marketing****Cookie Lee Jewelry****cPRIME****CR Health & Beauty Systems****Creative Memories****Customer Advantage****► Cyberwize****D****Daisy Blue****DBN- Downline Builders Network****DCHL - Digital Crown Holdings Ltd.****De Marle at Home****Destiny 2000****Direct from Vatican City****Discount Home Shoppers Club****(now Global Income Partners)****Do Terra Earth Essence****Dove Chocolate Discoveries****Drink ACT****DS Domination****DSX****Dubli****DXN****Dynapharm****Dynasty of Diamonds****E****Easy Daily Cash****E-bio (India)****Ebiz.com****► Ecoquest (now Vollara)****eCosway****eFoods Global****eFusion (acai products)****Eiro****Elite Marketing Alliance****Elur****Emgoldex****Emerald Essentials****Emerald Passport (Profit****Masters)****Emgoldex****Empire Dreams****► Empower Network****Enagic****Energetix****Enfinitia****Eniva Gold Marketing****Enliven****Envision CC****Envy Organics****Epic Network****Escape International****Essante****Essensa Naturale****Essentially Yours****Evolution International****Evolv Health****Excel Telecom's (acquired by
 non-MLM company))****eXfuse****Extreme Research****EZ Wealth by Design****EZ-Biz****F****Feeder Matrix****Fern****FFSI****FGExpress****Financial Education Services****First Financial Security****First Fitness International****First Source Marketing Alliance****Flexcom****FM Group World****For You****Foru Int'l****Forever Green****Forever International****Forever Living****Formor Int'l****Forte Builder****► FHTM (Fortune Hi-tech Mktng)****► Free Life International****Freedom Rocks****Fruda Vida International**

Frutaigo
 Fuel Freedom International
 Fuller Brush
 Fun Unlimited

G

Gano Excel, Gano Life
 Gatask
 GBG
 GDI - Global Domain Int'l
 Gem Lifestyle
 Gemcap
 Genesis Global Network
 Genesis Pure
 Genewize Life Sciences
 Global Equity Lending
 Global Health Trax
 Global Income Partners
 GIN- Global Information Network
 Globalinx
 Global Resorts Network
 Global Travel Trends (PRT Travel)
 Global Wealth Trade
 GNLD
 GOG (India)
 GoHFT
 Gold Canyon
 Gold Mine International
 Golden Neo-life Diamite
 GoldQuest
Goldshield Elite
Good Life International
Goyin
Great Life International
Green Organics
Green World
GVO Team Elite

H

Hand of Heaven
Havvn Jus (formerly Jus Int'l)
HBW Insurance & Financial
Health 4 Wealth
Healthy Coffee USA
Healthy Habits Global
 ► **Herbalife**
Heritage Health Products
Heritage Makers
Home Tec
Hsin Ten Enterprise USA
(HTE)

I

iBuzzPro
ID Life
Ideal Health (later Trump
Network)
IGlobalPro
 ► **Ignite/Stream Energy**
Igonet
Ingreso Cyber
 ► **Immunotec**
Independence Energy Alliance
 ► **iNet Global**
Infinii

Infinity Downline (no joke)
Ignite (Stream Energy)
Ingreso Cyber (Columbia)
Inner Light
Inspired Living App
Integris Global
IDN – Interior Design
Nutritionals
 (early Nu Skin division)
IGI - Internationall Galleries,
Inc.
 ► **Isagenix**
It Works Marketing
ITV Ventures
IV-7 Direct
iWowwe
iZigg Mobile Marketing

J

Jafra
Jamberry
Jasuru
Javita Coffee
JD Premium
Jeunesse Global
Jewelry by Park Lane
J Hilburn
Jillian Chase
JM Ocean Avenue
Juice Plus (NSA)
Jusuru International

K

Kaching Kaching
 Kaire
 Kangivity Global
 Kannaway
 Kanosis
 Karatbars
 Karemore
 Kilante Coffee
 KIS
 Kleeneze (UK)
 K-Link
 Klob International
 Kompound Strategies
 Kyani

L

Learning Global USA
 Leaving Prints
 Legacy for Life
 Legacy Max
 Legal Shield (was Prepaid Legal)
 LEO (UK)
 Le-Vel
 Level One Network
 Level 9 Marketing
 Lexus
 Lia Sophia
 Liberty International
 Liberty League Int'l (LLI)
 Life Force Int'l (2-up)
 Life Leadership
 LifeMax

Life Plus
 Life TEAM
 Life Vantage
 LifeWave
 Life without Debt
 Lifestyle Intra Supplements
 Lightyear Alliance
 Limu
 LiveSmart 360
 Live the Source
 Livity
 Longevity Network
 Longrich
 Loving Works
 LR Health & Beauty Systems
 LuLaRue
 Lyonness

M

Maakoa
 Mandura
 ► **Mannatech**
 Market America
 Mary Kay Cosmetics
 Matol Botanical
 Mavericks (World Health Card)
 Max International
 Maxxis 2000
 MB Social
 MCA - Motor Club of America
 Me2Everyone
 ► **Medifast (Take Shape for Life)**
 Mega Holdings
 ► **Melaleuca**
 Menage International
 Metabolife
 ML International
 MMOGULS
 Momentis
 ► **Momentum Plus**
 ► **Mona Vie**
 Monarch Health Sciences
 Morinda
 Moxxor
 MPB Today
 Multi-pure
 ► **MXI-Xocai**
 MWR Life
 MyDay1 (like One24)
 My Harvest America
 My Leisure Business
 My Travel & Cash
 My Video Talk
 My4Life
 My7Diamonds

N

NAA - National Agents Alliance
 Narc that Car
 National Lending Corp.
 National Wealth Centers (NWC)
 Native American Nutritionals
 Natural Air Products
 Naturally Plus
 Nature's Own

Nature's Pearl
 Nature's Sunshine
 Neucopia
 Nerium
 Netsurf
 Network Marketing VT
 Neucopia
 Neutrie
 NeutroGenesis
 New Face of Wealth
 New Image
 New Quest International
 New Vision USA
 Neways
 NextFit
 Nexx
 NHT Global - Nat'l Health Trends
 ► Nikken
 NMC – National Motor Club
 Noevir
 North American Power
 Norwex
 Nouveau Cosmeceuticals
 Nouveau Riche University
 NSA (Juice Plus)
 Nucurity
 NuLegacy Rx card
 NuMed
 ► Numis Network
 ► NuSkin Enterprises, Inc.
 Nussentials
 Nutronix
 Nuvante
 Nuverus

O

Ohana Health
 Olivana
 Omegatrends
 Ominex
 Omnitrition
 One24
 OneX
 Online Exchange
 OnPoint Direct
 One Viz
 ► Orenda Int'l
 Organo Gold
 Origami Owl
 Orovo
 Our World Network
 Oxyfresh

P

Palmary
 Pampered Chef
 Pangea Organics
 Paperly
 PartyLite
 Passion Parties
 Passport LLC
 Paycation
 Petromagic
 Pharmanex (was NuSkin division)
 PhotoMax

Pink Papaya
 Plexus
 PM International AG
 Polaris Global (was Liberty League Int'l)
 Power Mall
 Power2Marketing
 Premier Designs
 Prepaid Legal
 Prepaid Living
 Primerica Financial Services
 Princess House
 Private Quarters
 ProActiv (Empower Network)
 Protandim (Life Vantage)
 Priedale Ventures
 Pur3x
 PureNRG
 Pure Romance
 Pureworks
 Purium
 Purse Party

Q

Qing Mei
 Qing Mei (cards)
 Qivana
 QL Exchange
 Qnet (was GoldQuest)
 Qscience
 Questnet
 Quixtar (formerly Amway in USA - now Amway again)

R

Rain Nutrition
 RBC Life Sciences
 Refer Life
 Regeneca
 ► Reliv
 Rend Ltd.
 Resorts 360 Vacation Club
 Retire Quickly
 Rev Up Daily
 Ripplin
 RMP Infotech
 Rodan & Fields (Victoria Skin Care)
 Royal Body Care
 Royale Business Club

S

Sahara of India Pariwar
 Salu International
 Sami Direct
 Savings Highway
 Scent-sations
 Scentsy
 SDL Seminars (New Zealand)
 Seacret Direct
 ► Sendoutcards.com
 Sene Gence International
 Sensaria
 Serenigy
 Sevea
 Seven Point 2

SFI – Strong Future Int'l
 Shaklee
 Share the Wealth
 Shopping Sherlock
 Sibub
 Silpada Designs
 Silver Cache
 Simplicity
 Simply You
 Sisel International
 Skinny Body Care
 Slender Now
 Solavei
 Soteria/ (It Works Marketing)
 Southern Living at HOME
 Sozo
 SpeakAsiaOnline.com
 Sportron
 Spring Wellness
 Stampin' Up!
 Stanley Home Prod's (Fuller Brush)
 Stella and Dot
 Stem Tech Health Sciences
 STIFORP
 Stimulife
 Stream Energy (Ignite)
 Strongbrook (real estate)
 Success Life
 Success University
 ► Sunrider
 Supralife
 Surge 365
 Sweet Living
 Swiss Just
 ► Symmetry
 Synergy Worldwide
 Syntec Nutraceuticals
 Syntek Global

T

► Tahitian Noni Int'l
 ► Take Shape for Life (Medifast)
 Talk Fusion
 Tastefully Simple
 Team Everest
 Team Life Changes (Nutraburst)
 Team National
 Team Vinh University
 Telecom Plus
 TelexFree (Ponzi scheme promoted as MLM)
 That Free Thing
 The Green Polka Dot Box
 The Limu Company
 The Profit Masters
 The Right Solution
 The Traveling Vineyard
 The Trump Network
 Thirty One Gifts
 Thoughts Transpired
 Thrive Life
 Tianshi
 Tiarde
 Tiens Biotech Group
 TLC - Total Life Changes

TMI - Transcend Marketing Int'l
 Tom Danley's Tape of the Month
 Tomboy Tools
 Top Line Creations
 Traverus Travel
 Trevo
 Trilogy
 Trinity Communications Int'l
 Trio Global Company
 (Philippines)
 Triunity International
 Trivani
 Trivita
 Trump Network (sold to Bioceutica)
 ► Tupperware
 TVC Matrix
 TVI Express
 Tyra

U

Ubifone
 Ubox
 UltraStore
 Unicity
 UniLife Health Care (India)
 Univera Life Sciences
 Unlimited Profits
 UNO - Unlimited Network of
 Opportunities
 Upper Crust Living
 Uprize
 Uprize
 ► USANA Health Sciences
 Uways

V

Valentus
 V Mobile Technol's (Philippines)
 Vaxa Int'l
 ► Vemma
 ► Viridian
 ► Visalus Health Sciences
 Vision for Life
 Vision Travel
 Vitagenesis
 Vitamark
 Viva Life Science
 Viviane
 VM Direct (Helloworld)
 Vollara (was Ecoquest)
 Votre Vu

W

Waiora
 Wakaya Perfection
 Wake Up Now
 Watkins
 Wazzub
 Wazzub
 Wcm777
 Wealth Masters Int's
 Wealth Pools International
 WIN (Wellness Int'l Network)
 Winalite
 Woosh

World Financial Group
 World GMN
 World Group Securities
 World Leadership Group
 World Lending Group (recently
 Global Equity Lending)
 WMA -World Marketing Alliance
 ► World Ventures
 Wowgreen
 Wynlife Healthcare

X

► Xango
 Xeeklar
 XELR8
 Xerveo ("20 million positions open")
 Ximo
 Xocai
 Xooma
 XOWii
 Xplocial
 Xtra Plan
 Xyngular
 Xzotto

Y

Yagooft
 Yevo
 Yipiz
 Yoli
 ► YOR Health
 Young Living Essential Oils
 Youngevity
 Younique
 ► Your Travel Biz (YTB)

Z

Zamu
 ► Zamzoo
 Zeal
 Zeek Rewards
 Zeekler
 Zermat International
 Zhunrize
 Zija
 Zilergy
 Zinzino
 Zivano
 zoivi
 Zoom Mobile
 Zorpia
 Zrii
 Zu-B
 Zulian
 Zurvita
 Zyngular

Appendix 2F

Petition from Bruce Craig, former assistant to the Wisconsin Attorney General, addressed to FTC Chairman Robert Pitofsky

February 25, 2000

Robert Pitofsky, Chairman,
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Re: Petition for compliance analysis or enforcement review regarding In re Amway, 93 FTC 618 (1979), Docket 9023

Dear Chairman Pitofsky:

I served as an Assistant Attorney General for the State of Wisconsin for 30 years, until retirement in 1997. During this period I litigated a significant number of pyramid cases - including extensive litigation against Amway¹ in the early 1980s and cases against Koscot Interplanetary, Bestline, and Holiday Magic in the early 1970s. These actions were pursued with the direct co-operation of Commission staff. My most recent pyramid case, against Fortune In Motion, was successfully concluded in 1997. I recite this history only in the hope that it will lend credence to what follows.

I direct this letter to you because you drafted the Commission's Amway opinion in 1979. The opinion appears to hold that (a) "a pyramid distribution scheme should now be condemned even without the demonstration of its economic consequences. The Commission has studied the effects of such 'entrepreneurial chains' and seen the damage they do and a per se rule should be used." [ALJ finding at par 107] and (b) that Amway would have been one of those "chains" but for the existence, and enforcement, of the "buy back rule", the "70% rule" and the "10 customer" rule [93 F.T.C. 618, 716-17 (1979)].²

These exculpatory rules have now become boilerplate in the hundreds of pyramid offerings that have surfaced since 1979. In my 1997 case, Fortune In Motion sought dismissal because it had incorporated the "Amway" rules into its marketing plan.³ In Webster v. Omnitrition, 79F.3d 776, 782-84 (9th Cir, 1996), the 9th Circuit reversed summary judgment in favor of the defendant, granted by the district court on the basis it used the "Amway" rules. The court, at p. 782, held "Our review of the record does not reveal sufficient evidence as a matter of law that Omnitrition's rules actually work."

Since investments in pyramid type offerings have resulted in billions of dollars in losses over the years, I believe it critical that the Commission, initially, determines whether in fact Amway currently enforces its rules to the extent that they produce the results the Commission anticipated in its decision.

The Commission may also want to consider, on a going forward basis, whether it is good policy to declare a practice per se illegal and then permit operation if certain exculpatory "rules" are incorporated into the business plan. The attractive, but illegal, aspects of a pyramid proposal will continue to permeate a promoter's offering and recruiting efforts notwithstanding the theoretical dampening effect of the "rules." **The economic motivation of a company utilizing a pyramid concept is in direct conflict with the exculpatory "rules" it promulgates.**

There also exists the question, from an enforcement standpoint, whether these exculpatory factors can be effectively evaluated in time to prevent losses to the consuming public. When a pyramid, or "multi-level", company begins business operations there is no direct evidence if its "rules" are enforced or not. The time period between startup

and detection is all some pyramids need. Fortune In Motion obtained over \$4 million from Wisconsin residents during its short life and before we commenced litigation. The "buy back" rule was of no value since the company left the state and returned to its home offices in Canada. Does the enforcement agency bear the burden of proving that the "rules" are not enforced or is it an affirmative defense on the part of the pyramid company? Are all "multi-level" companies presumed to be pyramids until they prove their rules are effective in the manner contemplated by the Commission?

The contacts I have had with Amway, and other, distributors over the years indicates that the "rules" upon which the Commission based its decision are given, at best, token recognition and are not broadly implemented or enforced. I have attached some unedited Amway distributor statements to simply give a flavor of their views on these issues. One such statement comes from a high level "Emerald" distributor. Determining the actual practices of Amway and its distributors in this respect would seem to be uniquely within the domain of the Commission. To this end, I will be asking some ex-distributor organizations to contact their members for comment to the Commission on this point, pro or con.

I decided to submit this petition for enforcement review because it seems that most distributors, after failing in what they thought was a valid business enterprise, are not motivated to complain or seek redress. They have, in many instances, been conditioned to believe that any failure was their fault. Many such distributors have lost life savings, stable jobs, and their marriages. After having spent most of my career dealing with these companies from an enforcement standpoint, and witnessing the damage first-hand, I feel some obligation to these victims to make this effort on their behalf.

As indicated in Omnitrition, previously cited, and my Fortune In Motion case, the FTC Amway decision has created a good deal of uncertainty in respect to private and public legal efforts to deal with the abuses of pyramid plans. This will only increase with the onset of marketing over the Internet and the Globalization of this type of proposal.

I urge the Commission to make initial inquiry of Amway on the question of enforcement and enforceability of its rules. Documentation of compliance with the Commission's decision, and of the beneficial effects it anticipated, should be readily available from Amway and its distributors. I also urge the Commission to re-evaluate, in general, the efficacy of its "rules" in preventing the abuses it has documented in connection with pyramid marketing. **The premise of "multi-level vs. pyramid" marketing may well represent a distinction without a difference.**

If I can be of further assistance in any efforts of the Commission, or in clarifying matters stated herein, please feel free to contact me. I appreciate your taking the time to review this matter.

Sincerely,

Bruce A. Craig – Assistant to the Attorney General (Department of Justice), State of Wisconsin (Retired). State Bar No. 1009068, of Counsel, Lawton & Cates, S.C.

¹ This litigation was based on income misrepresentations. Documented evidence, from tax returns, disclosed that Wisconsin Amway Direct Distributors (the top 1%) had annual net incomes of minus \$900.

² Some language in the opinion, pp.716, 717, refers to the absence of inventory loading, "the purchase of a large amount of nonreturnable inventory" and the fact that an entry level Amway distributor makes no investment. However qualifying for the Direct distributor position does require mandatory monthly purchases, whether returnable or not depending on effective enforcement of the "buy-back" and other rules. **The existence of the entry level distributor is not relevant to a pyramid analysis; the pyramid begins when the new distributor seeks to become a Direct.** See Omnitrition par. 79 F.3d 776,782.

³ Wisconsin's pyramid rule, Ch. ATCP 122, Wis. Adm. Code does not contain the exculpatory "rules". It has been upheld by the Wisconsin Supreme Court.

Appendix 2G**Letter to Dr. Peter Vander Nat, chief economist for the
Federal Trade Commission**

April 24, 2001

To: Peter J. Vander Nat, Ph.D.
Federal Trade Commission

From: Bruce A. Craig, Assistant Attorney General, Wisconsin (Retired)

RE: PYRAMID ANALYSIS

I have reviewed your declaration in the Equinox case. I would like to submit an alternative analysis of pyramids. Although many of the elements and concerns referenced in your declaration mirror mine, I believe our point of departure differs.

BACKGROUND

I have litigated against pyramids since the late 1960s. The significant economic losses they engendered raised the concerns of our office over and above standard fraudulent business offerings that relied on misstated earnings potentials and related deceptions.

Wisconsin has a relatively unique regulatory status within the Department of Agriculture, Trade and Consumer Protection – whereby rules having the force and effect of law can be promulgated at the administrative level. One of those rules is ATCP 122, which can be found at the end of this memorandum. After extended public hearings, ATCP 122 declared illegal “chain distributor schemes.” The rule has withstood challenges in the Wisconsin Supreme Court and in Federal Court. Most recently, the rule was upheld, in 1997, by the Wisconsin Court of Appeals in State v. Fortune In Motion.

Perhaps of greater relevance to you is the fact that the then (c. 1972) Chairman of the Marketing Department of the Wisconsin School of Business, Howard Westing (now retired), was our primary witness in State v. H. M. Distributors and State v. Holiday Magic, the first significant legal challenges to ATCP 122.

Professor Westing’s testimony was forthcoming only after we spent several weeks discussing the elements of ATCP 122 and the pyramids it regulated. His initial reticence was based upon a natural inclination not to challenge what was then a novel means of marketing. Perhaps my interest at the time was based upon my undergraduate degree in marketing from Northwestern University and the stimulation provided by my mentor Stuart H. Britt.

The substance of Professor Westing’s testimony was that pyramids provided a form of “foreseeability” that enabled them to succeed notwithstanding non-competitive products, overlapping marketing areas, and saturated markets. In this context “foreseeability” was the element that let every new applicant see not only how he could recruit for profit but also that all those he recruited could similarly recruit, ad infinitum. In other words, there was no barrier within the terms of the pyramid plan to continued recruiting.

In essence, a pyramid is an endless chain in the guise of a business offering. This provides considerable leverage to pyramids because they could appeal to business success stories rather than the clearly gambling elements of a chain letter or lottery. Also they had the advantage of appearing, at first glance, as businesses to regulators and legislators – thus a foothold that has lasted until today.

Perhaps Wisconsin was fortunate in having a pyramid type endless chain reviewed, in 1907, by the Wisconsin Supreme Court in Twentieth Century Co. v. Quilling 130 Wis. 318, 319-20, 110 N.W. 174 (1907), the scheme involved the right to sell a “pole and thill coupling” to others:

It was further agreed that each person to whom a sale was made should have the same right as the defendant to sell exclusive territorial rights in other counties, and the purchasers from him still the same rights, and so on without limits.

We are unable to regard such a project as a legitimate business enterprise . . . it will infallibly leave a greater or less crown of dupes at the end with no opportunity to recoup their losses because the bubble has at last burst. It contemplates an endless chain of purchasers, or, rather a series of constantly multiplying endless chains, with nothing but fading rainbows as the reward of those who are unfortunate enough to become purchasers the moment before the collapse of the scheme.

What Twentieth Century did was focus Wisconsin’s efforts towards the endless characteristics of a pyramid. This was reflected in ATCP 122.

ANALYSIS

The controlling element of every pyramid I have examined is that reflected in ATCP 122:

ATCP 122.02 Definition. (1) “*Chain distributor scheme*” is a sales device whereby a person, upon a condition that the person make an investment, is granted a license or right to recruit for profit one or more additional persons who also are 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 the above license or right to recruit or the receipt of profits therefrom, does not change the identity of the scheme as a chain distributor scheme. (emphasis supplied)

Once product sales and lower level introductory positions are stripped from the plan, the skeleton remaining is one where the recruit, for an investment (usually in the form of a minimum purchase or minimum monthly purchases), earns the right to recruit others in the same manner he was recruited.

The elements presented by this scenario are as follows:

1. The rules by which the pyramid operates are initiated, administered and enforced by the sponsoring company.
2. The recruit seeking to participate in the pyramidal elements of the offering must make a purchase or series of purchases i.e. an “investment”. Usually this is a purchase from a recruiter who obtains his product from the sponsoring company at a discount from the amount paid by the recruit.
3. The required purchase generates profit to the recruiter and the sponsoring company from whom the product is purchased.
4. At the time the recruit makes his purchase investment he is fully aware that once reaching the distributive position for which the investment is made, he will be able to recruit others and profit in the manner described in Nos. 1,2, and 3 above.
5. Furthermore, the recruit realizes that his chances for recruiting others in a manner which will generate to him the profits above discussed are significantly enhanced by his ability to offer, pursuant to the plan of the sponsoring company, those recruits the same right (or in terms of ATCP 122 – “such license”) as he obtained with his investment.
6. All future recruits within this narrative will have the identical rights as those of the first recruit, including the ability to offer to their recruits such rights, ad infinitum.
7. The plan does not diminish the right to recruit, upon investment, at any time along the chain (such as regional managers recruiting district managers who in turn recruit sales

agents). If it did, the element of “foreseeability” would deter the first recruit from joining, since his recruits would not enjoy the same recruiting rights as he does, and thus be much less likely to join.

8. It is the “endless” element of these proposals that distinguishes pyramids from other business offerings that do not contain that element.

DISCUSSION

A pyramid is much like a lottery, its mechanism is what makes it illegal – because the mechanism has no limit in its implementation. Many chain schemes are classified as lotteries, see for instance sec. 945.12 of the Wisconsin Statutes:

945.12 Endless sales chains. Whoever sets up, promotes or aids in the promotion of a plan by which motor vehicles are sold to a person for a consideration and upon the further consideration that the purchaser agrees to secure one or more persons to participate in the plan by respectively making a similar purchase and in turn agreeing to secure one or more persons likewise to join in said plan, each purchaser being given the right to secure money, credits, goods or something of value, depending upon the number of persons joining in the plan, shall be held to have set up and promoted a lottery and shall be punished as provided in –

http://folio.legis.state.wi.us/cgi-bin/om_isapi.dll?clientID=78254&infobase=stats.nfo&jump=945.02&softpage=Document-JUMPDEST_945.02s.945.02

The further prosecution of any such plan may be enjoined.

This analysis goes directly to the element of the plan that makes it a pyramid. Take away the right to offer future recruits the same rights to profit and recruiting held by the recruiter and the plan fails – or must exist on other legal or illegal marketing elements.

The FTC in the Amway decision appeared to recognize this critical factor, and then ignored it by concluding that retail sales and buy back provisions in the plan somehow changed it into a legal enterprise.

A lottery is not made legal by adding requirements to participation or requiring acts, which would, in theory, mitigate the impact of the lottery. An illegal lottery is rendered legal by eliminating one of the elements of prize, chance and consideration.

A pyramid is rendered legal by eliminating either the investment or the unbridled right to pass on recruiting rights identical to those held by the recruiter. In the case of a pyramid, neither of these elements is critical to a bona fide business.

While requirements of bona fide retail sales and buy backs would undoubtedly mitigate the impact of a pyramid, they would also destroy the pyramid if truly enforced – just as the theatre referenced in footnote 3 would go broke if it truly let any meaningful number of persons participate in its lottery without buying a ticket to the movie.

As previously discussed in my petition to the Chairman of the Commission, from an enforcement standpoint, it would be impossible to monitor the efficacy of a retail sales or buy back rule at the time a pyramid started up and likely impossible to validate at the time when the pyramid collapsed and the company disappears. The other scenario, much more dangerous, is that the company continues in business and has the economic and political resources to deter the Commission from even determining whether the retail sales and buy back rules are in fact enforced. It is for these reasons that I contend that the only way to prevent a pyramid from operation is to prohibit it, like a lottery, and require the company to eliminate one of the pyramidal elements before operating.

In theory, a buy back rule could result in the conclusion that no “investment” was made since the money could be returned if requested. If this were the case, it would be the legal obligation of the defendant to prove that the buyback is readily and universally

available to the extent that no “investment” was made. Here, it would be the legal burden of the defendant, not the government, to prove the plan was not a pyramid.

CONCLUSION

I have no doubt that you are fully aware of the damage that a pyramid can cause. My recollection is that pyramids virtually destroyed the government infrastructure of Romania and areas of Russia. They clearly have taken billions from the thousands of participants over the years, not to speak of the diversion of funds from legitimate business enterprises.

*I recognize the difficulty the Commission has in undoing the Amway decision. However, if there was ever a time to reverse this trend it has to be now. I strongly urge you to focus your marketing and economic talents toward the “foreseeability” element referenced by Professor Westing and less towards traditional marketing analysis of products and markets. As I previously indicated, **I believe the MLM – Pyramid distinction to be illusory.** Proof of emphasis on retail sales and other distinctions that may mask the “investment” element neither go to the heart of the pyramid analysis nor escape the enforcement problems discussed above concerning the retail sales and buy back rule.*

I wish I had copies of Prof. Westing’s testimony, but it was 30 years ago. If you would like other information or documentation I would be pleased to supply it.

I sincerely ask for your comments on this memorandum, including areas where you think my legal or marketing analysis is flawed. I am not working on commission in respect to these matters.

I ask that this document, sent by e-mail, be currently treated as confidential, or at least not published, until we have had a further chance to discuss it. Be advised that I am sending copies of this correspondence to Prof. Keep, Ms. Perkins, and Taylor and Fitzpatrick. Attached to the e-mail is a copy of the Fortune In Motion opinion. Please note ATCP 122 set forth below.

Thank you for your time and consideration.

Bruce Craig

NOTE: In the Wisconsin law Chain Distributor Schemes are considered an unfair trade practice (The FTC should take note.):

ATCP 122.01 Unfair trade practice. The promotional use of a chain distributor scheme in connection with the solicitation of business investments from members of the public is an unfair trade practice under s. 100.20, Stats. When so used the scheme serves as a lure to improvident and uneconomical investment. Many small investors lack commercial expertise and anticipate unrealistic profits through use of the chance to further perpetuate a chain of distributors, without regard to actual market conditions affecting further distribution and sale of the property purchased by them or its market acceptance by final users or consumers. Substantial economic losses to participating distributors have occurred and will inevitably occur by reason of their reliance on perpetuation of the chain distributor scheme as a source of profit. (emphasis by author)

Appendix 2H

Definitions of – or related to – illegal pyramid schemes in state statutes

[Notes by JMT: Most of the states fail to specify the endless chain of recruitment in pyramid schemes, which would help to separate them from legitimate recruiting businesses. Also, in several states where a chain selling or recruitment program is exempt from being classified as a pyramid scheme if sales are made to anyone (not just to non-participants), or where buyback provisions are offered, the Direct Selling Association has likely influenced the legislation – especially if modifications were recent. Except where otherwise noted, the text for each state is a direct quote of that state's definition. For a compilation of MLM laws in the 50 states, go to the web site for The Advocate Group at – www.theadvocategroup.net .]

Alabama

As used herein, “pyramid sales structure” includes any plan or operation for the sale or distribution of goods, services, or other property wherein a person for consideration acquires the opportunity to receive a pecuniary benefit, which is based primarily upon the inducement of additional persons by that person, and others, regardless of number, to participate in the same plan or operation, and is not primarily contingent on the volume or quantity of goods, services, or other property sold or distributed. [Ala. § Code 8-19-15 (19)]

Alaska

“Chain distributor scheme” means a sales device whereby a person, upon condition that the person make an investment is granted a license or right to solicit or recruit for profit one or more additional persons who are also granted a license or right upon condition of making an investment and may further perpetuate the chain of persons who are granted a license or right upon the condition of investment. [Alaska Consumer Protection Act. AS § 45.50.561 (See definitions a.3)]

Arizona

“Pyramid promotional scheme” means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from any person's introduction of other persons into participation in the plan or operation rather than from the sale of goods, services or intangible property by the participant or other persons introduced into the plan or operation. (Ariz. Rev. Stat. § 44-1731. Modified 3-5-2010)

Arkansas

A pyramiding device shall mean any scheme whereby a participant pays valuable consideration for the chance to receive compensation primarily from introducing one (1) 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. (Ark. Code Ann. § 4-88-109)

California

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.* (Cal. Penal § 327)

Colorado

“Pyramid promotional scheme” means any program utilizing a pyramid or chain process by which a participant in the program gives a valuable consideration in excess of fifty dollars for the opportunity or right to receive compensation or other things of value in return for inducing other persons to become participants for the purpose of gaining new participants in the program. (Colo. Rev. Stat. Ann. § 6-1-102)

Connecticut

The advertisement for sale, lease or rent, or the actual sale, lease or rental of any merchandise, service or rights or privileges at a price or with a rebate or payment or other consideration to the purchaser which is contingent upon the procurement of prospective customers procured by the purchaser, or the procurement of sales, leases or rentals of merchandise, services, rights or privileges, to other persons procured by the purchaser, is declared to be an unlawful practice rendering any obligation incurred by the buyer in connection therewith, completely void and a nullity. The rights and obligations of any contract relating to such contingent price, rebate or payment shall be interdependent and inseverable from the rights and obligations relating to the sale, lease or rental. (Conn. Gen. Stat. Ann. 42-105)

Also – from State v. Bull Inv. Group, Inc. (1974) 351 A.2d 879, 32 Conn.Supp. 279:] Pyramid fraud law prohibits sale of rights or privileges where payment made or consideration given to purchaser is contingent on his procurement of prospective customers; since both vertical and horizontal pyramiding involve rebate or payment to purchaser which is contingent upon procurement of prospective customers procured by purchase, both forms of pyramiding are prohibited by this section.

Delaware

"Pyramid or chain distribution scheme" means a sales device whereby a person, upon a condition that the person part with money, property or any other thing of value, is granted a franchise license, distributorship or other right which person may further perpetuate the

pyramid or chain of persons who are granted such franchise, license, distributorship or right upon such condition. (Del. Code Ann. § 2561)

Florida

A "pyramid sales scheme," which is any sales or marketing plan or operation whereby a person pays a consideration of any kind, or makes an investment of any kind, in excess of \$100 and acquires the opportunity to receive a benefit or thing of value which is not primarily contingent on the volume or quantity of goods, services or other property sold in bona fide sales to consumers, and which is related to the inducement of additional persons, by himself or herself or others, regardless of number, to participate in the same sales or marketing plan or operation, is hereby declared to be a lottery, and whoever shall participate in any such lottery by becoming a member of or affiliating with, any such group or organization or who shall solicit any person for membership or affiliation in any such group or organization commits a misdemeanor of the first degree, punishable as provided in s. 775.082 or s. 775.083. For purposes of this subsection, the term "consideration" and the term "investment" do not include the purchase of goods or services furnished at cost for use in making sales, but not for resale, or time and effort spent in the pursuit of sales or recruiting activities. (Fla. Stat. Ann. § 849.091)

Georgia

"Pyramid promotional scheme" means any plan or operation in which a participant gives consideration for the right to receive compensation that is derived primarily from the recruitment of other persons as participants into the plan or operation rather than from the sale of goods, services, or intangible property to participants or by participants to others. (Georgia Code § 16-12-38 (8))

Hawaii

A person engages in an unfair method of competition and an unfair or deceptive act or practice within the meaning of section 480-2 when, in the conduct of any trade or commerce, the person contrives, prepares, sets up, proposes, or operates any endless chain scheme. As used in this section, an endless chain scheme 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 payments 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. [L. 1970, c 28, §1; gen ch 1985] (Hawaii Rev. Stat. § 480-3.3)

Idaho

"Pyramid promotional scheme" means any plan or operation in which a participant gives consideration for the right to receive compensation that is derived primarily from the recruitment of other persons as participants in the plan or operation rather than from the sales of goods, services or intangible property to

participants or by participants to others. (Idaho Code Ann. § 18-3101)

Illinois

The term "pyramid sales scheme" includes any plan or operation whereby a person in exchange for money or other thing of value acquires the opportunity to receive a benefit or thing of value, which is primarily based upon the inducement of additional persons, by himself or others, regardless of number, to participate in the same plan or operation and is not primarily contingent on the volume or quantity of goods, services, or other property sold or distributed or to be sold or distributed to persons for purposes of resale to consumers. (815 Illinois Comp. Stat. 505/1)

Indiana

"Pyramid promotional scheme" means any program utilizing a pyramid or chain process by which a participant in the program gives a valuable consideration exceeding one hundred dollars (\$100) for the opportunity or right to receive compensation or other things of value in return for inducing other persons to become participants for the purpose of gaining new participants in the program. (Ind. Code Ann. 24-5-0.5-2)

Iowa

The advertisement for sale, lease or rent, or the actual sale, lease or rental of any merchandise at a price or with a rebate or payment or other consideration to the purchaser which is contingent upon the procurement of prospective customers provided by the purchaser, or the procurement of sales, leases or rentals to persons suggested by the purchaser, is declared to be an unlawful practice rendering any obligation incurred by the buyer in connection therewith, completely void and a nullity. The rights and obligations of any contract relating to such contingent price, rebate or payment shall be interdependent and inseverable from the rights and obligations relating to the sale, lease or rental. (Iowa Code Ann. 714.16)

Kansas

"Pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from any person's introduction of other persons into participation in the plan or operation rather than from the sale of goods, services or intangible property by the participant or other persons introduced into the plan or operation. (Kan. Stat. Ann. § 21-3762)

Kentucky

"Pyramid distribution plan" means any plan, program, device, scheme, or other process by which a participant gives consideration for the opportunity to receive compensation or things of value in return for inducing other persons to become participants in the program. Ky. Rev. Stat. Ann. § 361)

Louisiana

"Pyramid promotional scheme" means any plan or operation by which a participant gives consideration for

the opportunity to receive compensation which is derived primarily from the person's introduction of other persons into a plan or operation rather than from the sale of goods, services, or intangible property by the participant or other persons introduced into the plan or operation. (La. Rev. Stat. Ann. § 361)

Maine

The organization of any multi-level distributor-ship arrangement, pyramid club or other group, organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by members thereof are to be paid or given to any other member thereof who has been required to pay or give anything of material value for the right to receive such sums, with the exception of payments based exclusively on sales of goods or services to persons who are not participants in the plan and who are not purchasing in order to participate in the plan, which plan or device includes any provision for the increase in such membership through a chain process of new members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues or things of material value from other members, is declared to be a lottery, and whoever shall organize or participate in any such lottery by organizing or inducing membership in any such group or organization shall be guilty of a misdemeanor, and upon conviction thereof shall be punished by a fine of not more than \$5,000 or by imprisonment for not more than 11 months, or by both. (Me. Rev. Stat. Ann. Title 17, § 2305)

Maryland

"Pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation to be derived primarily from any person's introductions of other persons into participation in the plan or operation rather than from the sale of goods, services, or other intangible property by the participant or other persons introduced into the plan or operation. [Md. Title 8: 4: 8-404 § (a) (5)]

Massachusetts

[Note by JMT: While the applicable Massachusetts statute does not define pyramid schemes as such, it defines multi-level marketing and has some unique and very salient restrictions regarding MLM, particularly Ch. 93:69 (a), (d), and (e)]

Section 69. (a) As used in this section the term "multi-level distribution company" shall mean any person, firm, corporation or other business entity which distributes for a valuable consideration, goods or services through independent agents, contractors or distributors, at different levels, wherein participants in the marketing program may recruit other participants, and wherein commissions, cross-commissions, bonuses, refunds, discounts, dividends or other considerations in the marketing program are or may be paid as a result of the sale of such goods and services or the recruitment, actions or performances of additional participants. (d) No multi-level distribution company or participant in its marketing program shall: (1) operate or, directly or indirectly, participate in the operation of any multi-level

marketing program wherein the financial gains to the participants are primarily dependent upon the continued, successive recruitment of other participants and where retail sales are not required as a condition precedent to realization of such financial gains; (2) offer to pay, pay or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration to any participants in a multi-level marketing program solely for the solicitation or recruitment of other participants therein; (3) offer to pay, pay or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration to any participants in a multi-level marketing program in connection with the sale of any product or service unless such participant performs a bona fide and essential supervisory, distributive, selling or soliciting function in the sale or delivery of such product or services to the ultimate consumer; or (4) offer to pay, pay or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration to any participant where payment thereof is or would be dependent on the element of chance dominating over the skill or judgment of such participant, or where no amount of judgment or skill exercised by the participant has any appreciable effect upon any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration which the participant may receive, or where the participant is without that degree of control over the operation of such plan as to enable him substantially to affect the amount of finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration which he may receive or be entitled to receive.

(e) Multi-level distribution companies shall not represent, directly or indirectly, that participants in a multi-level marketing program will earn or receive any stated gross or net amount, or represent in any manner, the past earnings of participants; provided, however, that a written or verbal description of the manner in which the marketing plan operates shall not, standing alone, constitute a representation of earnings, past or future. Multi-level distribution companies shall not represent, directly or indirectly, that additional distributors or sales personnel are easy to secure or retain, or that all or substantially all participants will succeed. (Mass. § 93:69)

Michigan

A pyramid or chain promotion is any plan or scheme or device by which (a) a participant gives a valuable consideration for the opportunity to receive compensation or things of value in return for inducing other persons to become participants in the program or (b) a participant is to receive compensation when a person introduced by the participant introduces one or more additional persons into participation in the plan, each of whom receives the same or similar right, privilege, license, chance, or opportunity. (Mich. Comp. Laws Ann. § 445.1528)

Minnesota

It shall be illegal for any seller or lessor to operate or attempt to operate any plans or operations for the

disposal or distribution of property or franchise or both whereby a participant gives or agrees to give a valuable consideration for the chance to receive something of value for inducing one or more additional persons to give a valuable consideration in order to participate in the plan or operation, or for the chance to receive something of value when a person induced by the participant induces a new participant to give such valuable consideration including such plans known as chain referrals, pyramid sales, or multilevel sales distributorships. (Minn. Stat. Ann. § 325F.69)

Mississippi

The term “pyramid sales scheme” includes any plan or operation for the sale or distribution of goods, services, or other property wherein a person for a consideration acquires the opportunity to receive a pecuniary benefit, which is not primarily contingent on the volume or quantity of goods, services, or other property sold or distributed to be sold or distributed to persons for purposes of resale to consumers, and is based upon the inducement of additional persons, by himself or others, regardless of number, to participate in the same plan or operation. (Miss. Code Ann. § 75-24-51)

Missouri

The term “pyramid sales scheme” includes any plan or operation for the sale or distribution of goods, services or other property wherein a person for a consideration acquires the opportunity to receive a pecuniary benefit, which is not primarily contingent on the volume or quantity of goods, services, or other property sold or distributed or to be sold or distributed to persons for purposes of resale to consumers, and is based upon the inducement of additional persons, by himself or herself or others, regardless of number, to participate in the same plan or operation. (Mo. Ann. Stat. § 407.400)

Montana

(a) “Pyramid promotional scheme” means a sales plan or operation in which a participant gives consideration for the opportunity to receive compensation derived primarily from obtaining the participation of other persons in the sales plan or operation rather than from the sale of goods or services by the participant or the other persons induced to participate in the sales plan or operation by the participant.

(b) A pyramid promotional scheme includes a Ponzi scheme, in which a person makes payments to investors from money obtained from later investors, rather than from any profits or other income of any underlying or purported underlying business venture.

(c) A pyramid promotional scheme does not include a sales plan or operation that:

(i) subject to the provisions of subsection (6)(b)(v)

(v) (A) provides for, upon the request of a participant deciding to terminate participation in the sales plan or operation, the repurchase, at not less than 90% of the amount paid by the participant, of any currently marketable goods or services sold to the participant within 12 months of the request that have not been resold or consumed by the participant; and

(B) if disclosed to the participant at the time of purchase, provides that goods or services are not considered

currently marketable if the goods have been consumed or the services rendered or if the goods or services are seasonal, discontinued, or special promotional items. Sales plan or operation promotional materials, sales aids, and sales kits are subject to the provisions of this subsection (6)(b)(v) if they are a required purchase for the participant or if the participant has received or may receive a financial benefit from their purchase. (Mont. Code Ann. § 30-10-324)

Nebraska

Chain distributor scheme also known as pyramid sales shall mean a sales device whereby a person, upon a condition that he or she make an investment, is granted a license or right to recruit for profit one or more additional persons who also are 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. (Neb. Rev. Stat. § 87-301)

Nevada

A “pyramid promotional scheme” means any program or plan for the disposal or distribution of property and merchandise or property or merchandise by which a participant gives or pays a valuable consideration for the opportunity or chance to receive any compensation or thing of value in return for procuring or obtaining one or more additional persons to participate in the program, or for the opportunity to receive compensation of any kind when a person introduced to the program or plan by the participant procures or obtains a new participant in such a program. (Nev. Rev. Stat. Ann. § 598.100)

New Hampshire

“Chain distributor scheme” means 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. (N.H. Rev. Stat. Ann. § 358-B:1)

New Jersey

[Note by JMT: New Jersey was the only state for which I could not find anything resembling a statute defining or restricting pyramid or chain selling schemes, but I found this excerpt from an informative article by Eric Witiw in the Law Review of Seton Hall University School of Law:]

Who would not like to make a 700% return on an investment in a relatively short period of time? Although this offer is obviously too good to be true, over the last sixty years countless people have fallen victim to this allure. In fact, fraudulent pyramid investment schemes recur regularly. To address this problem, New Jersey's Legislature considered a bill which would have prohibited pyramid scams, but ultimately declined to enact any new legislation. Although the state may bring civil actions against a

promoter under the Consumer Fraud Act and the Uniform Securities Law and criminally prosecute under the theft statute and the Uniform Securities Law, case law, including the appellate division decision *State of New Jersey v. Frederica Bey* and the New Jersey Supreme Court decision *State v. DeLuzio*, raises the question of whether New Jersey, like Delaware and Michigan, should adopt legislation prohibiting pyramid promotion scams.

The defendant, in *Bey*, was acquitted of theft by deception. On appeal, the New Jersey Superior Court, Appellate Division, overturned the defendant's conviction for promoting an illegal lottery after concluding that pyramid schemes do not fall within the statute which prohibits illegal lotteries. This decision, however, is more significant for the fact that it reveals a conflict in two lines of cases: one construing pyramid investments as merchandise under the Consumer Fraud Act and the other holding pyramid investments as securities under the Uniform Securities Law.

(Article on New Jersey Law: "Selling The Right to Sell the Same Right to Sell: Applying the Consumer Fraud Act, the Uniform Securities Law and the Criminal Code to Pyramid Schemes" 1996, 26 Seton Hall L. Rev. 1635)

New Mexico

"pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from any person's introduction of other persons into participation in the plan or operation rather than from the sale of goods, services or intangible property by the participant or other persons introduced into the plan or operation. (N. M. Stat. § 57-13-2)

New York

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. . . It does not include sales demonstration equipment and materials furnished at cost for use in making sales and not for resale. (N. Y. Gen. Bus. Law § 359-fff)

North Carolina

"Pyramid distribution plan" means any program utilizing a pyramid or chain process by which a participant gives a valuable consideration for the opportunity to receive compensation or things of value in return for inducing other persons to become participants in the program; and "*Compensation*" does not mean payment based on sales of goods or services to persons who are not participants in the scheme, and who are not purchasing in order to participate in the scheme. [N. C. Gen. Stat. Ann. § 14-291.2 (b)]

North Dakota

"Pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from any person's introduction of other persons into participation in the plan or operation rather than from the sale of goods, services, or intangible property by the participant or other persons introduced into the plan or operation. (N.D. Cent. Code § 51-16.1-01)

Ohio

"Pyramid sales plan or program" means any scheme, whether or not for the disposal or distribution of property, whereby a person pays a consideration for the chance or opportunity to receive compensation, regardless of whether he also receives other rights or property, under either of the following circumstances: (1) For introducing one or more persons into participation in the plan or program; (2) When another participant has introduced a person into participation in the plan or program. (Ohio Rev. Code Ann. § 1333.91)

Oklahoma

"Pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from the person's introduction of other persons into the plan or operation rather than from the sale of goods, services or intangible property by the participant or other persons introduced into the plan or operation. (Okla. Rev. Stat. § 21-1071)

Oregon

"Pyramid club" means a sales device whereby a person, upon condition that the person make an investment, is granted a license or right to solicit or recruit for economic gain one or more additional persons who are also granted such license or right upon condition of making an investment and who may further perpetuate the chain of persons who are granted such license or right upon such condition. "Pyramid club" also includes any such sales device which does not involve the sale or distribution of any real estate, goods, or services, including but not limited to a chain letter scheme. (Or. Rev. Stat. Ann. § 646.609)

Pennsylvania

The terms "Chain-Letter Plan" or "Pyramid Club" mean any scheme for the disposal or distribution of property, services or anything of value whereby a participant pays valuable consideration, in whole or in part, for an opportunity to receive compensation for introducing or attempting to introduce one or more additional persons to participate in the scheme or for the opportunity to receive compensation when a person introduced by the participant introduces a new participant. (73 Pa. Stat. Ann. § 201-2)

South Carolina

Any contract or agreement between an individual and any pyramid club, or other group organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by

members thereof are to be paid or given to any other member thereof, which plan or device includes any provision for the increase in such membership through a chain process of new members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues or things of material value from other members, is hereby declared to be an unfair trade practice pursuant to § 39-5-20 (a) of the South Carolina Unfair Trade Practices Act of 1971.

South Dakota

"Pyramid promotional scheme" defined. For the purposes of 37-33-1 to 37-33-11, inclusive, the term, pyramid promotional scheme, means any plan or operation by which a person gives consideration for the opportunity to receive compensation that is derived primarily from the introduction of other persons into the plan or operation rather than from the sale and consumption of goods, services, or intangible property by a participant or other persons introduced into the plan or operation. The term includes any plan or operation under which the number of persons who may participate is limited either expressly or by the application of conditions affecting the eligibility of a person to receive compensation under the plan or operation, or any plan or operation under which a person, on giving any consideration, obtains any goods, services, or intangible property in addition to the right to receive compensation. (S. D. Cod. Laws § 37-33-1)

Tennessee

A "pyramid distributorship" means any sales plan or operation for the sale or distribution of goods, services or other property wherein a person for a consideration acquires the opportunity to receive a pecuniary benefit, which is not primarily contingent on the volume or quantity of goods, services or other property sold or delivered to consumers, and is based upon the inducement of additional persons, by such person or others, regardless of number, to participate in the same plan or operation. (Tenn. Code Ann. § 47-18-104)

Texas

"Pyramid promotional scheme" means a plan or operation by which a person gives consideration for the opportunity to receive compensation that is derived primarily from a person's introduction of other persons to participate in the plan or operation rather than from the sale of a product by a person introduced into the plan or operation. (Texas Bus. & Com. Code Ann. § 17.461)

Utah

(b) "Compensation" does not include payment based on the sale of goods or services to *anyone purchasing the goods or services for actual personal use or consumption*.

[Note by JMT: I personally testified against the SB182 amendment to the statute in 2006 which allowed for compensation for personal use. The DSA used

deception and trickery to get it passed, with the support of Utah's Attorney General, whose main political donors were MLM companies. Similar tactics have been used by the DSA in other states.]

(2) "Consideration" does not include payment for sales demonstration equipment and materials furnished at cost for use in making sales and not for resale, or time or effort spent in selling or recruiting activities.

(4) "Pyramid scheme" means any sales device or plan under which a person gives consideration to another person in exchange for compensation or the right to receive compensation which is derived primarily from the introduction of other persons into the sales device or plan rather than from the sale of goods, services, or other property. (Utah Code § 76-6a-2)

Vermont

"Chain distributor scheme" is a sales device whereby a person, upon a 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 also are 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. ((06-031-002 Vt. Code R. §CF 101)

Virginia

"Pyramid promotional scheme" means any plan or operation by which a person gives consideration for the opportunity to receive compensation a majority of which is derived from the introduction of other persons into the plan or operation rather than from the sale or consumption of goods, services, or intangible property by a participant or other persons introduced into the plan or operation. (Va. Code Ann. § 18-2.239)

Washington

"Pyramid schemes" means any plan or operation in which a person gives consideration for the right or opportunity to receive compensation that is derived primarily from the recruitment of other persons as participants in the plan or operation, rather than from the bona fide sale of goods, services, or intangible property to a person or by persons to others. (Wash. Rev. Code Ann. § 19.275.020)

West Virginia

"Pyramid promotional scheme" shall mean the organization of any chain letter club, pyramid club, or other group organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by members thereof are to be paid or given to any other member thereof, which plan or device includes any provision for the increase in such membership through a chain process of any members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues or things of material value from other members.

Appendix 2I: Are All MLMs Pyramid Schemes?

Asking if an MLM is a pyramid scheme is like asking if an SUV is a car. The SUV may hold more people, but it is still a car.

MLMs, or what I prefer to call “product-based pyramid schemes” (PPSs), are structured exactly the same as classic, “no-product pyramid schemes” (NPSs). With unlimited endless-chains of recruitment, they both assume an infinite market, which does not exist in the real world. For both, the only way to advance in rank to where profits are possible is to recruit a "downline." Both have a "pay-to-play" feature, with the purchases more ongoing and substantial over time for PPSs than for NPSs. And commission structures for both are top-weighted, meaning the bulk of the rewards go to those at the top of the pyramid of participants; almost everyone else loses money.



The primary difference between the two classes of pyramid schemes is that to participate in an NPS, investments are made in cash, whereas in a PPS (MLM), the investments are in the form of purchases of products through an MLM company. Therefore, after covering costs of products and company infrastructure, a lower percentage of revenues is rebated back to the network of participants. Also, the downline networks for PPSs are far more elaborate. Classic 1-2-4-8 pyramid schemes (NPSs) have 15 participants with 100% of the money going to the person at the top, But with PPSs (MLMs), after covering product and company costs, generally less than 50% goes back to the participants – most of it to those at or near the top of their respective pyramids, which may include thousands of participants.



No-product pyramid scheme



Product-based pyramid schemes (MLMs) have much larger downlines

With less money shared by far more participants, and most of the commissions going to those at the top of the pyramid, the loss rate for PPS schemes (approx. 99.7%) is far greater than it is for NPSs (approx. 90%). So a person has over ten times as much chance of profiting from an NPS as from a PPS (MLM). PPSs are far worse than NPSs by any measure – loss rate, aggregate losses, and number of victims.

The Direct Selling Association and other industry defenders, have endeavored to confuse the issue by focusing on behavior of participants in defining what is a pyramid scheme, rather than the fundamental structure. They have also rebranded MLM as “direct selling.” But in legitimate direct selling, those doing the selling are paid the bulk of the commissions, whereas MLMs incentivize recruiting with compensation plans that provide huge upline rewards for recruiting a large downline. MLMs also require ongoing purchases to qualify for commissions and rank advancement to where profits are possible.

Chapter 3: MARKET SATURATION AND COLLAPSE – how MLMs exploit and skirt fundamental flaws in their systems

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Introduction and summary

This chapter expands on the concepts of market saturation and collapse introduced in Chapter 2. The impossible math of endless chains is explained. Chain letters evolved into pyramid schemes, which later evolved into MLMs with the introduction of products. However, this did not mitigate the financial losses suffered by participants, but instead increased them, as multitudes of participants had to share a smaller piece of the revenue pie.

MLM promoters have succeeded in convincing regulators that they operate on a different principle than “pay-to-play” chain letters. However, careful examination reveals that MLMs operate on precisely the same principle as chain letters, except that they are carried to the ultimate extreme – rewarding unlimited recruitment of a whole network of endless chains of participants.

Market saturation and collapse happens in MLM, but MLMs have found ways to limit the damage by “re-pyramiding” and by churning through new participants to absorb the losses. They ultimately devolve to a state of continual collapse and recruitment to replace dropouts.

Impossible math of endless chains

A distinguishing characteristic of MLM is unlimited recruitment into a network of endless chains of recruitment. Each new recruit is empowered and motivated by a recruitment-driven and top-weighted compensation plan to recruit others in a “downline” of participants beneath them, and these recruits are in turn motivated to recruit more recruits under them, and they still more under them, ad infinitum. MLMs assume an infinite market, which does not exist in the real world. They also assume virgin markets, which don't exist for long – which means they either collapse or re-pyramid into new markets. MLM is therefore flawed, uneconomic, and fraudulent. It is also extremely viral and predatory.



Recruitment of participants in an endless chain cannot continue indefinitely.

All of the hundreds of MLM programs I have analyzed are endless chain selling schemes. This is illustrated in a binary MLM that requires each participant to recruit two persons in order to be rewarded commissions on the purchases of those beneath them in the pyramid. And each of them must do the same, ad infinitum. To show how saturation is inevitable, in a binary system one person recruits two people, each of them two more, and they two more, etc., as follows:

1x2=2
2x2=4
4x2=8
8x2=16
16x2=32
32x2=64
64x2=128
128x2=256
256x2=512
512x2=1,024
1,024x2=2,048

—and so on until by the 32nd person in the chain of recruitment, the total number of recruits exceeds the population of the earth. Of course, it happens much more quickly if three or more participants are recruited by each new recruit. For example, in a highly leveraged breakaway compensation plan, a person may need a minimum of 1,000 persons in his/her downline to be at the top, where most of the money is made. So to realize the substantial “residual income” that is promised, each person would have to recruit a downline of 1,000 persons, and they each 1,000 more, as follows:

$$\begin{aligned} 1,000 \times 1,000 &= 1,000,000 \text{ (1 million)} \\ 1 \text{ million} \times 1,000 &= 1 \text{ billion} \\ 1 \text{ billion} \times 1,000 &= \underline{1 \text{ trillion}} \end{aligned}$$

— which in only three complete downline recruitment campaigns (to reach the top level) is hundreds of times the population of the earth. The utter absurdity of unlimited recruitment of a whole network of endless chains of participants becomes apparent.



The point is that *no matter when any endless chain selling scheme is halted or reaches a point of saturation, all those on the bottom are left in a losing position, which is the vast majority because of the pyramidal stacking of participants at the bottom who*

don't get paid. Any pyramid scheme, including MLM, is a mathematical trick played on unsophisticated new recruits.

Also, since each person who is recruited is empowered and motivated to recruit, MLMs can become extremely virulent. An illustration of the viral nature of MLM – like cancer – is depicted in Exhibit 3a.

A classic article on market saturation.

One of the earliest and best of the thousands of articles critical of MLM that has been posted on the web is one titled “What’s Wrong with Multi-level Marketing,” by Dean VanDruff.⁸¹ His section on market saturation is so well thought out and articulated that I am including it here as Appendix 3A. Anyone wishing to better understand the fundamental flaws in MLM as a business model would do well to read the entire article. Another excellent article by Matt Stewart on how retailers avoid market saturation (commenting on Bill Ackman’s accusation that Herbalife is a pyramid scheme⁸²) is found in Appendix 3B.

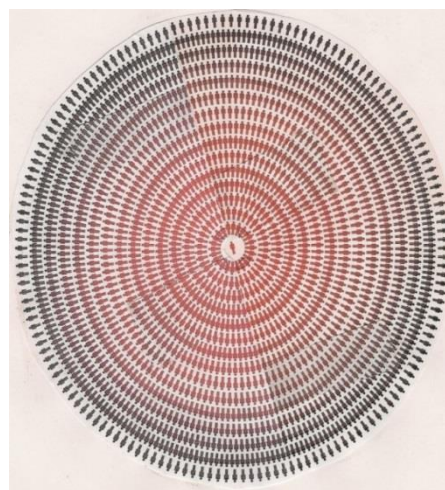


Exhibit 3a: Like cancer, MLM is viral and predatory.

MLM – as a business model that assumes an unlimited recruitment market – is not only flawed, uneconomic, and deceptive, it is also both viral and predatory, like a fast-growing cancer or virus. MLM promoters promise prospects relief from financial want, but their programs result in loss and disappointment for the vast majority of recruits who churn through their predatory programs.

⁸¹ <http://www.vandruff.com/mlm.html>

⁸² Posted on Seeking Alpha, Nov 25 2013 at – <http://seekingalpha.com/article/1860081-ackmans-pictures-tell-the-story-herbalife-oversaturates>

The precedence of chain letters.

For decades, consumers have been warned against “pay-to-play” chain letters sent through the mail. As the Federal Trade Commission warns in its online article: “The Lowdown on Chain Letters”:

Everybody's received them – chain letters or email messages that promise a big return on a small investment. The promises include unprecedented good luck, mountains of recipes, or worse, huge financial rewards for sending as little as \$5 to someone on a list or making a telephone call.

The simplest chain letters contain a list of names and addresses, with instructions to send something – usually a small sum of money – to the person at the top of the list, remove that name from the list, and add your own name to the bottom of the list. Then, the instructions call for you to mail or email copies of the letter to a certain number of other people, along with the directions of how they should “continue the chain.” The theory behind chain letters is that by the time your name gets to the top of the list, so many people will be involved that you'll be inundated with whatever the chain promises to deliver. . .

Whether you receive a chain letter by regular mail or email - especially one that involves money – the Federal Trade Commission reminds you that:

Chain letters that involve money or valuable items and promise big returns are illegal. If you start one or send one on, you are breaking the law.

Chances are you will receive little or no money back on your “investment.” Despite the claims, a chain letter will never make you rich.

Some chain letters try to win your confidence by claiming that they're legal, and even that they're endorsed by the government. Nothing is further from the truth.

The U.S. Postal Inspection Service offers the following warning about chain letters on its website⁸³:

A chain letter is a “get rich quick” scheme that promises that your mail box will soon be stuffed full of cash if you decide to participate. You're told you can make thousands of dollars every month if you follow the detailed instructions in the letter.

A typical chain letter includes names and addresses of several individuals whom you may or may not know. You are instructed to send a certain amount of money – usually \$5 – to the person at the top of the list, and then eliminate that name and add yours to the bottom. You are then instructed to mail copies of the letter to a few more individuals

who will hopefully repeat the entire process. The letter promises that if they follow the same procedure, your name will gradually move to the top of the list and you'll receive money -- lots of it.

There's at least one problem with chain letters. They're illegal if they request money or other items of value and promise a substantial return to the participants. Chain letters are a form of gambling, and sending them through the mail (or delivering them in person or by computer, but mailing money to participate) violates Title 18, United States Code, Section 1302, the Postal Lottery Statute. . . .

The main thing to remember is that a chain letter is simply a bad investment. You certainly won't get rich. You will receive little or no money. The few dollars you may get will probably not be as much as you spend making and mailing copies of the chain letter.

Chain letters don't work because the promise that all participants in a chain letter will be winners is mathematically impossible. . . . *Do not be fooled if the chain letter is used to sell inexpensive reports on credit, mail order sales, mailing lists, or other topics. The primary purpose is to take your money, not to sell information. “Selling” a product does not ensure legality. . . .*

“Pay-to-play” Chain letters are passé.

Unfortunately, both the FTC and the U.S. Postal Service are out of date in these recommendations. Decades have passed since “pay-to-play” chain letters – and even no-product pyramid schemes – were a problem. They have been replaced by MLMs, or product-based pyramid schemes. Why would anyone take the risk of doing the former when they can dupe law enforcement, the media, and others into thinking that they are operating a legitimate “direct selling program”? The same results accrue from their endless chains of recruitment. Almost everybody⁸⁴ loses money.

No-product pyramid schemes, or “entrepreneurial chains”

In case the reader has not already caught the significance of this information on chain letters, all pyramid schemes, including product-based pyramid schemes or MLMs, are built on the same principle as are chain letters – an endless chain of recruitment. And just like chain letters, the fundamental flaw in the system is that mathematically they don't work⁸⁵ – except for those

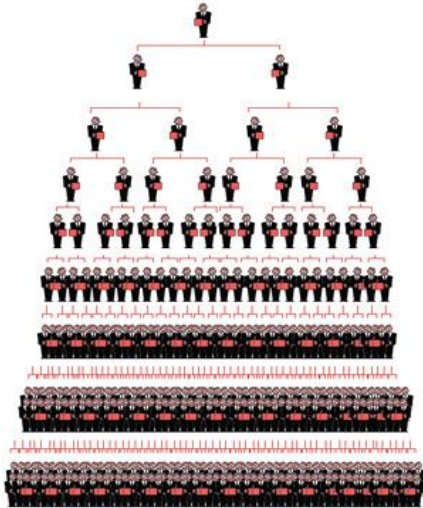
⁸³ <https://postalinspectors.uspis.gov/investigations/MailFraud/fraudschemes/sweepstakesfraud/ChainLetters.aspx>

⁸⁴ Approximately 99.7%. See Chapter 7.

⁸⁵ VanDruff, Dean, “What's Wrong with Multi-level Marketing,” available from his web site at www.vandruff.com/mlm

at the beginning of the recruitment chain who position themselves at or near the top of a pyramid of participants for pay purposes. They profit only at the expense of a revolving door of recruits who follow. New recruits are being sold a ticket on a flight that has already left the ground.

The number of participants in an MLM, or product-based pyramid scheme, is generally many times those in a 1-2-4-8 no-product pyramid scheme because there are typically many more levels in MLM.



MLM is characterized by unlimited recruitment of endless chains of recruits into pyramids of participants who buy products to “play the game.” Those on the top are enriched by the purchases of those at the bottom.

It is interesting that in the Koscot case⁸⁶, the court wisely noted, “The Commission has previously condemned so-called “entrepreneurial chains” as possessing an intolerable capacity to mislead.⁸⁷” This capacity has been demonstrated in literally thousands of MLMs (many now defunct) fashioned after the model of entrepreneurial chains which the FTC has allowed following the flawed 1979 “Amway decision.” Unfortunately, this warning of an “intolerable capacity to mislead” was set aside in favor of Amway’s “retail rules” which would supposedly mitigate the effects of the underlying flaws of any entrepreneurial chain, or MLM. However, the “retail rules” were never enforced to any significant degree.

Classic no-product pyramid schemes and product-based pyramid schemes. Some try to draw a distinction between classic, no-product pyramid schemes and MLM. But technically, it is a “distinction without a difference”⁸⁸ – except for the required “pay-to-play” purchase of products for full participation in the pyramids of participants in an MLM program. That is why I coined the term “product-based pyramid schemes” to distinguish MLMs from classic no-product pyramid schemes (which require cash investments for participation) – while recognizing both as pyramid schemes (regardless of confusion over definitions)⁸⁹

The FTC warning of “entrepreneurial chains” possessing an intolerable capacity to mislead” was set aside in favor of Amway’s “retail rules” which would supposedly mitigate the effects of the underlying flaws of any entrepreneurial chain, or MLM. However, the “retail rules” were not enforced.

Market saturation and collapse

Total saturation – or market saturation? In the 1979 case, Amway successfully argued to an FTC administrative law judge that saturation, theoretically associated with a pyramid scheme, had never happened and was not possible.⁹⁰ However, *it is important to draw a distinction between total saturation and market saturation.* In a city of 100,000 people, one would not expect that it could support 100,000 direct selling distributors. *Any expectation of such total saturation would be absurd unless everyone was selling only to oneself.*

However, it may be realistic for such a city to support 10-20 distributors, with each having a market of 5,000-10,000 prospects to whom to direct his or her sales efforts. *Adding more sales persons would increase competition, making it more difficult for the existing sales force. So the market could be said to be saturated with only a few sales persons. And of course, market saturation can be extended not only to communities, but to whole countries and*

⁸⁶ In re Koscot Interplanetary Inc., 86 F.T.C. 1106, 1181 (1975), aff’d., Turner F.T.C., 580 F. 2d 701 (D.C. Cir. 1978)

⁸⁷ Holiday Magic, Inc., Docket No. 8834, slip op. pp. 11-14 [84 F.T.C. 748 at pp. 1036-1039] (Oct. 15, 1974); Ger-Ro-Mar, Inc., Docket No. 8872, slip op. pp. 8-12 [84 F.T.C. 95, at pp. 145-149] (July 23, 1974), rev’d in part 518 F.2d 33 (2d Cir. 1975).

⁸⁸ Letter dated February 25, 2000, from Bruce Craig to Robert Pitofsky, Chairman of the FTC – and the official who drafted the Commission’s Amway opinion in 1979

⁸⁹ See Chapter 2.

⁹⁰ Robert L. FitzPatrick, *Pyramid Nation: The Growth, Acceptance and Legalization of Pyramid Schemes in America*, Pyramid Scheme Alert, page 39.

even the entire world. Eventually, to survive and grow, the MLM would have to introduce new product divisions or to promote to a whole new generation of unwitting recruits.

Not being market analysts or statisticians, the FTC attorneys handling the 1979 Amway case entirely missed this distinction between total saturation and market saturation. With intense sales and marketing efforts in a given area, market saturation can occur rather quickly.

Overlapping market saturation. In addition, distribution of products from numerous competing companies adds to the saturation of any given market for any given set of products. So whether or not market saturation has been reached with only a few MLM distributors in a city, the city could be said to have experienced overlapping market saturation from the efforts of distributors from multiple MLM companies recruiting in an area. By now many communities in the USA have experienced dozens, if not hundreds, of overlapping MLM recruitment campaigns since 1979. Such communities could be said to be heavily saturated.

For example, in Utah County, Utah, is found the highest concentration per capita of MLM company headquarters in the U.S. In a randomized survey of consumers we conducted there⁹¹, we found *four MLM distributors to every one MLM customer* who was not a participant. Many residents complained of being approached over and over by MLM recruiters, including family members they otherwise respected.

See Exhibit 3b, which shows the placement of MLMs based in Salt Lake and Utah counties (State of Utah), the most heavily saturated MLM market in the country. Utah County has had at least one MLM company for every 17,000 persons.

Ultimate – vs. continuous – collapse. Another distinction is to be made between ultimate collapse and continuous collapse. Participants in no-product pyramid schemes race to cash in on the scheme before it collapses or is shut down by authorities.

For persons familiar with the inherent flaws of a system that features recruitment of endless chains of participants as its primary customers, such schemes are fairly easy to recognize for what they

are. It is a closed system that merely transfers money from those at the bottom to those at the top, and thus a money trap for all who join – with the exception of a tiny percentage that have obtained a position at the top of a pyramid.

Mathematically, approximately 90% of all participants in classic 1-2-4-8 no-product pyramid schemes are guaranteed to suffer financial loss. This is because no matter how long it continues recycling through its series of pyramids, there will always be 87.7% to 93.3% beneath the person on the top who receives all the money – the exact loss rate depending on the number of those cashing in at the top who decide to start a new pyramid. So, as programs that promise unending or infinite expansion in a finite marketplace, pyramid schemes of all kinds are inherently flawed, unfair, and deceptive. In time, the public, the media, and law enforcement stiffen their resistance to further expansion, recruiting becomes difficult, and the scheme either collapses or is shut down by authorities.

MLM pyramids never mature and thus never reach market saturation. If all MLM matured by filling positions at all levels, they would quickly saturate markets and collapse. But due to high attrition, the more successful MLMs escape saturation and total collapse by recruiting and recycling a stream of new recruits through new markets and new product divisions.

In effect, collapse is continuous, with losses being born by new recruits. Meanwhile, instead of collapsing, the company continues to grow, as long as it can continue aggressively recycling new recruits through its system. Regulators completely miss this point in assuming that if an MLM were a pyramid scheme it would eventually reach saturation and collapse.

MLMs also escape total saturation by re-pyramiding into new markets or with new product offerings. This process used to prevent market collapse by entering new markets or introducing new product divisions, I have labeled “re-pyramiding.” Coupled with recycling of new recruits, they can continue for decades.

Eventually, if the MLM can hang on long enough, a whole new generation awaits a newly repackaged “opportunity” and the MLM is able to continue by exploiting their losses. This is what has happened with Amway (changed to Quixtar and later back to Amway) and Nu Skin (with its IDN, Big Planet, and Pharmanex product divisions). Each has gone from country to country seeking new markets to avoid collapse and to appear to be growing.

⁹¹ Jon M. Taylor, *Who Profits from Multi-level Marketing (MLM)? Preparers of Utah Tax Returns Have the Answer.* Consumer Awareness Institute, 2004. Note that since that time, the number of MLM companies in Utah has increased significantly, due in no small part to 2006 legislation exempting MLM from prosecution as pyramid schemes.

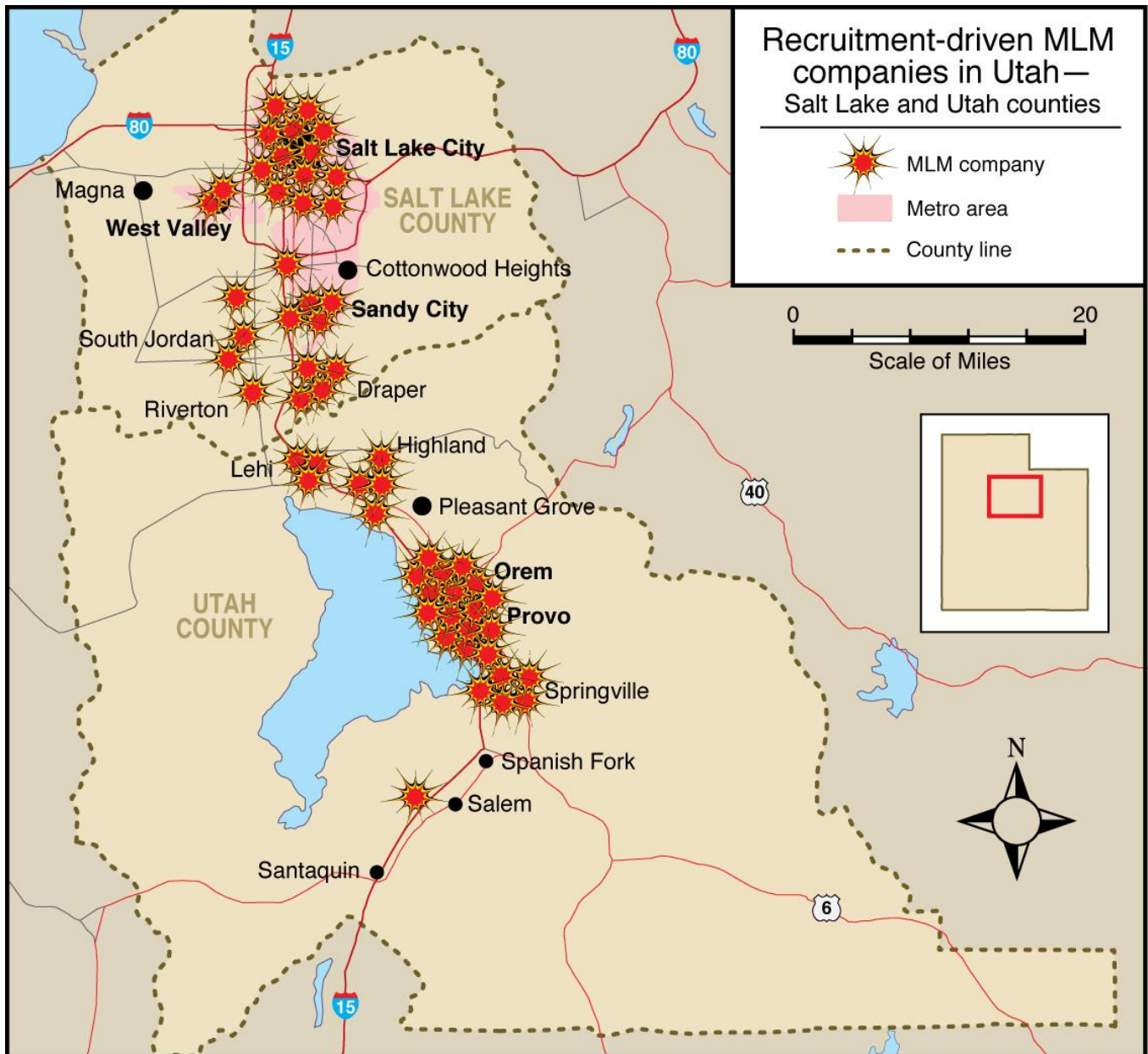


Exhibit 3b: MLMs are exploding in Utah.

The heaviest concentration of MLMs is in Salt Lake and Utah Counties, where MLMs are so concentrated that in one survey there were four MLM distributors for every one MLM customer (who was not participating in an MLM). Due to consumer resistance and market saturation, recruiters have been forced to expand aggressively beyond the state. There are hundreds of these MLMs flooding U.S. markets, resulting in heavy market saturation in many areas. Many have spread to less saturated markets overseas, and are now plundering vulnerable populations that can least afford it. MLM promoters promise relief from financial want, but their programs result in loss and disappointment for the vast majority of participants.

Survey of households in a highly saturated market

In the aforementioned survey of households in Utah County, we found more interesting statistics. In the preceding year, 6.9% of households (about one in 15) had been approached to buy MLM products – without being sold an “opportunity” connected with the purchases, usually at “opportunity meetings.” Only 1.1% actually made purchases from an MLM company.⁶

During the same period, 56% of the households had been approached to participate in an MLM “opportunity,” and 4.6% actually joined. Again, four “distributors” per customer suggests a market of distributors selling to “distributors,” not a market of direct sellers selling to legitimate customers.

Product-based pyramid schemes (MLMs) are more harmful than no-product pyramid schemes

The loss rate for product-based pyramid schemes is much higher than for no-product schemes – in which all the money goes to the person at the top. In MLMs, a portion of the revenues are siphoned off for payments to products and infrastructure. And what remains is shared with thousands, or even hundreds of thousands of participants, very few of whom are paid enough in commissions to exceed even “pay-to-play” purchases (to say nothing of operating expenses) necessary to progress or qualify for commissions.

Many critics and regulators are hesitant to refer to MLMs as pyramid schemes. However, all the evidence gathered in this research suggests that recruitment-driven MLMs (which describes virtually all MLMs), or product-based pyramid schemes, are by far the most damaging of pyramid schemes – by any measure, whether it be loss rates, aggregate losses, or number of victims.

The “pop and drop” phenomenon in MLM “growth” patterns.

Because of the viral nature of MLMs, with their endless chain of recruitment, MLMs often experience rapid growth when entering new countries. However, as there is no significant customer base outside of the network of participants, eventually an MLM company will reach a point of market saturation in a given country. The revenues for that country will reach a peak and then taper off. This has been dubbed “pop and drop,”⁹² as illustrated in Exhibit 3c. The more resourceful MLMs will then go to another country and to the same thing all over again. And then to another country, and another, etc. Financial analysts may see this as growth, when in fact it is an essential survival strategy for mature MLMs.

I prefer to use a term I created – “re-pyramiding” – to describe the same phenomenon of creating new pyramids of participants in new markets to prevent market collapse in unsustainable markets.

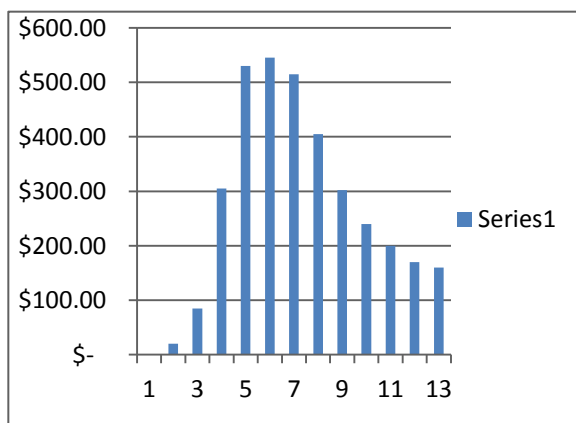


Exhibit 3c: “Pop and drop”

The numbers at the bottom represent the number of years from the time the MLM has entered a country. Revenues [in millions] show rapid growth, followed by gradual decline to a small level of sales volume.

⁹² This phenomenon was demonstrated by William Ackman in his Sohn Conference presentation on December 20, 2012. The above illustration was for Herbalife in Japan from 1993-2005. A similar pattern was shown in Israel, Spain, France, Germany, and Russia.

The 8 Rs of MLM durability

More established MLMs have managed to avoid collapse and grow massive downlines, resulting in greater damage than no-product schemes. Whether or not deliberately planned as a survival strategy by the company's executives, I have observed what I call the "8 Rs of MLM durability":

1. *Re-pyramiding.* When MLM leaders see that the "pyramid" is about to collapse, following a "pop and drop" pattern as just described, they start a new product division or enter a new geographic region, all within the same corporate umbrella. This is a process I call "re-pyramiding." This makes possible a whole new "ground floor opportunity" to participate in the "hyper growth" of the company, or to "ride the wave of opportunity." This is what Amway has done with Quixtar; and Nu Skin has cycled through numerous countries and several product divisions, including Nu Skin, IDN, Big Planet, Pharmanex, and Photomax.

We might assume that an MLM could reach market saturation when it has saturated readily available markets. But by re-pyramiding even to weak or developing countries, some have managed to continue recruiting worldwide indefinitely. MLMs may literally plunder those in these countries who are looking for relief from their struggles.



Re-pyramiding into new markets is not true growth, but viral expansion to prevent market collapse.

2. *Recycling, or recruitment of a revolving door of replacements.* MLM recruiters conduct "body shops." Those who drop out on the bottom levels are constantly

being replaced with new recruits who believe the promises of wealth and time freedom – or a little additional income for persons who are struggling to make ends meet (but which almost always sets them further behind financially).

In actuality, the potential losses from the collapse of an MLM company is transferred to the stream of new recruits who buy into the program and leave, believing they "failed to work the system" – not that the system has failed them. They were led by recruiters to believe that they were purchasing expensive products to take advantage of the "opportunity of a lifetime" and that failing to succeed would be no one's fault but their own.



A revolving door of recruits replaces dropouts.

3. *Rewards for misrepresenting.* The profitability for the MLM and the payout to TOPPs (top-of-the-pyramid promoters) is so great that promoters will routinely misrepresent both products and the "opportunity" and will go to great lengths to keep the scheme going, including all of the following:
4. *Ruse – or rebranding.* MLMs have been enormously successful in re-branding themselves as "direct sales programs" that are exempt from laws against pyramid schemes. Even regulators, the Better Business Bureau, educators, and the media will be quick to condemn a no-product pyramid scheme, but will exonerate a far more exploitive product-based pyramid scheme (MLM) as "direct

selling.” They may claim that participants can profit from seasonal or part-time selling – though primary incentives reward recruiting a large downline.

It should be clear by now that *an MLM is actually an institutionalized pyramid scheme*. Recruits in the hierarchy of “distributors become unwitting agents in collecting pyramid investments (in the form of “incentivized purchases) that fund the company and enrich top “distributors.”

Another ruse is the idea touted by promoters that their MLM “eliminates the middleman.” In fact, MLM guarantees that it will create a whole network of thousands of middle-men to be paid off. No wonder their prices are so high!

5. *Repeated purchases* (“pay to play”). Although the cost of signing up as an MLM distributor is usually less than \$100, the cumulative investment, in strongly incentivized ongoing purchases to “stay in the game,” may amount to hundreds or even thousands of dollars over several months. Products are often sold on an auto-ship subscription basis to maintain cash flow and upline residuals. Often purchases are far beyond the needs of the buyers and are stockpiled or given away. Usually such purchases are discontinued when the person withdraws from the program.
6. *Rationalization, self-blame and fear of retaliation*. Self-deception is common in MLMs, making it the perfect con game. The very people who are being victimized are often its most ardent promoters – until they run out of resources and quit. They seldom complain to regulators, having been taught that any failure is their fault for not having tried hard enough, rather than the fault of the MLM. They may also fear self-incrimination for their own recruiting efforts – or retaliation from or to their upline or downline, which may include close friends and relatives. I discovered this fear factor when I worked for almost a year with about two dozen victims of Nu Skin’s program. It took almost a year to get them to join together to file a group complaint with authorities.
7. *“Retail rules.”* The trick for an MLM seeking to evade regulatory scrutiny is to create the illusion that retailing is being done by establishing “rules” for minimum retailing with which distributors must comply – which are satisfied cosmetically so as not to arouse the attention of regulators. Compliance with these rules is not independently audited, nor are they reinforced by corresponding incentives in the compensation plan. MLM rule-making is ineffective without correcting problems in the compensation plan itself. You get the behavior you reward.
8. *Recognition and credibility*. Promoters may go to great lengths to enhance an MLM’s legitimacy and credibility. Some donate heavily to influential politicians and political parties, to the Olympics, and to worthy, highly visible causes. Their support for these causes is given top billing at opportunity meetings and often given recognition by an unwitting press. And celebrities are hired to speak at MLM conventions. Top MLM officials and founders have been honored by university and civic groups.



MLMs hire celebrities to tout their programs.

Effects of unlimited recruitment

Why MLM’s explosive “growth”? The lucrative recruitment incentives of an MLM or product-based pyramid scheme are what accounts for its explosive growth – until it collapses or is shut down by authorities. Unlike chain letters or Internet report chains, very intensive person-to-person recruiting drives MLMs, with each new recruit under pressure to recruit numerous others to recover his/her costs of participation – let

alone profit. MLMs are like a fast-growing cancer – extremely *viral and predatory*.

Each new recruit has a personal stake in advancing the scheme so that they may profit from an expanding downline. New recruits are taught to “be a product of the products” and to set the example of model recruiting and purchasing in suggested amounts so that others will duplicate their recruiting efforts and purchases, carrying them to success on the backs of downline participants.

Since the upline’s income is dependent on the recruiting success of downline participants, the upline is motivated to promote aggressive recruitment. And new recruits expect help with their recruiting from their upline in order to qualify for commissions and advancement in the scheme. This pressure from above and below can create explosive growth in recruitment and purchases by participants and sympathetic family members.

Not only are participants promised huge rewards for recruiting large downlines, but also the compensation plan penalizes them for not doing so. Participants might even be taunted for “leaving money on the table.” The pay plan serves as a constant reminder that their income could be multiplied many times over by increasing the body count of downline recruits and by achieving volume triggers to move up through the various payout levels.

Does unlimited recruiting doom most participants to failure? It is not the recruiting per se that creates the problems, as recruiting is essential in some businesses (e.g., sales and executive recruitment). But unlimited recruiting of participating recruiters, each of whom is empowered and given incentives to recruit other recruiters, who are empowered to recruit still other recruiters, etc., in an endless chain, inevitably dooms the majority of participants to failure and loss. This is not true of real estate or insurance agencies, direct sales, and other legitimate businesses – even recruiting firms.

Any endless chain marketing scheme is an unlimited recruiting program in a limited population of prospects – predetermined to failure and losses suffered by nearly all

participants, with the exception of a few at or near the top (often those who got in at the beginning) of a pyramid of participants. So making promises of rewards comparable to earlier entrants is misleading and becomes a primary device for defrauding recruits.

Like territorial franchises, MLMs could conceivably limit recruiting in a given area. This would conform to laws of supply and demand and the need to limit unfair competition. But limiting the number of participants is uncharacteristic of MLM. It would dampen the illusion of the potential for huge incomes for new recruits from what is typically portrayed as having unlimited potential. Such restrictions would render any pyramid scheme impotent.

MLM gets even more fraudulent when the compensation plan rewards infinite expansion in time and space. Though not discussed elsewhere, I believe this deserves serious thought by anyone considering MLM participation. Not only does MLM feature an endless chain of recruitment, but commissions and bonuses on downline sales (even to participants) supposedly go on FOREVER.

“Residual income,” or payments-in-perpetuity may work in principle on one level with creative writers, inventors, persons who sell insurance or annuities, etc. But in MLM, while such payments in perpetuity for more than one level increase the financial leverage of the upline, they also increase the mathematical absurdity of the whole system. In MLM, you actually have a system that features unlimited expansion in time and space in a marketplace that is limited in time and space. To anyone who perceives the mathematical absurdities, this makes MLM inherently flawed, unfair, and deceptive.

When I was recruiting for Nu Skin, we were led to believe that the market or “the opportunity” was unlimited. This almost gets into one’s perception of the size and duration of the universe. When the program reaches market saturation in this world, will space travel make it possible to continue the endless chain of recruitment on other planets? To listen to Nu Skin’s Blue Diamond spokesmen, one would think so. Other MLMs promote the same irrational talk about people being limited only by their efforts.

The business press is easily fooled.

From time to time, a business magazine publicizes a list of fastest growing companies in a state or in the country. What few business writers understand is that this is to be expected with any MLM, or product-based pyramid scheme. Even MLM promoters and defenders acknowledge the rapid growth of MLM in the “momentum phase,” followed by a leveling off period. What few acknowledge is that the leveling and decline periods are part of the natural progression from rapid momentum to market saturation and ultimate collapse – at least for most MLMs.

Dr. Charles King of the University of Illinois at Chicago has proposed the “curve of prosperity” experienced by MLM firms⁹³. He suggests that they go through stages in a growth cycle from formulation to concentration, then from momentum to stability.

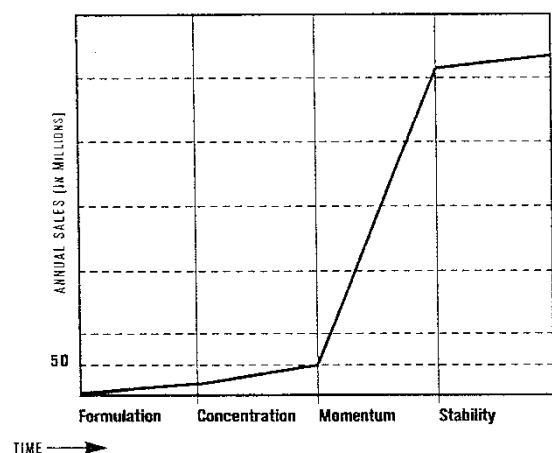


Exhibit 3d: The curve of (MLM) prosperity

However, Dr. King fails to mention the phase of market saturation and collapse, labeled “pop and drop.” described above. The MLM would collapse unless measures discussed above – such as re-pyramiding – are taken to replace the dropouts in a given market with new recruits from new markets. Thus, *participants churn through MLM programs sequentially, rather than exponentially, as some would expect with unlimited recruitment. And typically, with MLMs, there is no significant sustainable base of retail customers who are not participants.*

⁹³ “The Curve of Prosperity,” Dr. Charles King, *Success Magazine*, June, 1993.

Saturation Reality and the Myth of MLM “Growth.” Robert FitzPatrick, president of Pyramid Scheme Alert, issued a report showing that the “growth” touted by MLMs is illusory at best. In fact, not only have twelve publicly-traded MLMs experienced a drop in U.S. sales volume in the past several years, but the explosive growth overseas has shown signs of slowing down. He concludes that the larger companies such as Avon, Herbalife, and NuSkin face demographic and information saturation, preventing future growth. His report titled *MLM: Investors’ Guide to “Multi-level Marketing”* can be ordered from FitzPatrick’s web site at www.falseprofits.com.

Conclusions

MLM is inherently flawed, unfair, and deceptive – and both viral and predatory. It bears repeating here that a fundamental flaw in all MLMs is a compensation system that empowers and motivates each participant to recruit other participants in a network of endless chains of participants. MLMs assume an infinite market, which does not exist in the real world. They also assume virgin markets, which don’t exist for long – which means they either collapse or re-pyramid into new markets. They are therefore fundamentally flawed, deceptive, and profitable only for founders and a few at or near the top of the pyramid of participants. They are also extremely viral and predatory.

Markets quickly become saturated, and the MLM would collapse except for the ability of promoters to churn through a multitude of recruits who shoulder any potential losses. So the MLM is in a state of continuous collapse, which is borne not by the company, but by new recruits.

Again, this makes MLM as a business model profitable primarily for the first ones in who position themselves at or near the top of a pyramid of participants for pay purposes. So purchases made by a revolving door of hopeful new recruits enrich those at the top at the expense of the vast majority of participants who are positioned in a losing position beneath them in the pyramid of participants. MLM is an unfair and deceptive practice, far more so than no-product pyramid schemes or any other packaged home business or income opportunity.

Appendix 3A

Market Saturation: An Inherent Problem: Back to the Basics⁹⁴

By Dean VanDruff

A tutorial on market saturation hardly seems necessary in most business discussions, but with MLM, unfortunately, it is. Common sense seems to get suspended when considering if MLMs are viable, even theoretically, as a profitable means of distribution for all parties involved. This suspension is created by a heightened expectation of "easy money," but more on that later.

New, Innovative?

MLM can no longer claim to be new and, thus, exempt from the normal rules of the market and the way goods and services are sold. They have been tried and, for the most part, have failed. Some have been miserable failures in spite of offering excellent products.

Marketing innovations are not rare in the modern world, as evidenced by the success of Wal-Mart, which found a more efficient and profitable way to distribute goods and services than the status quo, providing lasting value to stockholders, employees, distributors, and consumers. But this is not the case with any MLM to date, and after 25 years of failed attempts, it is time to point out the reasons why.

Don't Some People Make Money in MLM?

First, we will analyze the "driving mechanism" of MLMs. We will detail how they are intrinsically unstable, guaranteed by design to oversaturate the market with no one noticing. We will look at why MLMs can never equalize into profitability the way companies in the real world can, so that the result will be that the organization as a whole cannot, even in theory, be profitable. When this inevitable destiny occurs, the only money to be made is not from the product or service but from the losses of people lower down in the organization.

Thus the MLM organization becomes exploitative, and many high-level MLM promoters have been shut down, the "executives" incarcerated, for selling the fraud of impossible success to others. Other, larger MLMs have survived by hiring large batteries of attorneys to ward off federal prosecutors, even bragging about the funds they have in reserve for this purpose.

The unfortunate "distributor" at the bottom is the loser, and once this becomes apparent beyond all the slick videotapes and motivational pep-talks, good people start to get a bad taste in their mouths about the whole situation.

So, yes, money can be made with MLM. The question is whether the money being made is legitimate or "made" via a sophisticated con scheme. And if MLM is "doomed by design" to fail, then the answer is, unfortunately, the latter.

But how exactly does this happen, and must it always?

Doomed by Design?

The first question is this: Is any company choosing this marketing strategy destined to fail, to degenerate into an exploitative venture, regardless of how good the product is?

⁹⁴ From "What's Wrong with Multi-level Marketing," by Dean vanDruff at - <http://www.vandruff.com/mlm.html>

To see this clearly we must go through an, otherwise, obvious and elementary discussion of how any business must be careful not to over hire, overextend, or oversupply a market.

The Real World

Any business must carefully consider supply and demand. For example, if the ReVo Corporation thinks that it will have a full-fledged fad on their ovoid sunglasses next summer, perhaps they should plan to build and distribute, say, 10M units. This involves gearing up factories, setting up distribution and dealer networks, and carefully managing the inventories at each level so that ReVo will still have credibility with their distributors, retail outlets, and the public the following year.

If it turns out that there is a "run" on ReVo products, and they sell out in mid-June, then they have miscalculated demand and will miss out on profits they could have made. The more serious problem, however, is overestimating the saturation point for the product. If they make 10M units, and sell only 2M units, this may be the end of ReVo as a company.

The all-too-obvious point here is that management of supply and demand, and keen insight into realistic market penetration and saturation are crucial to any business, for any product or service. Mismanagement of this aspect of a business will eclipse good market access, excellent product design, human resource assets, production quality, and so on. Simply stated, a failure to "hit the target" of supply and demand can ruin a company if the market is oversaturated.

Market Dynamics and the End of the Cold War

Interestingly, the issue of supply and demand is what brought the USSR to its knees. By design, the Soviet government tried to macro-manage supply, where bureaucrats would decide how many potatoes were needed, how much toilet paper, etc. Assuming these bureaucrats did the best they could, unfortunately their efforts to deliberately manipulate the control "knob" of supply and demand was not good enough. Notwithstanding their good intentions, they were usually wrong, which created huge shortages and surpluses, and led to a massive economic collapse.

Seeing the disastrous end of market naiveté in Russia should help clarify the fundamental problem with the MLM approach. In the real world, the profit of a company is directly related to the skill and prescience of the "hand" on the "supply knob," so to speak. In the USSR, that "hand" could not react fast or accurately enough to market realities through the best efforts of the bureaucrats.

With MLMs, the situation is much worse. Nobody is home. Even the Soviets had someone thinking about how much was enough! If the bureaucrat in Russia was having a hard time trying to play Adam Smith's "invisible hand" in setting the supply level in the Soviet Union, then an MLM "executive" is in a truly unfortunate position. Not only is there no one assigned to make the decision of how much is enough, the MLM is set up by design to blindly go past the saturation point and keep on going. It will grow till it collapses under its own weight, without even a bureaucrat noticing.

MLM is like a train with no brakes and no engineer headed full-throttle towards a terminal.

"Everyone Will Want to Buy This Product!"

All products and services have partial market penetration. For example, only so many people wish to use a discount broker, as evidenced by the very successful but only partial market penetration of Charles Schwab. Not everyone wishes to join a particular discount club, or buy gold, or drink filtered water, or wear a particular style of

shoe, or use any product or service. No one in the real world of business would seriously consider the thin arguments of the MLMers when they flippantly mention the infinite market need for their product or services.

The Demand Problem: Of Widgets and MLMs

Imagine a neat new product called a Widget that will sell for \$100 (a fixed price, to keep it simple). Now, while everyone could use a Widget, not everyone will. Some will be afraid of anything new. Some will be loyal to existing brands. Some will want to buy an inferior product for less money. Some will want a more expensive product for prestige, regardless of quality. The reasons go on and on, and the fact is that only "X" Widgets will sell at \$100.

The question for would-be marketeers is... what is "X," and how can it be predicted to maximize profits? The fact that "X" is hard to pin down does not mean that it does not exist, and every Widget built beyond "X" will end up producing a problem for the organization. The market only wants "X" Widgets at \$100. What are you going to do with your extra inventory of Widgets beyond "X" that no one wants, and the sales people you hired to sell them?

No one can perfectly predict "X," and the situation is not nearly as simple as considered here, but the objective for marketeers is to forecast "X" as closely as possible in order to provide lasting value to all parties involved: to avoid missed opportunities as well as waste, loss, or failure.

The MLM Forecasting Approach: Ignoring the Target

Who has an eye on "X," the point of market saturation at a given price, in an MLM? Well, the funny thing, or perhaps the tragic thing, is that "X" will be reached and exceeded without anyone noticing or caring.

Let's just suppose that "X" has been reached today in a particular MLM; the number of possible units sold at this price has just been exceeded, and you happen to be a starry-eyed prospect sitting in an MLM meeting listening to the pitch. Now consider: Does anyone in this company know about "X"? Does anyone care? Is the issue being suppressed on purpose for some other motive? Since we are supposing that the market saturation number "X" has been reached, everyone joining the MLM from now on is buying into a false hope. But that is not what the speaker will be saying. He will be telling you, "Now is the time to join. Get in on the 'ground floor'." But it is all a lie, even though the speaker may not know it. The total available market "X" has been reached and nobody noticed. All the distributors will lose from here on out. Could this be you? How could you possibly know at what point you will become the liar in an MLM?

Pop or Drop

Perhaps a better paradigm than the runaway train analogy offered earlier of how MLMs perform over time is this: a helium balloon let loose in an empty room with a spiked ceiling, where product quality is analogous to the amount of helium. The better the product, the faster the balloon will rise, accelerating unhindered, towards disaster. The other option would be the case of a lousy product, in which case the balloon will sink of its own accord, never getting off the ground. To be sure, equilibrium is not in the cards, except perhaps as an accident, and then only temporarily. MLMs are intrinsically unstable. For any company that chooses an MLM approach, its pop or drop.⁹⁵

⁹⁵ For more on the "pop and drop" phenomenon in MLM, go to the section preceding "The 8 Rs of MLM durability."

MLMs vs. the Real World

The basic question that needs to be asked is this: If this product or service is so great, then why isn't it being sold through the customary marketing system that has served human society for thousands of years? Why does it need to resort to a "special marketing" scheme like an MLM? Why does everyone need to be so inexperienced at marketing this! Is the product just a thin cover for what is really a pyramid scheme of exploiting others? But more on that later.

From Contracted, Protected Distribution . . . to Mayhem

Imagine that Wendy's became suddenly possessed by the idea that "everyone needs to eat," and opened four Wendy's franchises on the four corners of an intersection in your neighborhood. Who would benefit from this folly? The consumer? Certainly not the franchises; they would all lose. Wendy's corporate? Perhaps temporarily, by speculative inventory sales while the unfortunate franchises were under the delusion that they could all make money. But in the end, the negative image of four outlets dying a slow death would likely offset the temporary inventory sales bubble. Even the most unreflective of the hapless franchisees would think twice about doing business in such a manner again. This is why real-world distributorships and franchises are contractually protected by territory and/or market.

Again, the simple fact is that even the most successful products will have partial market penetration. The same is true for services. Demand and "market share" are finite, and to overestimate either is catastrophic.

So why are MLM promoters obscuring this? Who is in control of the supply "knob," carefully and skillfully managing the size of the distribution channels, number of salespeople, inventory, etc., to insure the success of all involved in the business? The truth is chilling: nobody.

Imagine trying to write a computer model of how MLMs work, and you will see this point most vividly. An MLM could never work, even in theory. Think about it.

The People Machine

Chernobyl had a control system that failed. MLMs have no control mechanisms at all. Where is the "switch" that can be flipped in an MLM when enough sales people are hired? In a normal company a manager says, "We have enough, let's stop hiring people at this point." But in an MLM, there is no way to do this. An MLM is a human "churning" machine with no "off button." Out of control by design, its gears will grind up the money, time, credibility, and entrepreneurial energy of well-meaning people who joined merely to supplement their income. Better to just steer clear of this monster to begin with.

There is simply no way to avoid the built-in failure mechanism of MLMs. If a company chooses to market this way, it will eventually "hire" (with no base pay and charging to join) far too many people.

Thus, the only "control system" will be the inevitable losses and subsequent bad image the MLM company will gain after it does what it was designed to do: fail. And sooner or later we have got to stop blaming this particular MLM company or that, and admit that the MLM technique itself is fundamentally flawed.

Appendix 3B

Ackman's Pictures Tell the Story: Herbalife Oversaturates

From an article by Matt Stewart⁹⁶

Last Friday, Pershing Square presented at the Robin Hood Investment Conference a summary of their pyramid scheme thesis for Herbalife ([HLF](#)).

. . .When I was in college, I worked as a real estate analyst for Canada's largest grocery store chain. My summer job was to analyze potential sites for retail viability. Specifically, we would model/proforma an income statement for a given retail location using bottom-up analysis. The analysis was always the same.

We started with a simple question: "How many people live within the trade area of our site?"

From there we used government census data to assess the demographic information of the people who lived in the site's trade area; e.g., What was their annual income? How much were they likely to spend on groceries per week, etc.

We mapped a primary trade area around each site in 1/4 square mile blocks. Within each cell on the grid we knew exactly how many people lived there and what their weekly spend was likely to be on groceries. We then estimated the % market share we were likely to earn from each cell on the grid. Multiplying the market share % by the # of people in the grid by the estimated weekly grocery spend allowed us to work-up our revenue model. We went through this process in detail cell by cell/block by block until we had a proforma.

The exercise continued by mapping competitors on the map. In each geographic location/micro-market we competed in we pretty much knew how much business was available (market size), how much volume the competitors were doing, and what our own opportunity set looked like.

There are 4 microeconomic truths that we always had to contend with when doing our store proformas.

- 1) The size of the total market in any given geography for groceries is finite.
- 2) There is only enough room for so much sales per square foot/so many stores per geography
- 3) If an area gets overserviced/overstored in the short-run all market participants will suffer.
- 4) In the long-run if an area gets overserviced/overstored the weakest market participants will fail.

Pershing Square's diagrams in their presentation demonstrate the "rational" location of various McDonald's Restaurants in and around the Queens area. It is easy for investors to imagine the trade area that surrounds each of these locations. Presumably, there are enough customers who desire to eat fast food on a daily basis to make each one of these locations economically viable for both the franchisor and franchisee. What we don't see from the image is evidence of location overlap. It appears, visually, that each McDonald's franchisee enjoys some level of territorial exclusivity. At the margin, each store competes with the

⁹⁶ Matt Stewart, *Seeking Alpha*, Nov 25 2013 (directed to investors). This is one of the first of many articles for and against Herbalife as a stock and MLM as an industry.

other. As customers cross over from one franchisees trade area into another's, perhaps they see some cannibalization of their customer traffic. However, there is an apparent calculus to the approach. Specifically, McDonald's appears to limit the number of franchises it grants contingent on the viability of each location.

Now, contrast the locations of the McDonald's sites to the Herbalife locations. The map tells a very different story.

1) It is immediately apparent that the Herbalife locations cluster in a concentrated way. Why would it be that Formula 1 would be interesting and compelling to certain residents of Queens but yet of no interest to people who live merely a few blocks away? Is obesity not an epidemic?

2) If Formula 1 is, indeed, the miracle cure for obesity, why do we not see coverage analogous to McDonald's in the Queens, NY geography?

3) What evidence do we see visually that Herbalife makes any efforts whatsoever to limit distributorships by territory?

4) Does Herbalife's marketing plan seem to encourage over-saturation or not?

5) What is the likely economic outcome for a distributor trying to compete in a geography that is over-stored/over-saturated?

6) If you had the license to Formula 1 as a strong and prosperous brand analogous to McDonald's would you be inclined to sell distributorships ad nauseam for \$59 or to limit them by geography and sell them for a much higher value like a franchise?

What does common sense tell you?

Pyramid Schemes are business opportunity frauds because they recruit an endless chain of participants which, when taken to their logical end-state leave the last guy in the door holding the bag.

One needn't look further than the maps provided by Pershing Square of the business activity in Queens, NY as direct and obvious evidence that:

a) Herbalife makes no efforts to protect its distributors from hyper-competition.

b) That over-storing, over-saturating geographies with a finite opportunity set leads to economic harm for most participants.

c) That the promise of infinite profits for the marginal participant in any given geography is a ruse.

e.g., Logically, what does the Herbalife opportunity look like for the marginal entrant in Queens, NY. What does it look like for the marginal McDonald's franchisee?

d) If McDonald's limits its number of stores based upon bottom-up analysis of viability, why wouldn't Herbalife do the same?

e) If Formula 1 was the greatest weight-loss solution since Weight Watchers, wouldn't we expect to see fewer distributorships on the map and not more?

Successful business partnerships/relationships work because everyone in the value chain is able to earn a reasonable return on economic capital. In the franchise model, the franchisee pays a fee to the franchisor for territorial exclusivity and the license to use trademarks, business processes, etc. The franchisor also offers training support, advertising, etc. The reason these relationships work is because the franchisor looks out for the interests of the franchisee. Effectively, their interests run with some degree of tension but if there is enough business to be had in a given geography, everyone makes money. Everybody wins.

Herbalife's business model, in contrast, is absurd. Herbalife's business model/Marketing Plan is not designed to provide support to individual entrepreneurs. Rather, the model is designed to deceive people - especially the marginal recruit. Herbalife distributors over-recruit people who act in good faith until the point when there are so many distributors in a given geography that it becomes impossible for anyone to make money other than the company.

Investors point to the results of the public company as evidence that the business model works. The company's own churn data reveals that the reason the model works is simple. The company is endlessly recruiting new victims all of the time. And, the ruse is always the same.

- Have I got an opportunity for you?
- Boy can you get rich quick!
- Look how much I made!
- You can do it too!

Herbalife makes faith healers look benevolent by comparison.

Bill Ackman's presentation on Friday showed us some pictures. These pictures tell the story loud and clear. Herbalife's Marketing Plan is designed to endlessly recruit and to saturate geographies to the point of economic extinction for its unsuspecting business partners. Why? Because it's Marketing Plan is a pyramid scheme.

Individuals who assert that HLF is not a pyramid scheme can't seem to be able to answer the following questions:

- 1) Why can't the company show any evidence of actual retail sales?
- 2) If Formula 1 is truly a miraculous weight-loss product, why does the business model give away distributorships like candy to anyone with a heartbeat?
- 3) If Michael Johnson was a genius marketer why would he support a Marketing Plan that undermines the chance of economic success for his distributors/encourages failure and churn?
- 4) Why so much emphasis on the economic success stories of Doran Andry, Leslie Stanford, John Tartol, etc. Shouldn't the product sell itself?
- 5) Why does a company with such a great product and huge profits see such high turnover in its salesforce each and every single year it operates? How often does the guy who owns a McDonald's throw in the towel by comparison?

Queens, NY is but one Latino micro-market that has been targeted by Herbalife.

Q. What do Mr. Ackman's pictures tell you?

Do pictures of Queens appear to show evidence of over-saturation or not?

You be the judge.

Herbalife is a pyramid scheme. The sooner the SEC shuts it down the better. Mr. Bill Stirtz has risked hundreds of millions of dollars investing in a business that mistreats its distributors with a [recruiting] salesforce and a multitude of deceptions.

Unsuspecting entrepreneurs continue every day to risk their financial, intellectual and human capital in pursuit of "The Dream" that is unscrupulously marketed by Herbalife and its gang of disciples. The Dream quickly becomes a nightmare for most while the faith healers continue to hive-off the spoils. . .

Chapter 4: PRODUCTS AND PRICES – questionable MLM product claims – and overpriced products

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Introduction and summary

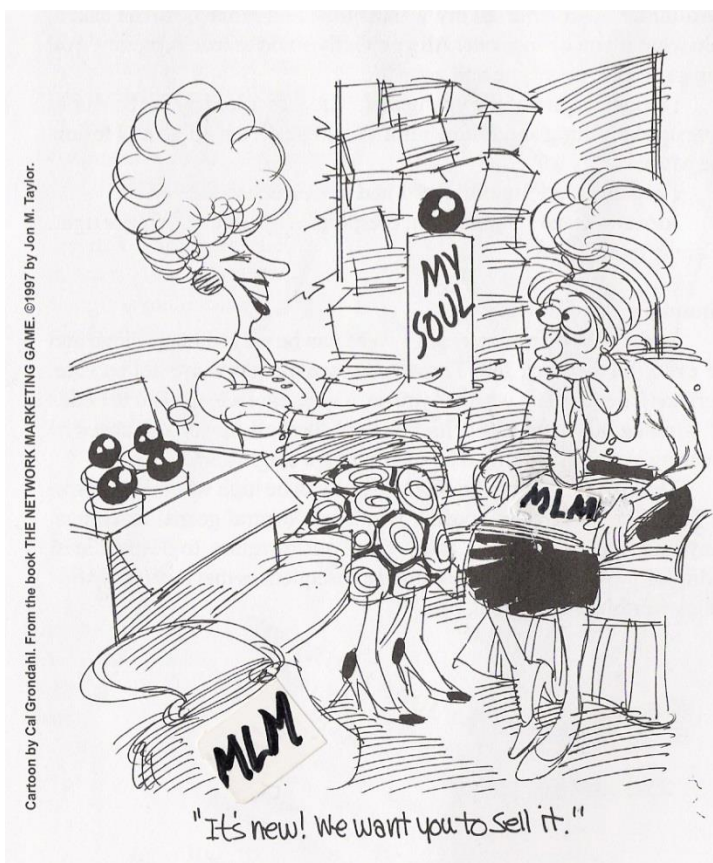
Industry claims that most recruits are “just customers.” When anyone challenges an MLM spokesman about the high attrition (dropout) rates of participants, the typical response is that the majority of recruits join because they like the products and can get them wholesale by becoming a distributor (or “representative,” “associate,” “IBO,” etc.).

We examine this claim by looking at the types and quality of MLM products and how experts view them. We will also show how their prices compare with prices of similar products at standard retail outlets.

Careful review of hundreds of MLM product offerings reveals questionable product claims and overpriced products. Of course, there are exceptions to the usual patterns that we see. For example, not all MLMs sell “pills, potions, and lotions.” And occasionally an MLM offers a product at a competitive price – but this would only be a rare and secondary product, not the core set of products that participants are incentivized to buy.

Pills, potions, and lotions.

Experts are critical of “pills, potions and lotions” typically offered by MLM companies. Questions about product claims persist: Do the “pills, potions, and lotions” typically sold by MLM companies meet the claims of promoters? Are their prices competitive with standard retail outlets? And are MLM products merely disguised investments in a product-based pyramid scheme?



After analyzing over 600 MLM programs, it has become apparent that a common strategy of MLM sponsors is to produce dietary supplements that supposedly cure or prevent every disease under the sun. Most MLM companies I have

studied claim to have the latest and greatest supplement that is not available anywhere else in such high quality for the price. They even claim to “bypass the middle man,” when in fact with their endless chain of recruitment, they create thousands of middle men – all hoping for a share of commissions. (See Chapter 8 for typical misrepresentations used in MLM recruitment.)

I consulted three experts on the validity of typical claims by MLM companies about the superior benefits of their products, which are used to justify their high prices. To protect their professional reputations, I am not publishing the full names of two of them.

The first was Lane, a nutritional scientist and the former vice president of product development for one of the leading MLM's, who told me that the product claims of these companies are overblown and misleading. “The modern version of snake oil,” he called them. He said the supplement industry is rife with people making fraudulent claims, especially MLM promoters.

Lane was very critical of MLM sponsors who promote products with exotic secret ingredients obtained from some remote island, etc. He suggested what many nutrition experts have recommended – that the best way to get needed vitamins and minerals is from a healthy diet.

MLMs claim to “bypass the middle man,” when in fact with their endless chain of recruitment, they create thousands of middle men – all hoping for a share of commissions.

The second was Allen, a nutritional formulator who has for many years manufactured supplements for both MLM companies and standard supplement companies that sell to health food stores. “This is a scumbag business,” he grumbled. He told of his desire to get MLM promoters to buy quality formulations, using top-quality ingredients. He said that in every case, they chose to cut corners so as to allow plenty of margin to pay their many levels of distributors. For example, if a product sold

for \$50, they would not pay over \$5 in production costs.

The third is Dr. Stephen Barrett,⁹⁷ editor of Consumer Health Digest and a medical doctor who has spent many years exposing all kinds of health quackery. He too recommends a healthy diet as the best source of needed nutrients. However, there are special cases where supplementation is needed, and this should be done in consultation with one’s doctor.

Dr. Barrett has also done much writing and research on supplements available from MLM companies. He has posted dozens of research reports and legal cases related to fraudulent claims by MLMs on mlmwatch.org. An excellent example is one on dietary supplements, available from his web site at – www.quackwatch.com.

“MLMs offer “the modern version of snake oil,” – nutritionist and former MLM product developer

“This is a scumbag business” – nutritional formulator for MLM companies

Do anti-oxidants extend life and improve general health? A review⁹⁸ of dozens of studies delivers a blow to popular antioxidants. Researchers found that the popular antioxidant vitamin E doesn't lead to a longer life. Neither do vitamins A or C. But experts are divided on whether that means you should skip the pills altogether.

Antioxidant vitamins, including A, E and C, don't help you live longer, according to this analysis of a large sample of studies of these popular supplements. The new review showing no long-life benefit from those vitamins, plus beta carotene and selenium, adds to growing

⁹⁷ The websites of Dr. Barrett include, among others: <http://www.quackwatch.org> (health fraud and quackery) <http://www.mlmwatch.org> (multi-level marketing) <http://www.naturowatch.org> (naturopathy) <http://www.ncahf.org> (National Council Against Health Fraud Archive)

⁹⁸ “Vitamins A, C, and E don't help you live longer.” MSNBC- Associated Press, Updated: 4:18 p.m. MT Feb 27, 2007

evidence questioning the value of these supplements.

Some experts said, however, that it's too early to toss out all vitamin pills — or the possibility that they may have some health benefits. Others said the study supports the theory that antioxidants work best when they are consumed in food rather than pills.



Highly touted anti-oxidant supplements may not be anti-anything – just costly.

An estimated 80 million to 160 million people take antioxidants in North America and in Europe, about 10 to 20 percent of adults, the study's authors said. [And in the year prior to this study, Americans spent \$2.3 billion on nutritional supplements and vitamins at grocery stores, drug stores and retail outlets, excluding Wal-Mart, according to Information Resources Inc., which tracks sales.]

For the report⁹⁹ on antioxidants, the researchers first analyzed 68 studies involving 232,606 people and found no significant effect on mortality — neither good nor bad — linked to taking antioxidants.

However, I have read reports that many nutritional scientists and doctors do take supplements, but usually in modest amounts, not mega-doses. They often explain their use of supplements as “insurance” to make sure they get what they may be missing in their diet (anti-oxidants, etc.). But they usually buy reasonably priced supplements and tend to focus on a nutritionally sound diet.

⁹⁹ The study, appearing in a February 2007 Journal of the American Medical Association, was led by the Cochrane Hepato-Biliary Group at Copenhagen University Hospital in Denmark. The Cochrane organization is a respected international network of experts that conducts systematic reviews of scientific evidence on health interventions. Also reported by Associated Press, February 27, 2007.

Unique, consumable, and pricey

When I tested the Nu Skin program, the spokesmen at opportunity meetings told us that for products to work in an MLM setting, they must be unique and consumable. They did not openly admit that the reason for the requirement of uniqueness was that the prices were so high that it would be a hard sell if anyone were to make price comparisons with alternate outlets. More on that point later.

MLM products must be consumable because that helps to assure repeat business. As was explained in Chapter Two, MLM companies sustain themselves primarily by incentivizing ongoing purchases participants must make in order to qualify for commissions and to advance up the various levels in the pay plan (rank advancement). Often these are sold on a monthly subscription basis to assure that these quotas are met and to assure a revenue stream for the company.

Also, MLM products must be priced high enough to support the commissions for a bloated multi-level hierarchy of thousands of distributors, in addition to founders and a costly infrastructure.

Price comparisons for nutritional supplements

Prices for typical MLM vitamin and mineral supplements. One of the most common products sold through MLM companies are vitamin and mineral supplements. When one compares what MLM participants pay for such supplements with what is charged at health food stores and supermarkets, some interesting comparisons can be made.

And how do they compare? Not very well. In spite of the claims of MLM/DSA communicators that most MLM participants sign up to buy the products at a discount or to resell them for “a little extra income,” the facts do not support either claim. MLM products purchased at wholesale prices are so expensive that few participants sell them at listed retail prices for a profit.

Also, since MLM sponsors have struck a deal with state tax commissioners,

requiring sales taxes to be paid on wholesale purchases, and since shipping charges to one's home must be added, the margin between total cost and the retail price is too slim to provide much incentive to sell direct to non-participants.

To check on the price disparity between MLM products and comparable products sold elsewhere, I asked representatives from ten MLM companies for the prices of their "best reasonably priced formulation of multi-vitamin multi-mineral products, with antioxidant protection." Then I made the same request of ten health food retailers. Interestingly, representatives for each of the health food stores recommended a different product. Here are the results:

- Average cost per person per month (listed retail prices) from MLMs, including Pharmanex (Nu Skin), Quixtar, Melaleuca, Shaklee, Usana, Isagenix, Sunrider, Herbalife, Arbonne, and Neways - **\$61.22** (not much less at wholesale, after taxes and shipping are added)
- Average cost per person per month for ten separate products from ten separate retail outlets - **\$11.52** (including shipping)
So the MLMs charged over **five times** as much!

As mentioned earlier, I also spoke with three nutritional formulators who formulate and manufacture supplements for both retailers and MLM companies. One of the three, Allen, shared an interesting experience alluded to above. He said he had formulated vitamin and mineral supplements with production costs billed to MLM companies of about \$4-5/month.

This formulator said he made the offer to at least two MLM companies to upgrade to an improved formula with much higher grade ingredients for an additional \$2-3/month, making the total cost to the MLM company about \$7/month. Though these companies sold these formulations for about \$50/month, they would not consider paying the higher cost of production for superior products, as that "would not leave them enough margin."



\$50 a bottle – for fruit juice? (MLMs use a fancier bottle.)

In spite of DSA claims of that most MLM participants “sign up to buy the products at a discount” or to resell them for “a little extra income,” the facts do not support either claim. MLM products purchased at wholesale prices are so expensive that few participants sell them at listed retail prices for a profit. MLM prices for vitamins were priced five times as much as shelf items!

Superfruit juices. Around the turn of the millennium, several MLM companies began to sell what were called superfruit juices - from faraway and exotic forests and remote mountains. These included mangosteen from Indonesia, noni juice from Tahiti, goji juice from the Himalayas, and acai juice from acai palm trees in Central and South America. Others bottled several fruit juices for a supposedly optimal blend of antioxidant and other health benefits, including increased energy, weight loss, and longevity.

As with nutritional supplements, these superfruit juices were pricey – often from \$40 to \$70 in a fancy bottle similar to those used for fancy wines. Distributors were encouraged and incentivized to buy a box of four or more bottles at a time.

Again I visited some retail outlets to make some comparisons. Super-markets were selling a variety of similar formulations of superfruit juices for from \$3.09 to \$6.99 for smaller 11-15 oz. bottles. Prices per ounce were less than half the prices charged by MLMs.

I visited two health food stores and I was told of an interesting phenomenon that they had both observed. For several years there was a surge in demand for superfruit juices, coinciding with the selling of similar juices by MLM companies.

Apparently, some health food producers responded by producing similar juices and pricing them at higher prices than they would normally charge for fruit juices because of the supposed high demand.

They didn't charge quite as much as the MLMs did, but they were selling quite a few bottles every month at \$28 to \$33 for a 32-oz. (one quart) bottle. People who had balked at paying MLM prices were going to the health food stores to get it cheaper.

But more recently, apparently after the MLM fruit juice craze had peaked, the demand for expensive superfruit juices at health food stores dropped to near zero. The exceptions were old standard juices that had always been popular and inexpensive – such as Aloe Vera juice by George's, which helps to heal intestinal inflammations. A one-quart bottle sells for \$8.19. The demand for this product – up or down - has changed very little during the superfruit craze. As one health food retailer put it, "The shelf life of the demand for the type of products sold by MLMs coincides with the MLM "business opportunity" – and vice versa!"

Interestingly, several years ago I wrote a satirical article and posted it online titled "*How to start a pyramid scheme that is very profitable for the founders – and get away with it.*"¹⁰⁰ My first suggestion was that the founder find a rare fruit drink derived from an exotic rain forest or other remote location – something that could be high priced because it would be unavailable elsewhere. Then the founder was to find some scientists who would – for a fee – vouch for its effectiveness. This approach is precisely what some of the newer MLM companies have done. (Hopefully, I am not to blame. I was only joking!)

*The shelf life of the demand for the type of products sold by MLMs coincides with the MLM "business opportunity" – and vice versa!
–Health food retailer*

Studies on Herbalife pricing

In extensive research on the pricing of Herbalife products as reported by hedge fund manager Bill Ackman¹⁰¹, conclusions about MLM products were drawn, which could also be applied to the product offerings of similar MLMs:

1. While Herbalife's dollar volume compares with many recognized brands, it is not a typical consumer product company. Few have even heard of Formula 1, with reported sales exceeding recognized brands, such as Palmolive, Betty Crocker, and Clorox. "Formula 1 is the only \$2 billion brand nobody has ever heard of."
2. Herbalife sells 10-20 times more nutrition powder than its competitors, including Ensure and Slim-Fast.

Ackman asked the question: "How is it possible that Herbalife sells six times more nutrition powder than Abbott Labs (Ensure), Unilever (Slim-Fast) and GNC (Lean Shake) combined?" All likely explanations fail: (1) It's products are not cheaper, but far more expensive, (2) It spends little on advertising (advertising its name, but not its products), (3) It's R&D is touted, but actually minimal, and in fact, it has only one patent.

Ackman finally concluded that it's not about the products but the opportunity. What he says could apply to hundreds of similar MLMs: "Herbalife bundles its products with a business opportunity."

Why MLM products are priced so high.

Thousands of middlemen). If MLM were involved in standard retail markets, they would of course have to price products low enough to compete with the competition. And as will be discussed in Chapter 10, in order to avoid operating as an illegal pyramid scheme, they need to sell most of their products to customers who are not involved in the network of participants. To do this, one would think that MLM products would be

¹⁰⁰ Chapter 11, Appendix 11C.

¹⁰¹ Ackman's research was presented in a 340-slide Power Point presentation to investors at a Sohn Conference, December 20, 2012.

priced competitively. But typically they are not. So why not?

The obvious reason is that they must pay multiple levels of participants – far more than is the case in a standard retail market. So again, the claim by MLM promoters that they cut out the middleman is patently false. MLMs can create thousands of middlemen in the form of downline participants.

Skimming by founders. Another reason is not so obvious, but as one who has observed the life styles of many MLM founders, as well as TOPPs (top-of-the-pyramid promoters), I am keenly aware of how these people profit handsomely from the purchases of downline recruits. Even those who simply founded the business and do no recruiting often engage in a practice I call “skimming,” in which they siphon off a significant percentage of every sale before covering product costs and before anything is shared with management, the infrastructure, or with participants.

As I am located in Utah, I have observed founders of Nu Skin and other MLMs living lavish life styles by skimming a substantial portion of company revenues – even while 99% of participants are losing money. I was informed from an inside source that one MLM founder has luxury homes in several states and in a couple of foreign countries, ranch properties, and her own private jet. Another had a home built that had so many rooms that the building contractor said that he many never enter some of the rooms. He wanted to know if he really wanted that many. “Go ahead and build it as planned,” was the response.

In the recently settled California case¹⁰² against Quixtar (recent U.S. version of Amway), an organization of IBO distributors complained about the company’s high prices numerous times and every time was told that “the multilevel marketing business plan requires higher margins and that the company will not reduce its margins.”

A consultant who analyzed Quixtar’s prices concluded that “Quixtar has few

actual customers and that few IBOs (‘independent business owners’) are selling their products.” When it was explained that “the Quixtar pricing formula is to take a product and multiply the manufacturing cost by three [‘the Jay factor’ – named after one of the founders] just to determine the IBO cost, which is supposed to be the wholesale cost,” one of the affiants commented, “With such a pricing formula, it is clear why ‘Quixtar IBOs cannot retail products.’”

MLM a brilliant business model for the founders. In the complaint filed against Quixtar¹⁰³, this statement is germane to the issue of high prices:

The MLM’s Quixtar business model is brilliant if you are a member of the DeVos or Van Andel families [founders]. Elevate the price of all products to gain an alarmingly high profit margin for the company. Market the company as a business opportunity, promising retail salability, to get unsuspecting distributors to purchase products at exorbitant prices while investing their time and energies promoting the business opportunity. Offer monetary rewards to incentivize distributors to recruit new distributors who also buy the company’s products. Teach all distributors to consume the products that cannot be sold, which is all of the products. . .

Quixtar has created an army of IBOs who are effectively trapped in Quixtar’s system, forced to buy and consume outrageously priced products, and recruit new victims as the only means of avoiding financial loss, [because leaving Quixtar for another MLM is rendered almost impossible by the noncompetition and non-solicitation rules.]

Again, the Quixtar case is offered only as an example of a problem that is widespread in the MLM industry. This top-down pricing which enriches founders and TOPPs by selling overpriced products primarily to a revolving door of hopeful new recruits is one of the features that make MLMs so unfair and deceptive as a “business opportunity.”

¹⁰² Notice of Errata re exhibits E,F, and G to affidavit of Billy Florence submitted with complaint, U.S. District Court for the Central District of California, Case No. CV 07-05194 GAF (JTLx), §45

¹⁰³ Complaint and demand for Jury Trial, U.S. District Court for the Central District of California, Case No. CV 07-05194 GAF (JTLx), § 117

The hard sell of “superior products” at MLM opportunity meetings

I speak from experience, having attended dozens of MLM “opportunity meetings” where participants drag in their friends, relatives, and other potential recruits they’ve been able to round up for slick presentations by upline presenters and product “experts.” The objective seems to be to create an atmosphere of excitement and “group think” characteristic of evangelical or political rallies, or gatherings of team sports fans, or even of thriving cults.

For years I made my living in legitimate direct selling, including selling encyclopedias to help pay my way through college. One of the techniques I learned early was to “anticipate the objection.” This entailed answering and overcoming key objections before the prospect had a chance to raise it. The sale went much more smoothly if we didn’t have to counter it after it was raised.

Speakers at MLM opportunity meetings invariably begin by hyping magical properties of the products they will be selling, which only amplifies the value of the “business opportunity.” And no wonder. They must convince those attending that their products are far superior to those available in retail outlets in order to anticipate and overcome any objections to the high prices they would be expected to pay – hopefully taking a supply home that very evening.

This top-down pricing which enriches founders and TOPPs by selling overpriced products primarily to a revolving door of hopeful new recruits is one of the features that make MLMs so unfair and deceptive as a “business opportunity.”

Other MLM products

Not all MLM companies sell vitamins or fruit juices. Many other products and services have been used as a product base for their programs. These include telephone and internet services, insurance and investments, fuel additives, pre-paid legal services, online photos, weight loss programs, seminars on secrets of building wealth, water filtration devices, energy services, and even tax avoidance advice. (The latter – “Renaissance – The Tax People” was shut down by federal and state authorities.)

What’s next? As long as it’s unique and consumable, almost anything can be sold through MLM. Just identify something that people get excited about, and you have the basis for the launch of a new MLM. How about online education? Memory enhancers? Exercise programs? And of course – aphrodisiacs to enhance ones sex life!

“No requirement to buy” to join

“Pay to Play.” Another line typically used in MLM recruitment is that anyone can join without any requirement to buy products or to stock inventory. But analyses of the compensation plans of over 600 MLMs confirms what I and others have long believed – that MLMs incentivize purchases of participants to generate the bulk of their income. In other words, participants must “pay to play” the game.

There is usually a nominal signup fee – often under \$50 – to join an MLM. This enables them to avoid exceeding any threshold requirements for initial investment that would require that they register as a “business opportunity” in some states. This may be \$500, so they manage to be exempt.

However, the signup fee is merely a ruse. In order to get to any of the payout levels where significant commissions are paid, one must meet minimum purchase quotas, either from one’s own purchases (“personal consumption”) or from those in one’s immediate group that they have recruited.



MLM participants make minimum "pay to play" purchases

The sellers are the buyers, and the buyers are the sellers – to themselves and their families.

Some participants are in reality sympathy buyers, counterfeit customers, and dummy distributors. As new recruits struggle to maintain "pay to play" purchases in order to qualify for commissions and to advance up the various levels in the scheme, they soon become desperate for buyers. They may pressure family members to buy - or give them away even if they are not interested. In my research, I found many buyers of MLM products made purchases to "help out" these new recruits – often family members. I call these "sympathy buyers." Other participants would buy products that they could not use in the name of someone

they knew but who had no interest in the products just to satisfy any retail requirement the company may have. They may even give products away to these people as gifts or samples, but claim credit to satisfy "pay to play" minimums. These I call "counterfeit customers."

Head counts and "dummy distributors." Some MLMs have not only volume requirements to qualify for escalating commissions and bonuses as participants move up the pay scale, but also head count requirements, such as in binary and breakaway systems. So in Nu Skin and other such programs, I observed the phenomenon of "dummy distributors" who were persons who agreed to sign up and allow their name to be used to satisfy the head count, even though they were not interested in becoming a distributor. The distributor would then buy products in their name to satisfy head count requirements.

Stockpiling. These kinds of purchases often lead to what MLM has a bad name for – stockpiling, which is personal consumption beyond participants' needs. If it becomes a widespread practice encouraged by an MLM, the company may be found guilty of operating an illegal pyramid scheme. MLM companies claim to have rules to protect against stockpiling, but in practice the compensation plans reward and even encourage stockpiling. But this is difficult to prove.



Stockpiling by MLM participants is common.

Getting MLM products cheap on eBay

If a person really wanted some specific MLM products, but didn't want to pay exorbitant prices, there is another option some people are discovering – eBay. *Ex-participants often seek to unload these overpriced "potions & lotions" – or other MLM products at a tiny fraction of the wholesale price!* Just go to the eBay website, click on the "Buy" tab, select the product category (such as "health & beauty"), enter the name of the company, click "search," and see what comes up.

Here are some examples of products I found at a fraction of the prices listed through the MLM:

- For Usana, I found (among a variety of Usana products) Healthpak 100 going for about \$34 (US) plus shipping.
- For Pharmanex (Nu Skin), I found LifePak for \$0.99 (US) plus shipping.
- Melaleuca's Vitality Mineral Complex was going for \$2.01 (US) plus shipping.
- A case (4 bottles) of Xango's Mango-steen juice for \$0.99 (US) plus shipping.

In the Ackman slide presentation discussed earlier, he noted that Herbalife products were also readily available at sharply reduced prices through eBay and Amazon.com – as low as 30-50% off standard retail prices. He also found that inflated surcharges for shipping and handling would leave little margin for retail selling, though it was a major source of revenue for Herbalife.

Analyses of the compensation plans of over 600 MLMs confirms what I and others have long believed – that MLMs incentivize purchases of participants to generate the bulk of their income. In other words, participants must “pay to play” the game.

Conclusions

As a qualified independent investigator who has studied hundreds of MLM compensation plans and marketing strategies, it is clear that the products promoted by MLM companies (MLMs) are merely a disguise for investing in a supposed “business opportunity,” or – more accurately – a product-based pyramid scheme. People are primarily buying the “opportunity,” not the products. This at least partly explains the unusually high prices for MLM products and services. Paying commissions for more levels of distributors than are functionally needed to manage the sales function also requires higher prices to pay commissions on all those levels.

Products are unique to prevent price comparisons with much lower priced products from other sources. To pump up the perceived value of the products, speakers at MLM opportunity meetings tout the unusual or magical properties of the products and services offered “exclusively” by the MLM. But the perceived value of the products is seldom translated into sales to non-participants at the suggested retail price. The sellers are the buyers, and the buyers are the sellers – to themselves and their family.

MLM products are also consumable to encourage repeat purchases – and are therefore often sold by monthly subscription. Minimum purchases are rewarded with the opportunity to reap commissions from sales through recruitment of new recruits and/or to advance to higher levels in the compensation plan. In fact, quotas must be met to realize any significant benefit from the recruitment-driven system of rewards. .

Stockpiling, though discouraged in company policies, is common and driven by purchases powerfully incentivized within the compensation plan.



"There, you see how painless it can be if you just say 'yes' to joining my downline of distributors."

Chapter 5: RECRUITING A DOWNLINE – why the emphasis in company communications is on selling, but in practice on recruitment – and what it costs to recruit a downline, as I experienced with Nu Skin

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Psychologists have found that you get the behavior you reward. And economists have learned that incentives drive behavior. So it is imperative to understand the compensation plan to determine the emphasis – on selling products or on recruiting people.

Introduction and summary

MLM promoters would have prospects believe that the costs of selling products and recruiting a downline are insignificant, since participants are merely sharing the opportunity with their “warm market,” or circle of friends and family. When communicating with regulators and the media, MLM spokesmen claim that they really cannot know what their distributors are spending, as this information is not shared with them.

The truth is that one must recruit aggressively beyond one's warm market in order to achieve the volume and to advance high enough in rank to make a profit – after subtracting from commissions their minimum operating expenses and the purchases required to qualify for commissions and advancement. The cost of conducting a successful recruitment has been tested and found to be high in areas where significant recruitment has already occurred, as is demonstrated in this chapter.



You get the behavior you reward.

Rewards stacked in favor of recruiting

Incentives drive decisions. Since it is so vital to understanding MLM incentives, I will quote from Chapter 2: “Psychologists experimenting with both animals and people learned decades ago that *you get the behavior you reward*. For example, if you place a dog in a room with two bowls, the first containing a pound of beef, and the second an ounce of dry dog food, invariably the dog will choose to eat from the first bowl.”

While working on my doctorate at the University of Utah, I had a small office on the 9th floor of the Social and Behavioral Science Building, which is where what we called the “rat psychologists” did their research. It was amazing how even rats could be motivated to learn fairly complicated tasks by manipulating their rewards. Over and over again, the principle was demonstrated that you get the behavior you reward.

We find a similar principle at work in economics: *Incentives drive decisions*. People will decide to invest or to put forth rigorous effort when the right incentives are in place. This is the reason for executive stock options, performance bonuses, etc. It is also a major factor that drives entrepreneurs to take extraordinary risks in hopes of a potentially handsome eventual payoff.

Similarly, since an MLM compensation plan specifies how participants are rewarded,

it reveals whether the primary emphasis of income is on recruiting a downline of participants or on retailing products to the (non-participating) general public. In Chapter 2, I explained how such emphasis can best be determined.

“Retail rules” inconsequential. If the MLM’s compensation plan rewards recruiting over retailing, it matters very little whether or not “retail rules” are included in the policy and procedures manual – or how often company officials urge participants to meet minimum retail sales requirements. Following basic psychological principles, participants will focus their efforts where they perceive the greatest payoff to be.

MLMs weighted towards building a downline. The DSA claims that “recruiting is not a requirement for success in “direct selling.”¹⁰⁴ However, in every one of the compensation plans of over 600 MLM programs I analyzed, the rewards were clearly weighted towards building a downline – which requires constant and aggressive recruitment. I certainly found this to be true during my one-year test of the Nu Skin program. My recruitment efforts were successful, having risen to the top 1% of participants by the end of a year (though not high enough to profit), assuming all who signed up as distributors were counted.

Compared to recruiting, selling MLM products at full retail price becomes a waste of time. The incentive to recruit to move up a level becomes very great. One can see that in such a system, the legal requirement (for a program to be a pyramid scheme) of “primary emphasis” on income from recruitment (in the form of downline purchases) is satisfied.

The phony argument of joining to buy wholesale. MLM defenders, including the Direct Selling Association (DSA), attempt to dismiss those who did not succeed in building a downline or who dropped out as having joined “just to get the products wholesale.” But as demonstrated in Chapter 4, prices were not competitive even at wholesale, especially after adding taxes and shipping. Eventually, those who attempt to

sell MLM products at suggested retail price soon give up when they cannot overcome stiff price objections.

An extreme differential. The differential between rewards for retailing and those for recruiting are so extreme that few MLM participants seriously attempt to retail products except to a few “sympathy purchasers” – usually close friends or family members. When those who succeed at recruiting a large downline are held up as examples for all to follow, new recruits soon sense the extreme gulf in payout between the two activities.

Who would retail overpriced products for \$100-\$200 a month in profits, when they could conceivably be earning the \$10,000 to \$20,000 a month held out as bait for downline-building – a ratio of 1 to 100? (These numbers are just for illustration, as the actual returns vary. But the extreme differentials apply to all MLMs I’ve studied.

Actually, as will be shown in Chapter 7, the profit ratio is worse than 1 to 100 because at least 99% actually lose money after subtracting “pay to play” purchases and

minimum operating expenses – which can be substantial. So the comparison is between a loss of hundreds of dollars for direct selling – versus the potential gain of hundreds of thousands of dollars for aggressive, long-term recruit-

ment efforts. At least that is my perception looking back, and I have noticed the same perception on incentives from worldwide feedback I have received from participants in hundreds of MLMs.

However, even the latter perception is incorrect because it is extremely rare for anyone to be earning such huge incomes, except for the first downline builders (who MLM promoters like to call “business builders”) to join the program. As a general rule, the more new recruit invest in time and money, the more they lose.

¹⁰⁴ “Ten Myths & Facts about Direct Selling.” Direct Selling 411 web site, registered by DSA communicator Amy Robinson.

TOPPs get the lion's share of payout to distributors.

In addition to the founders, those who I call TOPPs (top-of-the-pyramid promoters) are the chief beneficiaries in MLM. In every one of the hundreds of MLMs I've analyzed, this stands out as a key characteristic.

For example, when I tested the Nu Skin program, one of my top upline Blue Diamonds boasted he had over 100,000 downline "distributors" from whom he was collecting commissions. Later, careful analysis of a Nu Skin "Distributor Compensation Summary" report revealed that approximately 61% of company payout of commissions to distributors went to the Blue Diamonds (Nu Skin's TOPPs). That means the other 39% was shared by over 100,000 hapless downliners, almost none of whom received enough to exceed expenses.

This extreme differential in payout was often misrepresented in company reports and at opportunity meetings. It was likely one reason that in 1994 the FTC issued an Order for Nu Skin to cease its misrepresentations of distributor earnings.

However, Nu Skin was not unique in this regard. In virtually all of the MLM compensation plans I have analyzed, payout to participants increased exponentially as they were positioned at higher and higher levels in the pay plan. This is why "rank advancement" is so heavily emphasized by "business builders."

“\$750,000 a year. If that’s true, I could live on that. If not, I’ll tell the world about it.”

The life of an MLM recruiter

When new recruits catch the vision of the enormous rewards supposedly awaiting them for recruiting a large downline, they must make some dramatic lifestyle changes.

Forget the drudgery of an 8-hour workday. Now it's an 18-hour workday! Every waking moment is spent thinking up ways to recruit friends, relatives, and anyone within one's circle of influence who is breathing. We used to call this the "3-foot rule" – anyone within three feet is a prospect.

In 1994-95, I tested the Nu Skin program, partly because no one with my background had done a thorough analysis of the costs and success rates of MLM (then called "network marketing"). Many of my friends had been recruited into an MLM program, and several persons I respected had repeatedly tried to recruit me.

When a friend who was a Nu Skin distributor recruited me, his upline sponsor told me that with my contacts, within two years I could achieve the rank of "Blue Diamond." He pointed to a report that the average income for Blue Diamonds at that time was about \$750,000 per year!

Though I told them "no" four times, I finally relented and decided to give it a try. I told myself, "\$750,000 a year. If that's true, I could live on that. If not, I'll tell the world about it." So I decided to give it my all for a year.

I bought the more expensive \$1,500 package, including "Executive starter packs" of products and sales materials, so that I could sign up five people and have on hand what I would have to sell them to get started. Five "active" distributors were required to become an "Executive." No one really got anywhere unless they achieved that rank. (Levels, or ranks, in the compensation plan were determined by the number of people recruited and the volume of purchases.)

I soon found that I needed to be on the phone constantly and was setting up appointments for 3-way calls with my upline sponsor so that he could help convince my prospects that they should come to the next opportunity meeting. The meetings were held locally weekly, and regionally at least monthly.

Then there were training meetings we were expected to attend (for a fee), in addition to the annual Nu Skin company conference. Impressive presentations were given by Blue Diamonds and by “experts” on the various products and the occasional celebrity from athletic or nutritional fields who were using the products and allowing their names to be associated with them (I assume for handsome speaking fees).

We were to begin by recruiting our “warm market” of close friends and relatives. I soon found myself having gone through all my close relationships and having to advertise outside my warm market – placing small ads in newspapers and magazines, posting notices or signs any place that allowed them, leaving cards on windshields in parking lots, etc. And I began setting up my own opportunity meetings in nearby cities and towns – and even at some distance when anyone responded to my advertising. Even if I had only one or two persons attend, I went ahead with my presentation.

A reality check. After about a year of aggressive recruitment, I had a reality check. My wife threatened to leave me. My focus on recruiting was affecting all our relationships. People we had known and loved for years were now avoiding us. I was burning through our social capital as though it was of no consequence.

“It’s Nu Skin or me, take your pick,” JoAnn challenged. This was my wake-up call, though I honestly felt that with another year or two of concentrated effort I could become a Blue Diamond.

I love my wife and had no desire to lose her – no matter how much it cost. So I did a careful re-examination of what I was doing and of the results so far from my efforts. I had been too busy to tally my expenses as I had done in previous business ventures. This was truly a reality check for me. I began to rethink what I was doing.

*“It’s Nu Skin or me, take your pick,”
my wife challenged.*



The costs of a successful recruitment campaign

To my surprise, though I was in the top 1% in the Nu Skin Distributor hierarchy (counting ALL who had joined), I was only bringing in about \$250 a month – while spending over \$1,500 a month, thus losing \$1,250 a month! I would have to rise several more levels to realize profits (after expenses).

As I mentioned earlier, after exhausting my “warm list” of friends, relatives, and acquaintances I found it necessary to turn to advertising and other resources to obtain additional prospects. *The argument that this is a no-cost or low cost business was found to be totally misleading*, at least for those seeking “success” advancing in the pay plan through an aggressive recruitment campaign.

I could have spent a lot more, but I am quite conservative and spent only what was needed to succeed in my recruitment. However, even though I was only receiving commission checks of about \$250/month, I believed that with enough effort and expense,

I could become a Blue Diamond and profit handsomely within a couple of years.

But now I had a moral dilemma. It became apparent that to be successful in recruiting a large enough downline to become a Blue Diamond, I would have to deceive hundreds – even thousands – of people, as I had been deceived. Being a deeply religious person with strong moral convictions, I decided to terminate my distributorship with Nu Skin. Since I would no longer have to make expensive “pay to play” purchases. I purchased my vitamins cheaper elsewhere.

Table 1 below provides a breakdown of my recruiting expenses for my one-year test of the Nu Skin program. I could not have conducted a successful recruitment campaign for less, unless it was in a virgin market – which does not exist in this country.

Table 1: One year of recruiting expenses with Nu Skin

Money paid to Nu Skin

Nu Skin products (including samples and “pay to play” purchases to qualify for commissions & advancement)	\$5,416.75
“VIP” services (by Nu Skin)	102.21
Nu Skin training & conferences	755.00
Nu Skin publications & tapes (“tools for success” to pass out)	<u>459.98</u>
Total amount paid to Nu Skin	<u>\$6,733.94</u>

Operating expenses (not paid to Nu Skin)

Advertising	\$1,457.81
Supplies	586.30
Printing & duplication	418.99
Telephone & computer costs	3,496.15
Postage & shipping	329.85
Travel (including car mileage), hotel meeting rooms, etc.	5,277.12
Miscellaneous	<u>216.76</u>
Total operating expenses	<u>\$11,782.98</u>

Total expenses	<u><u>\$18,516.92</u></u>
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Plus – the opportunity cost of income lost doing MLM. Prior to my stint with Nu Skin I had been selling insurance and was doing fairly well. So during the year, I lost time I could have better spent selling insurance. For me, that loss was significant – likely three or four times as

much in lost insurance commissions and residuals as my out-of-pocket costs recruiting for Nu Skin.

New sales and recruitment “tools” – and travel costs. Now of course, much of that has changed. New recruits use the internet for much of their recruiting. And they have access to lead generation systems that are competing for their dollars – each of them claiming to have the best system that will guarantee results. But if anything, the costs for a successful recruitment campaign are much higher today than they were then, especially since the market has become increasingly saturated with hundreds of MLMs engaged in recruiting simultaneously.

This means that new recruits who are ambitious enough to seek advancement to the higher levels in the pay plan (where the money is made) will likely have to do a lot of travel to less saturated areas, even overseas, to get in on the ground floor of a more new market for the MLM program they are promoting. I believe it would be much more expensive to mount a successful recruitment campaign today than it was then.

Minimum breakeven amounts. To be conservative, I will say that the total costs for a combination of minimum “pay to play” purchases, selling tools and training, and operating expenses would be as listed in Table 2 below for each year from 1995 to 2011, allowing for inflation using a standard CPI (Consumer Price Index) adjustment. I will start with a bare minimum of \$18,517 for the year 1995, the year I was last involved. Based on careful analysis of my records and of the reports of others, I believe this to be a realistic estimate.

These figures will come in handy later when we look at the profitability for MLM participants of carrying out a successful recruitment campaign. Since recruiting a downline is where any profits are made from MLM participation, this information is highly relevant as breakeven points in doing any analysis of profitability.

MLM defenders will likely argue that the costs presented here are atypical, as Nu Skin is such a highly leveraged program. Though there is some truth to that, analysis

of hundreds of MLM compensation plans and worldwide feedback convinces me that all MLMs are recruitment-driven (with the possible exception of some party plans) and would all require expenditures of at least as much as I had to make in order to have any hope of reaching a high enough level to realize any significant profits – or even to be lifted out of the loss column.

In addition, I have observed that costs for higher level distributors, especially for TOPPs (top-of-the-pyramid promoters), can be several times the amounts I spent. I have observed TOPPs from a wide variety of MLMs who are continually travelling to pump up their downlines and to sell the prospects of downline recruiters on signing up for this “opportunity of a lifetime.”

It should also be noted that most MLM participants don't spend nearly as much as I spent, but these are not serious recruiters and – based on analysis of MLM company reports and surveys of tax professionals – never reach profitability.

The usual pattern is to buy a few products, or enough to meet “pay to play” requirements. After attempts at selling and recruiting, they eventually drop out, only to be replaced by others in a revolving door of thousands of hopeful but hapless new recruits – who are the primary source of income for the MLM. Based on tax studies and my analyses of average earnings of MLM participants where such data is available, those who reaped the promised rewards always did it by recruiting large downlines.

It is both very demanding and very expensive to recruit a large downline, which is essential if one is to realize significant profits from MLM.

Table 2: Minimum operating expenses for conducting a successful MLM recruitment campaign, with cost of living (COL) adjusted by changes in Consumer Price Index¹⁰⁵

Year	COL (cost Of living) adjustment	Min. costs of participation and recruitment for the year
1995	2.8%	\$18,517
1996	3.0%	\$19,073
1997	2.3%	\$19,512
1998	1.6%	\$19,824
1999	2.2%	\$20,260
2000	3.4%	\$20,887
2001	2.8%	\$21,472
2002	1.6%	\$21,815
2003	2.3%	\$22,317
2004	2.7%	\$22,919
2005	3.4%	\$23,699
2006	3.2%	\$24,457
2007	2.8%	\$25,142
2008	3.8%	\$26,097
2009	-0.4%	\$25,993
2010	1.6%	\$25,408
2011	3.3%	\$27,254
2012	2.1%	\$27,826
2013	1.5%	\$28,243
2014	0.8%	\$28,469



¹⁰⁵ “Consumer Price Index Data from 1913 to 2014,” U.S. Dept. of Labor Bureau of Labor Statistics

Like other MLMs, the cost of “building the business” limits any profits for Amway IBOs. The high cost of recruitment was emphasized in a UK action against Amway.¹⁰⁶ One of the points of objection was expressed as follows:

. . . because of the requirement that an IBO pay a joining and renewal fee and the likelihood that an IBO would purchase BSM there was a certainty that the Amway business would cause a loss to a large number of people (to the extent that out of an IBO population which exceeded 33,000 only about 90 IBOs earned sufficient bonus to cover the costs of actively building the business).

This means that at best one out of 367 IBOs (Independent Business Operators) are in a position to even show a profit, especially since very few products are sold at suggested retail. After subtracting incentivized purchases and operating expenses, the number who earned a significant income (more than a minimum wage) would likely be far less than one out of a thousand.

The lucky few who actually earned the substantial ongoing income (profits above expenses) suggested in opportunity meetings could be said to be virtually nil. In fact, another statement in the same (UK) judgment suggests that “instances of those who did have some success . . . are the equivalent of one out of many thousands.”¹⁰⁷

Labeling such an activity as a business or income opportunity is a major misrepresentation. This lack of profitability will be examined in detail in Chapter 7.

Recruiters in UK called “gang masters.” In the UK case, the importance of recruiting as the life blood of the business was strongly emphasized in these words:

The existing IBOs effectively act as gang masters, the gang master being rewarded under a system which rewards him or her more highly for the assembly of a gang (the “downline” with the aggregation of the group volume to produce ever higher commission rates) than for the direct selling of product.¹⁰⁸

The argument that this is a no-cost or low cost business was found to be totally misleading, at least for those seeking “success” advancing in the pay plan through an aggressive recruitment campaign.

Conclusions

It should be clear to any qualified analyst who looks at the available data, MLM compensation plans, and the arguments for and against MLM; that MLM is predicated on recruitment of endless chains of participants as primary customers. My analysis of hundreds of MLM programs supports the conclusion that MLMs are recruitment-driven with very little incentive to sell products to non-participants. Products are priced too high to be competitive, and compensation plans provide rewards to participants that escalate exponentially as they climb the hierarchy (pyramid) of participants.

It is both very demanding and very expensive to recruit a large downline, which is essential if one is to realize significant profits from MLM. Those who lock in a position as the first ones in the network of recruitment chains have a huge advantage over those who come in later, but this is seldom disclosed to new recruits.

Based on tax studies and on my analysis of average earnings of MLM participants where such data is available, those who reaped the promised rewards did it by recruiting large downlines.

¹⁰⁶ Approved Judgment: The Secretary of State for Business Enterprise and Regulatory Reform v. Amway (UK) Limited May 14, 2008. § 7(c),

Op. Cit., § 54 (c)

¹⁰⁷ Op. Cit., § 54 (c)

¹⁰⁸ Op. Cit., § 46

Cartoon by Cal Grondahl. From the book THE NETWORK MARKETING GAME. © 1997 by Jon M. Taylor.



"Take two aspirin... recruit two distributors
and call me in the morning."

Chapter 6: ATTRITION RATES OF MLM PARTICIPANTS – why few recruits stay, and why it matters

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Introduction and summary

High attrition - an Achilles heel for MLM defenders. MLM promoters are often touting to prospects the “residual income” that MLM provides for those who participate. They make it sound like an author’s royalties or an annuity – a steady stream of income from the commissions that will flow to them from their downline, even while they sleep, or travel in luxury with all that money they’re going to make.

While the endless chain of recruitment assumes an infinite market, the promised residual income from MLM assumes perpetual residuals from a permanent cast of downline buyers. As we shall see, careful investigation suggests that nothing is further from the truth. Unwittingly, MLM participants recruit their own competition, requiring that they recruit aggressively in increasingly saturated markets, leading to high loss rates among participants.

We will find that attrition rates in MLM are extremely high, which will have a huge impact on profit and loss rates, and vice versa. This may explain why MLM companies are loathe to disclose information on “turnover” or “attrition” (or the opposite – “retention”) rates. It requires considerable sleuthing to get this information, but enough is available to make some realistic estimates of actual rates.

As explained in the last chapter, replacement of dropouts is accomplished by continual recruitment of a revolving door of new recruits, which is one reason that “TOPPs” (top-of-the-pyramid promoters), or “kingpins,” garner a disproportionate share of the revenues. TOPPs are the driving force of MLMs.

Evidence of high attrition rates

What turns up in a Google search. When one does an “Advanced Search” in Google for “MLM” - associated with the words “attrition,” “retention,” or “turnover” - thousands of interesting search results come up. Nearly all of them acknowledge horrible turnover of new recruits into the MLM business, and sponsors of most of the web sites each have their own solution to the “problem.” It may be a special lead system, a revolutionary training program, or an unusual compensation plan, etc. However, few acknowledge the stark truth of the cause of such high attrition – the flawed system of unlimited recruitment of a network of endless chains of recruitment that has led to increasingly saturated markets and high loss rates. Participants may be quitting for some very good reasons, whether they fully understand them or not.



Except for TOPPs (top-of-the-pyramid promoters), almost all MLM participants wind up losing money – and eventually drop out of the program, many of them discouraged and blaming themselves – rather than a flawed program.

Melaleuca’s phony boast. There was one MLM that for some time boasted of having the highest retention rate in the industry. In fact, Melaleuca claimed to have an incredible 94.5% retention rate. However, when the issue was investigated in a Texas court case, it came out that the 94.5% was not per year or longer, but *per month*, which meant they were losing 5.5% per month – or about 66% per year. Nu Skin, Pre-Paid Legal, and other MLMs have admitted losing over 50% per year. Extended out over time, 95% or more would likely be gone in five to ten years.

Nu Skin’s “permanent income.” When I tested the Nu Skin program, the promoters touted the “permanent income” that one can attain through network marketing. Ten years after leaving the program, I was curious enough to attend a couple of their “opportunity meetings” to see if anything had changed.

The Nu Skin speakers were still talking of a “ground floor opportunity” and “permanent income.” One thing had changed – the people. I looked around – all new faces, except for the top-level “Blue Diamond” speakers, who were essentially the same cast of characters with an audience of new prospects before them. I thought then, “How could they be enjoying permanent or residual income, if they have to recruit a whole new set of participants to replace the 98% or 99% who had dropped out?”

After 10 years, the Nu Skin speakers were still talking of a “ground floor opportunity” and “permanent income.” One thing had changed – the people. I looked around – all new faces, except for the speakers themselves, who were essentially the same cast of characters with an audience of new prospects before them.

Another analyst, Robert FitzPatrick observed that “The pattern of 50-70% of all distributors quitting within one year holds true also for Nu Skin.”¹⁰⁹

Admission of Pre-Paid Legal.

FitzPatrick also noted: In its annual report to the SEC, Pre-Paid Legal, another large MLM, revealed that 1/2 of all its customers and distributors quit each year and are replaced by another group of hopeful investors.¹¹⁰

Out of 10,000 participating Amway IBOs, only 414 remained in the business after the 5th renewal. That’s a 95.9% dropout rate in only five years for the largest of all MLMs – truly a smoking gun!

Amway’s “smoking gun.” According to Eric Scheibeler¹¹¹, author of the book *Merchants of Deception*, out of 10,000 participating IBOs, only 414 remained in the business after the 5th renewal. That’s a 95.9% dropout rate in only five years for the largest of all MLMs – truly a smoking gun!¹¹²

Speaking of Amway (or Quixtar in the U.S. from 2000-2009), an active participant is called an “IBO” for “Independent Business Owner.” As one of a group of consumer advocates who has studied the deceptions in Amway’s program, I find this IBO designation amusing. Why? Because Amway’s distributors are not *independent*, as anyone who has sought to work with any other MLM while with Amway can testify. It is not a *business*, unless one considers odds of success far below gambling a real business. And Amway’s IBOs *don’t own anything*, as anyone who tries to leave Amway and take their downline (that they spent years building) with them can testify. They don’t even own the promised residual

¹⁰⁹ FitzPatrick, Robert, “10 Big Myths of Multi-level Marketing”. Report published in 2009. Available from the web site pyramidschemealert.org

¹¹⁰ FitzPatrick, Robert, *ibid.*

¹¹¹ Scheibeler was citing a 2005 Quixtar (Amway) internal management report

¹¹² Term used by Bruce Craig, former Assistant Attorney General for Wisconsin

income because the high attrition rate assures them that they cannot count on those residuals – and because there are seldom any profits at all.

Estimates of minimum attrition rates – and a challenge to “prove me wrong.”

Statistical distortion common in MLM. MLM companies that furnish data on average incomes are careful to include only “active distributors” (or “representatives,” “associates,” “agents,” etc.) in their population of participants, comparing them with those who have achieved certain profitable levels in the pay plan – even if they have been with the MLM for ten or twenty years. This hugely distorts any resulting conclusions that would be drawn from the data. *Statistical integrity would require that all recruits (not non-participating customers) be included for a given time period and none interjected into the data set from an earlier time period.*

Deleting dropouts from the population of recruits hugely distorts average income statistics.

Reasonable attrition estimates – and a challenge to “prove me wrong.” Based on my analysis of hundreds of MLMs, on investigations in court cases by myself and others, on comments by MLM spokesmen in the media, and on worldwide feedback on the Internet, I would estimate that that over a five-year period, at least 90% of participants would have quit their respective MLMs, and in ten years, 95% would be gone. This would mean retention of 5-10% at most. The only exception to that might be some party plans that can produce profits for legitimate sales to non-participants

I am open to making an exception to these figures if officials from any MLM can produce their entire list of recruits over a five or ten year period and show retention higher than that.

Comparisons with failure rates for small businesses and franchises.

MLM defenders attempt to compare MLM to legitimate businesses. When confronted with evidence of high turnover, or attrition, MLM promoters are fond of comparing it to high failure rates in small businesses generally. But the latter do not even approach the high failure rates experienced by MLM participants.

In sharp contrast, one nationwide survey of small businesses¹¹³ showed that over the lifetime of a business, 39% are profitable, 30% break even, and 30% lose money. Cumulatively, 64.2% of businesses failed in a 10-year period. Franchises do much better. The following quote from an article in the *Journal of Small Business Management*¹¹⁴ is highly relevant here:

When aspiring business owners compare the options of franchise versus independent business ownership, an important consideration is the relative risk of business failure. To date, the primary referent for examining franchise failure rates has been surveys conducted by Andrew Kostecka (1988)(1) under the auspices of the U.S. Department of Commerce, which indicate that less than 4 percent of all franchises fail each year. This figure compares favorably with various estimates of independent small business failures (e.g., Dun and Bradstreet 1989).

If only 64.2% of businesses failed in ten years, this totally refutes the argument of MLM defenders that – “MLM is just like any business. Those who work at it succeed. Most fail because they didn’t really try.” With a 99% loss rate, MLM is definitely not like a real, legitimate business.

If 99% of all MLM participants lose money¹¹⁵ (compared to 30% of small businesses), and if in ten years, 95% quit (compared to 64% of small businesses), there must be something wrong with the

¹¹³ William Dennis, Nat’l Federation of Independent Businesses, reported by Karen E. Klein in *Business Week*, September 30, 1999.

¹¹⁴ Castrogiovanni, Gary J., Justis, Robert T., and Julian, Scott C. “Franchise failure rates: an assessment of magnitude and influencing factors.” *Journal of Small Business Management* (April 1, 1993)

¹¹⁵ See Chapter 7.

entire MLM industry; that is, with the MLM business model itself. MLMs are not real, legitimate businesses – any more than classic no-product pyramid schemes are real businesses. MLMs are simply product-based pyramid schemes.¹¹⁶

Comparisons of MLM with other types of selling

Comparisons of attrition rates for MLM participants to those for retail sales persons. In desperate attempts to explain away MLM annual attrition of 50%¹¹⁷, the DSA makes comparisons with the high turnover among retail sales persons. But as PSA's Robert FitzPatrick wrote:

For attrition rates, you may find DSA's latest statement of interest. They state that the average turnover rate in ["direct selling" is 56%], but then go on to compare that number with [53%] turnover rates in the traditional "retail" sales industry.

This, as we would expect, is spurious. Retail sales in stores is seasonal and, by design, part time. And, as you work, you actually get paid so there is no relation to the attrition rate in real retail sales and financial loss. And you are not required or even induced to buy the goods in the store as part of your pay plan. Finally, MLMs should not be compared to retail sales at all, since few MLMers ever retail anything anyway.

Since MLM is not sales work, but pyramid recruiting, it has no counterpart in the real world or work or employment.¹¹⁸

Temporary participation in "direct selling." In another attempt to explain away the high turnover in the MLM industry, the DSA often suggests that many persons participate in MLM (which they call "direct selling") only temporarily or seasonally to raise money for Christmas or college, etc. – not for regular income. So they claim these dropouts should not be counted as dropouts.

The problem with this argument is that the DSA equates MLM to legitimate direct selling – where part-time or seasonal income is possible. However, *none of the*

compensation plans of the hundreds of MLMs I have analyzed are set up to reward those who participate on a temporary basis. They are all recruitment-driven and top-weighted, meaning rewards are weighted towards those who recruit and maintain huge downlines. This is not possible for seasonal or part-time participants. Add to that the problem of MLM products that are not priced competitively for resale – and the cost of purchases required to participate fully in the pay plan – and seasonal participants are merely fattening the coffers of the MLM and TOPPs.

While some may be fooled by the DSAs argument, it rings hollow to me. Decades ago, when door-to-door selling was viable, I sold encyclopedias to help pay my way through college. My commissions were much larger than overrides paid to my sales manager. So I was able to make a good part-time income without recruiting a single person. This meant reporting a net income from selling on my income taxes – which MLM participants seldom do.¹¹⁹ And I did not have to buy a set of encyclopedias to qualify for commissions!

Decades ago, when direct selling was viable, I sold encyclopedias to help pay my way through college. My commissions were much larger than overrides paid to my sales manager, so I was able to make a good part-time income without recruiting a single person. This meant reporting a net income from selling on my income taxes – which MLM participants seldom do. And I did not have to buy a set of encyclopedias to qualify for commissions!

¹¹⁶ See Chapter 2: and 7.

Chapter 1 ¹¹⁷ "Top 10 Myths & Facts About Direct Selling," by DSA's Amy Robinson, posted at – www.directselling411.com.

¹¹⁸ Letter to Jon Taylor dated October 21, 2010

¹¹⁹ "Who profits from MLM? Preparers of Utah tax returns have the answer," by Jon M. Taylor. Posted on mlm-thetruth.com

The revolving door of MLM participation. This is so generic in MLM, that it's worth repeating what I said in Chapter 3 about how MLMs endure despite high attrition rates:

MLM recruitment is conducted as “body shops.” Those who drop out on the bottom levels are constantly being replaced with new recruits who believe the promises of wealth and time freedom – or a little additional income for persons who are struggling to make ends meet (which almost always places them further behind financially).¹²⁰



A revolving door of recruits replaces dropouts.

Most of the money paid by the MLM company goes to TOPPs (top-of-the-pyramid promoters) at the expense of a revolving door of unwitting new downline recruits, who try an MLM program and quit, only to enrich the founders and TOPPs with commissions from the purchases these recruits made in a vain effort to “succeed.”

High attrition is one of the most striking attributes of MLM. The “permanent income” or “residual income” touted by MLM promoters is a myth.

Conclusions.

High attrition is one of the most striking attributes of MLM. This should be expected, since the business model is based on an endless chain of recruitment, which is inherently flawed, uneconomic, and deceptive. Mathematically, it cannot work in the long run in the real world. So the vast majority are destined to failure and financial loss. This is the primary reason for such high attrition rates – not lack of effort, poor products, ineffective marketing, or bad management.

MLM officials are loath to disclose attrition data and even hugely distort average earnings reports by including only “active” participants in their reporting. However, from available data and worldwide feedback, it appears that throughout the industry at least 90% of MLM recruits are gone in five years, and at least 95% in ten years. With the possible exception of TOPPs, the “residual” or “permanent” Income touted by MLM promoters is a myth.

¹²⁰ See Chapter 3



"Is this elevator really stuck?"

Chapter 7: MLM'S ABYSMAL NUMBERS – What are the odds of profiting from MLM, and how does MLM compare with other options, like small business or gambling?

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Introduction and summary

Are MLMs profitable business opportunities? And if so, for whom? Just do the math – the numbers don't lie. In this chapter, you will find the most rigorous and thorough analysis of MLM profitability ever done by an independent research entity. Questions about the viability and profitability of MLM as a business model and its many company manifestations are answered in this and prior chapters – based on 20 years' research, world-wide feedback, and analysis of the compensation plans of over 600 MLMs, as well as average earnings data, where available. The answers are not pretty.

Our studies, along with those done by other independent analysts (not connected to the MLM industry), clearly prove that MLM as a business model – with unlimited recruitment of a network of endless chains of participants as primary customers – is flawed, unfair, and deceptive. Worldwide feedback suggests it is also extremely viral, predatory and harmful to many participants. This conclusion does not apply to just a few specific MLM companies, but to the entire MLM industry. It is a systemic problem with the MLM business model itself.

Of the 600 MLMs I have analyzed for which a compensation plan was published¹²¹, 100% of them are recruitment-driven and top-weighted. In other words, the vast majority of commissions paid by MLM companies go to a tiny percentage of TOPPs (top-of-the-pyramid promoters) at the expense of a revolving door of new recruits, almost 100% of whom lose money. This is after subtracting purchases they must make in order to qualify for commissions and rank advancement, to say nothing of minimal operating expenses for conducting an aggressive recruitment campaign – which (as explained in Chapters 2 and 5) is essential to get into the profit column.

¹²¹ Listed in Appendix 2E. Most were MLMs for which I responded to inquiries about them.

I found the claim by MLM promoters that many participants work for part-time or seasonal income to be a totally false argument. Without full-time and long-sustained effort, MLM participants cannot build and maintain a large enough downline to meet expenses, and realize a net profit. (Those who get in early in the endless chain of recruitment have a huge advantage.)

These conclusions were confirmed in the average earnings reports of all 50 current MLMs for which we were able to obtain data published by the companies themselves. (Such high loss rates were also found in MLMs that had folded or been shut down.) Such statistics are invaluable for analysts to debunk the many misrepresentations that are told to thousands of prospects every day.

Failure and loss rates for MLMs are not comparable with legitimate small businesses, which have been found to be profitable for 39% over the lifetime of the business; whereas less than 1% of MLM participants profit. MLM makes even gambling look like a safe bet in comparison.

MLM stocks are questionable investments at best. And the case can be made that losses from MLM participation should not be allowed as a tax deduction – beyond the amount of actual income, as is the case with other risky income options such as gambling and horse racing.

MLM as a business model is the epitome of an “unfair and deceptive act or practice” that the FTC is pledged to protect against. It is even worse than classic, no-product pyramid schemes (for which the loss rate is only about 90%) and “pay to play” chain letters. Given MLMs’ abysmal numbers, for promoters to present MLM as a “business opportunity” or “income opportunity” is a blatant misrepresentation. Some would say it is simple fraud.

When these numbers are properly understood, losses from MLM fraud easily exceed all other classes of “work from home” or “business opportunity” fraud put together.

Assumptions and cautions needed to proceed with this analysis

In any analysis, especially on a controversial topic and using less than perfectly gathered and controlled data, the analyst must make certain assumptions and recognize certain cautions or potential pitfalls in order to proceed. So in order for me or anyone to do this analysis of profitability for MLM participants, certain assumptions will be identified – such as whether or not participants seek to optimize their gains, and what costs could be incurred (and therefore should be subtracted from earnings) in a successful recruitment campaign. Questionable reporting that could mislead those seeking to get at the truth must be guarded against, such as how numbers are reported and displayed.

Calculations validated by experts

The author, Dr. Jon Taylor, has a two-year MBA with two years of coursework in statistics, accounting, economics, finance, and analysis of business enterprises prior to his research training in his PhD program and his experience evaluating the research of others in administrative positions at two universities and in his consulting work. Also, these analyses and calculations have been validated by independent experts in fields requiring much sophistication in statistics, finance, and accounting. (See Appendix 7A)

Legal disclaimer

These opinions, calculations, analyses, and reports are intended purely to communicate information in accordance with the right of free speech. They do not constitute legal or tax advice. Anyone seeking such advice should consult a competent professional who has expertise on endless chain or pyramid selling schemes. Readers are invited to validate the author’s research using the analytical tools provided. Readers are also advised to obey all applicable laws, whether or not enforced in their area. Neither the Consumer Awareness Institute nor the author assumes any responsibility for the consequences of anyone acting according to this information.

What tax studies have revealed about MLM profitability

The Wisconsin experience with Amway. In 1980, as part of a suit against Amway, an investigation was undertaken by the Office of Attorney General for the State of Wisconsin, led by Assistant AG Bruce Craig. Out of approximately 20,000 distributors operating in Wisconsin, state tax returns were obtained for all of the Amway “Direct” Distributors in Wisconsin, which numbered about 200, which represented approximately the top 1% of distributors in Wisconsin. Attached to the returns were the federal forms, which revealed a breakdown of revenue and expense information.



Though these were the top distributors in the state, with an average gross profit of about \$12,500, *the average net income after subtracting operating expenses for these 200 top Amway distributors was about minus \$900.* (Obviously those who profit must be much higher in the hierarchy of participants than the top 1% – and most not living in Wisconsin.) This information was reported on the nationally televised show “60 Minutes.”

The average net income (after subtracting expenses) for the 200 top Amway distributors in Wisconsin was approximately minus \$900.

It should be noted that had the costs of all Amway products that were consumed or given away as gifts – but which were required to qualify for commissions and advancement in the scheme – been subtracted, the net losses could have been much higher.

Mr. Craig recalled that a couple of distributors may have grossed \$50,000, with actual net income after expenses that would have exceeded a minimum wage for the time spent on their Amway “business” – but far below the income suggested at Amway “opportunity meetings.” *Approximately two distributors who operated profitably out of 20,000 total distributors yields a one in 10,000 ratio – decidedly uneconomic.*

In MLM the more a new recruit invests, the more he or she loses, except for those at the top of a huge pyramid of participants – who are often the first to join. The lucky ones are those who invested very little and then quit.

The Utah tax study. In 2004, I personally telephoned 99 tax preparers in four Utah counties, three of which were rural counties with no MLMs (MLM companies) headquartered in their boundaries. So I felt it was a safe assumption that few if any TOPPs (top-of-the-pyramid promoters), or “kingpins,” would live in those counties. None of the 33 tax preparers could remember anyone reporting a profit on their income taxes from participating in MLM, for any length of time, even though an earlier randomized survey of Utah consumers showed that approximately 21% of the population had at some time been involved in MLM.

Then I called 33 CPAs who perform tax preparation in Utah County, in which is located the highest concentration of MLM company headquarters in the country – now over 60 MLMs (about 1 for every 18,000 persons). While they could not reveal specific amounts, collectively these CPAs could recall 38 clients who made large sums of money from MLM. These of course were TOPPs who lived close to company headquarters and (I assume) used CPAs because the income amounts were so large.

I called another 33 tax preparers in Utah County who were not CPAs. From these, an additional five tax filers were reported to have very large incomes from MLM participation – likely also TOPPs. These results strongly support what the rest of this chapter will show – that most of the money goes to TOPPs at the expense of a revolving door of unwitting new downline recruits who try an MLM program and quit, only to enrich the founders and TOPPs with commissions from the purchases they made in a vain effort to “succeed.”

Open disclosure of information supporting income claims – is vigorously resisted by the MLM industry.

Since the income claims of MLMs touted by their promoters are at the heart of the legitimacy of their programs, it is important to disclose the truth about average earnings so that prospects can have valid information upon which to base their decision on participation.

So far, regulatory agencies have not required honest and understandable disclosure of essential information to MLM prospects. I have examined the compensation plans of hundreds of MLMs and found that virtually all hide the near-zero odds of making a profit, and in fact almost certain loss after subtracting purchases of products necessary to qualify for commissions and advancement in the pyramid of participants. It is no wonder that MLMs and their chief lobbyist, the DSA (Direct Selling Association), vigorously resist transparency regarding income claims to protect consumers.

And it is no surprise that recent efforts by the FTC (Federal Trade Commission) to get business opportunity sellers to disclose average earnings and other minimal information to help consumers was met with fierce objections from the DSA/MLM lobby. Why did they lobby so aggressively (spending over \$4 million) to avoid even minimal transparency if they had nothing to hide – or if they wanted to prove their legitimacy? This by itself should be a red flag signaling something very wrong with MLM as an industry and/or as a fundamental business model.

The DSA/MLM lobbyists argued that handing out a one-page disclosure of average earnings, legal claims against the company, and references, etc. prepared by the company would be an “intolerable burden” for direct sellers. FTC personnel should have seen this as a blatant effort to avoid consumer protective transparency. The argument of an “intolerable burden” to supply a single page of information is absurd, especially since franchisors are

required by the FTC to furnish a disclosure document to prospects that is often hundreds of pages long.

Handing out a one-page disclosure document to prospects – an intolerable burden?

It should also be noted that the average earnings data that has been disclosed by a select few MLMs (whether mandated or not) appears to have been cleverly designed to mislead prospects and regulators. So in my opinion, it is imperative that the deceptions be identified and a more true portrayal of average earnings be made available. A sample form that could be used to disclose crucial information to prospects is displayed (with explanations) in Appendix 7C I will also endeavor in this chapter to provide a set of procedures for any qualified analyst to use to debunk deceptions in current reporting and to replicate my findings.

MLMs Inherent flaws

In prior chapters, the flaws in the MLM as a business model were discussed. In a nutshell, MLM is predicated on unlimited recruitment of a whole network of endless chains of participants as primary customers.



The fundamental flaw in MLM is the unlimited recruitment of a whole network of endless chains of participants as primary customers. MLM pay plans assume an infinite market, which does not exist in the real world. They also assume virgin markets, which don't exist for long – which means they either collapse or reprimid into new markets or with new products..

All MLM compensation plans assume an infinite market, which does not exist in the real world. They also assume virgin markets, which don't exist for long – which means they either collapse or re-pyramid into new markets. MLM is therefore inherently flawed, unfair, and deceptive.

From analyses of the compensation plans of over 600 MLMs, I have found a consistent pattern of pay plans that are recruitment-driven and top-weighted, meaning they are driven by incentives to recruit, with company payout of commissions (after “skimming” by founders) going primarily to a select few “TOPPs” (top-of-the pyramid promoters) who are often those who were positioned at or near the beginning of the recruitment chains. A list of the MLMs for which I have analyzed the compensation plans and which displayed at least four of the five causative and defining characteristics of recruitment-driven MLMs is found in Appendix 2E.

Worldwide feedback suggests that MLMs are also extremely viral and predatory. They feed on the product investments of a revolving door of new recruits, each subscribing to product purchases to qualify for commissions or advancement in the pyramid of participants. But almost all newcomers are being sold a ticket on a flight that has already left the ground. MLMs can be extremely harmful, causing huge losses for those who invest the most in the schemes.

Assuming all this were true, we would expect to see it reflected in the average earnings of MLM participants. And that is precisely what I will examine in detail.

NOTE: Another fundamental flaw in MLM is relative vertical equality (RVE) of commissions as spelled out in the companies' compensation plans. While RVE may appear to be fair, the effect is extreme inequality in payout to participants, again making it an incredibly unfair and deceptive practice. This is a more complex concept that will be explained later in this chapter.

How can the odds of profiting from an MLM be calculated?

Statistics of average earnings that have been provided by MLMs are laden with obfuscation and deception, apparently to avoid revealing the abysmal odds of success for new recruits. But careful analysis can lead to a more accurate picture of profitability (or loss rate) for those considering a particular MLM. I have found that by following the steps outlined here a more truthful assessment of profitability can be made. Here are the steps that I would recommend for persons being recruited into an MLM to estimate the true odds of their realizing a profit:

Step 1: Obtain average earnings statistics

Obtain from the MLM recruiter the average earnings statistics for the MLM you are examining, showing the average amount of money paid by the company in commissions and bonuses to participants at the various levels in the compensation plan.

Caution: If the MLM won't provide statistics of average earnings, you should consider that a red flag, as you should for anything promoted as a packaged “business opportunity” or “income opportunity” – without disclosing average income results.

Step 2: Determine total incentivized or “pay to play” purchases – and other purchases expected of participants.

From the compensation plan, determine the minimum incentivized or “pay to play” purchase requirements. In other words, how much in products and services will you be expected to purchase (even if supposedly for resale) in order to qualify for commissions and bonuses, and to advance up the various levels in the pay plan (commonly referred to as “rank advancement”).

In addition to product purchases, TOPPs for many MLMs expect downline participants to pay for training, conferences, books, recordings, sales literature, and other “tools” needed to be successful. (In a legitimate sales setting, such expenses are usually paid by the company.)

For most of the MLMs I examined, incentivized or “pay-to-play” purchases ranged from \$50 to \$500 a month. I often discovered at least “\$100 a month as a minimum figure for incentivized purchases and necessary “tools of success”

Caution: Avoid falling for the ruse that you don’t have to purchase anything, or that you can sign up just to get the products at a discount. If you listen carefully to the pitch of the MLM recruiter, it should soon become clear whether they are selling the products – or the opportunity. If the latter, it is deceptive to sell you on signing up so you can buy products. Ask this question: “Is this a buyers’ club – or an opportunity chain?”

Another sign that you are being sold an opportunity (with products merely a means of laundering investments in a product-based pyramid scheme) is when the products are hugely overpriced. If promoters are hyping the unique features of the products to justify prices several times what you would pay for comparable products in your local supermarket, then you may want to hold on to your wallet.

Step 3: Try to find out the average total amount of money paid to the company by participants.

If the company will provide it, you should also get the average of the total amount of money paid to the company by participants at each level for products and services purchased from the company, including “pay to play” purchases (Step 2). I have found this to be an important piece of information that MLMs have been unwilling to provide, though it is crucial information, since prospects have a right to know the likelihood they will lose money or come out ahead. Even if – as MLM promoters claim – it was not possible to get total operating expenses, average amounts of

money paid in to the company per participant should be readily available.

Caution: Avoid falling for the line that purchases for your own use are purchases you would have made anyway and therefore should not count. Typically, similar products can be purchased for a fraction of the price from alternative sources. And purchases are seldom continued after participants terminate.

The point that you want to determine is how many people come out ahead financially from their participation. The formula for gross profits (before operating expenses) is very simple – money paid by the MLM to participants less money paid to the MLM by participants. As will be seen, our calculations show the balance is nearly always negative, meaning a net loss for participants. And it is even worse if you subtract operating expenses. More on that later.

Caution: You should not assume you can sell the products at a heightened “retail” price to others, as promoters claim is possible. Our extensive research and feedback leads to the firm conclusion that such re-selling by MLM participants is usually only a very minor portion of product sales. Typically, MLM products are far too expensive to compete with products purchased from standard retail outlets. (See Chapter 4.) “Direct selling” by MLM participants to non-participants in significant volume is a myth promoted by well-paid MLM company and industry (DSA) communicators. Exceptions to this are “sympathy buyers” – friends and family that may purchase the overpriced products out of sympathy for participants. As with participants, such purchases usually cease when the participant leaves the MLM.

However, if an MLM promoter insists that significant retail selling is going on, ask for proof in the form of receipts. If it were a legitimate direct selling operation, sales to non-participants would be many times the amount of sales to sales persons.

Caution: Avoid accepting uncritically the MLM promoter’s claims that the products have magical properties that will heal or prevent every disease on the planet

and that they can only be obtained through this particular MLM. Many MLM promoters claim to have the latest and greatest “pills, potions, and lotions” – or the best and most unique of some other products or services. Note the ingredients and shop around for at least comparable products through other outlets – you will be surprised at what you can save. (Again – see Chapter 4.)

Step 4: Obtain – or estimate – minimum operating expenses needed to conduct a successful recruitment campaign.

Estimate minimum expenses necessary to recruit successfully. Most MLM participants purchase a few products, find recruiting and selling very tough, and then quit without spending much money. But my analysis of hundreds of MLM compensation plans convinces me that *participants rarely – if ever – move into the profit column without an aggressive recruitment campaign carried out over an extended period of time.*

In 1994-5, I put Nu Skin, a leading MLM, to the test for a year, devoting all my time to climb to the top 1% of distributors (counting ALL distributors, including dropouts). I kept careful records of my spending and wound up with expenses of over \$1,500 per month including products and services from the company, plus all operating expenses, such as travel, telephone, computer supplies, advertising, meeting rooms, etc. My commissions totaled only about \$250 a month, netting an annual loss of over \$15,000 – plus lost income from not spending that time doing something profitable. Even a minimum wage job would have been far more profitable.

I included purchases as expenses, even though some were given away or personally consumed, because these are purchases necessary to qualify for commissions or for rank advancement. Some may not be treated as a deduction for tax purposes, but they should be considered as a cost of doing business for analytical purposes, especially if participants would not have made the purchases were they not intending to earn commissions or to advance in rank.

Important notes regarding breakeven expenses for MLM participation: My \$18,000 (\$1,500/mo.) operating expense figure would be equivalent to over \$27,000 in 2011 dollars (the year for the latest figures in Exhibit 7d). So as a reasonable assumption based on my experience, in U.S. markets, I would estimate a bare minimum of \$25,000 in total expenses to mount an effective recruitment campaign today, which is essential for any hope of success in a typical recruitment-focused, top-weighted MLM program. This is a conservative figure, and the figure could be several times that for TOPPs who must frequently travel, rent meeting facilities, etc., in order to recruit sufficient new recruits to replace those who are continually dropping out. Also, many costs have increased since 1994, along with new recruitment resources, such as maintaining a web site, lead generation programs, and other “sales tools” sold to new recruits.

Also, this level of breakeven expenses corresponds closely with IRS statistics, in which average expense deductions for sole proprietorship non-store retailers (direct sellers) in 2011 totaled \$23,715, with estimated breakeven at \$20,763.¹²² If we accept the DSA claim that 95.7% of direct sellers are multi-level,¹²³ the \$20,763 breakeven point is only about 17% less the MLM breakeven point cited above. *And to give MLMs the benefit of the doubt, I used half of my expenses (adjusted by cost-of-living index) as the breakeven amount*

Caution: *MLM promoters and the DSA, often claim that many or most participants just work part time for a little cash to supplement income, to meet Christmas expenses, etc. This is one of their biggest deceptions. Profitability in MLM does not come cheaply or easily – it very costly and time-consuming, and compensation plans require consistent effort over time to advance in any MLM program. Based on the foregoing, I feel confident in my conclusion that part-timers and seasonal participants are not profiting,*

¹²² IRS, Statistics of Income Division, July 2013 at - <http://www.irs.gov/uac/SOI-Tax-Stats-Nonfarm-Sole-Proprietorship-Statistics>. Processed by applied mathematician Dr. Kay Herbert

¹²³ “FACT SHEET – U.S. Direct Selling in 2011

but are merely contributing to the coffers of the company, founders, and TOPPs.

Tax studies and analyses of reports of average incomes (assuming minimal expenses are subtracted) show that few ever earn a profit from MLM participation, with the notable exception of those who arrive at or near the top of their respective pyramids – who may make a lot of money, often millions of dollars – harvesting commissions from purchases of hopeful new recruits beneath them.

Caution: Don't accept the argument by promoters that success in MLM recruitment costs little or nothing. New MLM recruiters will soon start getting the cold shoulder from friends and relatives and have to recruit elsewhere. Again, anyone who climbs the ladder in the compensation plan must spend not only a great deal of time, but a considerable amount of money to be successful.

Step 5: Obtain – or estimate – the company's attrition/retention rate

Prospects should ask their recruiter to furnish the company's attrition (dropout) rate; i.e., the percentage of recruits who sign up only to drop out within a year – and over a five or ten-year period. If they can't or won't furnish it, you can assume that it exceeds the minimum of 50% per year, which we have found where such data is available. Over a five-year period, at least 95% typically have left the company; and usually after ten years, nearly all except for those at or near the top of their respective pyramids will have dropped out.

At the very least, you can assume that 90% of participants will terminate within five years, and at least 95% within ten years. This is useful to know, since MLMs published average earnings reports will often include top-level participants who were there from the beginning – which may be ten years or more. To be statistically valid, all dropouts and terminations should be included for the same period as for TOPPs in their reports.

If any company challenges the assumption of attrition of 90% for five years, and 95% for ten years (or retention rates of 10% and 5% respectively), ask company officials for data to prove otherwise. To my knowledge, no MLM has been able to show

more favorable retention statistics than these. (For important information on attrition rates, see Chapter 6.)

Caution: Don't accept an MLM statistic for the total number of "active" distributors or participants as the base used for calculating what percentage of participants succeeded in rising to the various levels. Again, if the "successful" participants who have been with the MLM for ten years are counted, then every person who signed on with the program during that same ten-year time period. should be counted in calculating success rates – whether they are active, inactive, or terminated. *The MLM practice (endorsed by the DSA) of comparing only currently "active" participants (most of whom have been there only a short time) with "successful" participants who have been there for many years, greatly skews the numbers in their favor - a huge deception.*

The MLMs' practice of comparing only currently "active" participants with "successful" participants who have been there for many years, greatly skews the numbers in their favor – a huge deception.

Step 6: Calculate the profit/loss rate

Now put it all together. This means debunking the figures supplied by the company by including ALL who signed up during the same period during which those who "succeeded" are counted – and then subtracting expenses as explained above. Even if you just go back five years, you can multiply the MLM company's published success rate by a factor of 0.10 (retention rate – with 0.90 attrition rate) to get a success rate much closer to the truth. Then select all distributors who earned enough to have exceeded the break-even point; i.e., incentivized or "pay to play" purchases plus estimated operating costs. Again, don't assume resale of products at heightened retail prices unless they can show you the actual sales receipts to prove it.

The case of Nu Skin – responding to an FTC Order to cease its misrepresentations

Exhibit 7b demonstrates how a compensation plan with extreme leverage¹²⁴ can concentrate income to those at the top of a pyramid of participants at the expense of a multitude of hapless recruits at the bottom. This example illustrates the extreme concentration of income for TOPPs (top-of-the-pyramid promoters). While the compensation plans of other MLMs may not be as extreme, all of the 600 MLMs I have analyzed are unfairly top-weighted – a fact not disclosed. (I have observed that few prospects have the background to discover this on their own by studying the compensation plan.)

Exhibit b is extracted from a report of 80,613 "active distributors" in the U.S. for Nu Skin Enterprises¹²⁵, a leading MLM company which was ordered to cease its misrepresentations of distributor earnings in 1994 – and has since then periodically provided average earnings data. Even though the report fails to include dropouts and any expenses (even incentivized purchases) in its report, these can be estimated as explained here. In this section, you will learn how to unravel the deceptions and interpret the numbers in the average income reports of MLMs that do provide such information.

All of the 600 MLMs I analyzed are unfairly top-weighted, concentrating income to those at the top of a pyramid of participants at the expense of a multitude of hapless recruits at the bottom.

¹²⁴ In this analysis, "leverage" refers to the degree to which those at the top profit from the losses – or commissions from product investments – of those at the bottom.

¹²⁵ "2011 Nu Skin Enterprises, Inc., Distributor Compensation Summary," which is posted on the Nu Skin web site. The report is updated periodically, but for each year we see the same pattern of extreme concentration of payout to Blue Diamonds at the top.

Cautions: Great care must be taken in reading the numbers in reports of average incomes by MLMs. Note these deceptive techniques used to mislead readers:

➤ Quarterly commissions are given and then the figures are annualized. Since many terminate before a year is over, these *annualized* numbers could be much higher than actual *annual* figures. But in this analysis we'll give them the benefit of the doubt.

➤ Percentages are presented in a way to make the odds appear much higher than they are, especially if we assume 90% dropout rate over 5 years, or 95% over ten years (or retention of 10% and 5% respectively) – an optimistic assumption, based on actual statements by Nu Skin. Since the company was 27 years old when these 2011 statistics were reported, and the top earners (Blue Diamonds) in the U.S.A. have been there for well over ten years, it is reasonable to use the ten-year figure. *Using these assumptions, we begin with the stated number of people achieving Blue Diamond status – 0.14%, or 0.0014. Then, 0.0014x 0.05 (5% remaining after 10 years) equals 0.00007 – which looks a lot less than the reported ".14%". (0.00007 to a statistician is virtually zero.) And it could be far worse if actual annual percentages were used, instead of annualized percentages.*

➤ Minimum pay-to-play in this program is \$100 a month, or 1,200 a year – in order to qualify for commissions. This is not included in the report, as it should be. Only a small percentage of distributors would earn enough in commissions to exceed this amount.

➤ Add to the \$1,200 the minimum operating expenses needed to conduct a successful recruitment campaign¹²⁶, which the author found to be absolutely essential for rank advancement. In my one-year test¹²⁷ of the Nu Skin program, the minimum total expenses to recruit successfully was over \$18,000 per year (over \$27,000 in 2011 dollars), including products and services from the company, travel and telephone expenses, home office and rooms for opportunity meetings, printing and duplicating expenses, advertising, telephone and internet services, and miscellaneous supplies.

¹²⁶ See Chapter 5 for details.

¹²⁷ For a more complete account of my Nu Skin experience, read Chapter 1.

Exhibit 7a

Nu Skin's Blue Diamonds cash in on a mega-pyramid of downline victims – far more extreme than a classic pyramid scheme

Nu Skin's program can be described as a *mega-pyramid*, that uses a highly leveraged breakaway compensation plan that enriches each Blue Diamond distributor at the expense of as many as tens of thousands of downline participants. (Leverage refers to the degree to which those at the top profit from the losses – or commissions from product purchases – of those at the bottom.) These become a revolving door of new recruits, each of whom join and buy products in hopes of reaching the coveted Blue Diamond status. However, no one informs them of the infinitesimal odds of achieving this elusive goal.

To qualify as a Blue Diamond, one must recruit twelve separate "pyramids" of participants (which they prefer to call "organizations"), headed up by qualified Executive distributors on the Blue Diamond's first level of distributors, each of whom must meet volume quotas, from which the Blue Diamond can collect commissions and bonuses, along with their respective downlines.

Nu Skin can be viewed as an extreme product-based pyramid scheme with a whole constellation of multiple pyramids (or poly-pyramids) nested within a downline of one grand pyramid, or more accurately "mega-pyramid" made up of numerous smaller pyramids – each pyramid counting as a unit headed by a qualified executive. . The harmful effects of classic, 1-2-4-8 no-product pyramid schemes are mild in comparison – with a loss rate of no more than 93.3% and aggregate losses and number of victims only a tiny fraction of those in product-based schemes, or MLMs such as Nu Skin. In fact, the odds of profiting from a no-product pyramid scheme are dozens of times greater than that of profiting as a Nu Skin distributor.

So a Blue Diamond Executive distributor sits atop and collects commissions on the purchases of a downline of thousands of hopeful distributors, all of whom have been led to believe that they too could profit from their

recruitment efforts. However, over half of Nu Skin's payout to distributors goes to the Blue Diamonds at the top. In the mega-pyramid, one wins, while thousands lose.

What remains of the commissions paid out is divided up among tens of thousands of downline participants. Few participants get enough commission income to exceed "pay to play" or incentivized purchases and other expenses. Analyses of reports of Nu Skin distributor incomes suggest that about 99.9% of Nu Skin distributors lose money, after all expenses are subtracted – only to enrich the Blue Diamonds at the top and fatten Nu Skin's coffers. The chances for new recruits realizing a profit is virtually zero. This would not be as big a problem if the truth about Nu Skin's odds of "success" were disclosed in a more honest average income disclosure document.

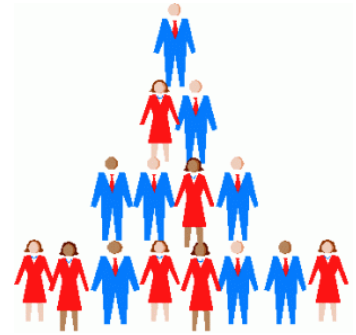
In the illustration below, Nu Skin's mega-pyramid breakaway compensation plan pays approximately 58% of commissions and bonuses to Blue Diamonds at the top. This illustration of "downline" structure (organizational hierarchy) is merely hypothetical. In practice, the downline of participants may number in the tens of thousands, with many vacancies where people have dropped out. However, in Nu Skin, commissions from the sales of those in the downline who drop out "roll up" to those above them who still qualify for commissions. So upline distributors profit even from those who quit.

When one compares the pyramidal structure and compensation plans of product-based pyramid schemes (MLMs) to no-product pyramid schemes, one can see why MLMs are much more damaging by any measure – loss rate, aggregate losses, number of victims, and degree of MLM leverage, or the degree to which those at the top of the pyramid profit from the losses of a multitude of downline participants who churn through the system. MLMs like Nu Skin are clearly unfair and deceptive practices.

Exhibit 7a, continued –

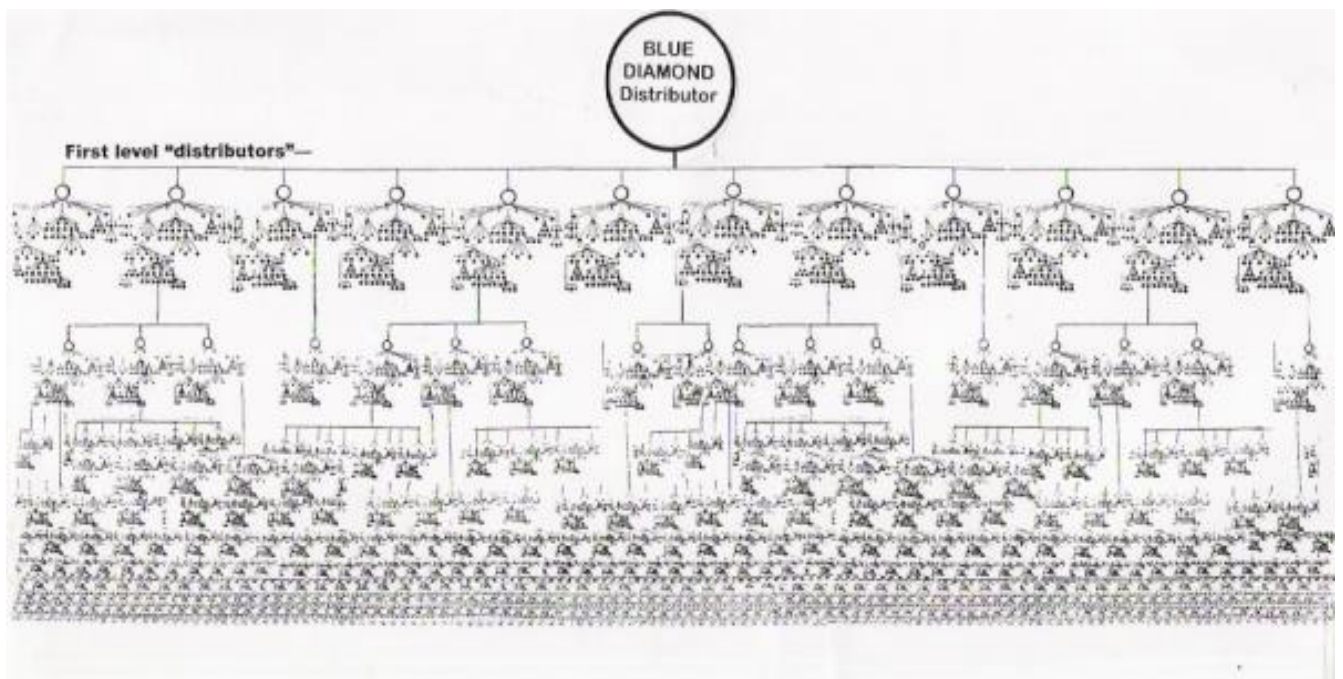
Classic, 1-2-4-8 no-product pyramid scheme:

In a classic, 1-2-4-8, no-product pyramid scheme, the person at the top collects all the money from only 14 downline persons.



Massive downline of a highly-leveraged product-based pyramid scheme:

In a product-based pyramid scheme, the person at the top gets a small commission for each sale, but may get commissions from purchases by thousands of distributors in his/her downline – who have been sold a bogus “business opportunity.” In Nu Skin, a Blue Diamond has 12 Executives in his front line, each with their own downline. The Blue Diamond gets over half of the commissions paid to his entire organization of thousands of distributors –almost all of whom (99.9%) lose money. (The chart below illustrates the possible downline of a Blue Diamond, with each circle representing an “Executive Distributor” and dot representing an “Active Distributor.” The chart is reduced from an eight-foot wall chart, which is much more readable.)



Sample calculations, using Nu Skin data:

Follow the steps outlined above in the section titled: “How can the odds of profiting from an MLM be calculated?” as follows:

Step 1: Average earnings statistics are published by Nu Skin, as shown in the table in Exhibit 7b and labeled “2011 Nu Skin Enterprises, Inc. Distributor Compensation Summary.”

Step 2: “Pay to play” purchases have for years been at least \$100 per month, with many times that amount (in group volume) required to qualify for Executive status, the lowest “pin level” in the pay plan. In addition, the company and its “Blue Diamonds” (“TOPPs”) encourage participants to make additional purchases of a wide range of products and services – and to pay for training and opportunity meetings to enhance their “success.”

Step 3: Data on average amounts of money paid by participants to Nu Skin is not provided.

Step 4: Nu Skin has been in business since 1994, and several of the Blue Diamonds included in the report have been with the company for more than ten years. So – based on the information in Chapter 6 – we can use 95% as the minimum attrition rate.

Step 5: I found from my one-year test of the Nu Skin program that to conduct a successful recruitment campaign is expensive. Including products and services from Nu Skin, I spent over \$18,000 (at least \$27,000 in 2011 dollars), and others at

higher levels were spending considerably more than that.

Of course, Blue Diamonds at Nu Skin claim that good money can be made just selling products to friends, neighbors, etc. This deceptive claim has been discussed in Chapter 4. The compensation plan for Nu Skin, like for the hundreds of other MLMs I have analyzed, is heavily weighted towards building a huge downline in order to get to where profits are even possible after expenses, including purchases from Nu Skin.

So I am completely comfortable placing the breakeven bar (the amount above which profits are possible after subtracting costs) at \$27,000 per year, allowing for cost of living adjustments (Chapter 5).

Step 6: Based on the above, only those achieving status of Ruby and above were likely (on average) to have risen from a net loss to actual net profits, since most of those beneath them do not earn enough in commissions to meet expenses of \$27,000 a year. In fact, it is unlikely that many distributors below Diamond level profited significantly from their participation, after subtracting product purchases and recruitment costs.

With the odds of profiting being less than one in a thousand, it is more appropriate to call MLM programs like Nu Skin a “loss certainty” than an “income opportunity.”

Exhibit 7b: Average earnings statistics for Nu Skin Enterprises, Inc. – Extracted from “2011 Nu Skin Enterprises, Inc. Distributor Compensation Summary”¹²⁸

Average number of “Active Distributors” in the United States during 2011 – 80,613

Commissions paid to distributors in the United States in 2011 – approximately \$114,191,000

Average commissions paid to U.S. Active Distributors \$1,416.64 on an annualized basis.

On a monthly basis, an average of 12.68%% of U.S. Active Distributors earned a commission check.

Active Distributors represented an average of 41.61% of total distributors” [of record]

How data are presented by Nu Skin Enterprises, Inc.

	Annualized Average Commissions at each Level for 2011 ¹²⁹	Average Percentage of Active Distributors ¹³⁰
Active Distributor earning a check (non-Executive)	\$492.00	6.44%
Qualifying Executives	\$1,968.00	0.96%
Provisional Executives	\$516.00	0.31%
Executives	\$4,704.00	2.89%
Gold Executives	\$9,240.00	0.96%
Lapis Executives	\$15,912.00	.056%
Ruby Executives	\$31,860.00	.024%
Emerald Executives	\$64,800.00	.010%
Diamond Executives	\$127,500.00	0.08%
Blue Diamond Executives	\$582,660.00	.014%

Note: The report includes the following disclaimer:

Generating meaningful compensation as a Distributor requires considerable time, effort, and commitment. This is not a get rich quick program. There are no guarantees of financial success.

However, a more honest disclosure would state something like the following:

Generating significant net income as a Distributor requires positioning oneself at or near the top of a mega-pyramid of Distributors, by meeting major purchase requirements and preferably being first in a given country. One must aggressively recruit and deceive a downline of thousands of recruits, who must be trained to likewise engage in aggressive recruitment and willing to recruit and deceive others into believing that they and their downlines will have the same opportunity. Even with the investment of considerable time, energy, and effort, unless you are one of the first in a given market, the odds of profiting may be one in several hundred.

NOTE: More current data are available for Nu Skin. However, the compensation breakdown is almost identical because the compensation plan has remained essentially the same.

¹²⁸ “2011 Nu Skin Enterprises, Inc. Distributor Compensation Summary.” More current data posted on the Nu Skin web site at – <http://www.nuskin.com/content/dam/global/library/pdf/distearnings.pdf>

¹²⁹ These numbers are calculated by taking the monthly average commissions and multiplying by twelve. [I deleted The column labeled “Monthly Average Commission Income at Each Level for 2011,” as it is irrelevant to this analysis.]

¹³⁰ These percentages are calculated by taking the total monthly Distributor/Executive count and dividing it by the total number of monthly Active Distributors. One must then add the average percentage of Active Distributors at each level for each month during the year and divide by twelve. [The column labeled “Average Percentage of Executive- and above level Distributors” has been deleted, as it is irrelevant to this analysis.]

Exhibit 7c: Data with highlighted information that is important for prospects to know, but which is not disclosed in Nu Skin's report

Title	Annualized Commissions ¹³¹	Average % of Active Distributors ¹³²	Number of Distributors at that Level	Company Payout by Level ¹³³	% of Co. Payout by Level ¹³⁴
Active Distributors not earning a check	\$0	87.32%	70,613	0	0%
Active Distributors earning a check (non-Executive)	\$492	6.44%	5,191	\$2,553,972	2.24%
Qualifying Exec.'s	\$1,968	0.96%	774	\$1,523,232	1.33%
Provisional Exec.'s	\$516	0.31%	250	\$129,000	0.11%
Executives	\$4,704	2.89%	2,330	\$10,960,320	9.60%
Gold Executives	\$9,240	0.96%	774	\$7,151,760	6.26%
Lapis Executives	\$15,912	.056%	451	\$7,176,312	6.28%
Ruby Executives	\$31,860	.024%	193	\$6,148,980	5.38%
Emerald Exec.'s	\$64,800	.010%	81	\$5,248,800	4.60%
Diamond Exec.'s	\$127,500	0.08%	64	\$8,160,000	7.15%
Blue Diamonds	\$582,660	0.14%	113	\$65,840,580	57.66%

Actually, it is even far worse than these numbers show, because dropouts are not included for the same period as the period of activity for those at the higher levels who have stayed with the company. We will address this issue below.

Ruby and above – 0.56%, or .0056 could have profited after expenses – not counting dropouts. Corrected for 5% retention – $.0056 \times 0.05 = 0.00028$, or 0.028%, or **1 in 3,571 recruits could have profited.**

Thus, the loss rate is $1 - 0.00028 = 0.9997$ or 99.97%. Rounded off, **virtually 100% of new recruits lose money.**

Subtract Blue Diamonds (whose outsized commissions hugely skew the averages), and the loss rate for everyone else is even worse – calculated as follows:

Ruby to Diamond – 0.42%, or $.0042 \times 0.05 = 0.00021$, or 0.021%, or **1 in 4,762 recruits could have profited.**

113 Blue Diamonds \times \$582.660 = \$65,840,580

$\$65,840,580 / \$114,191,000 = 57.66\%$ of total company payout is paid to Blue Diamonds (TOPPs), who comprise only a very tiny percentage of distributors (0.00007, or 0.007%)

So – excluding Blue Diamonds, who receive a disproportionate share of commissions –severely skewing any statistics on average incomes, **the average loss rate is closer to 99.9%, which rounds off to ZERO. In other words, the chances of profiting for new recruits joining the Nu Skin program is essentially ZERO!**

¹³¹ Commissions calculated on an annual basis

¹³² These percentages are calculated by taking the total monthly Distributor/Executive count and dividing it by the total number of monthly Active Distributors. One must then add the average percentage of Active Distributors at each level for each month during the year and divide by twelve. The column labeled "Average Percentage of Executive-and-above level Distributors" has been deleted, as it is irrelevant to this analysis.

¹³³ Added to table by author. Calculated by multiplying the "Average Percentage of Active Distributors" (first column) by 80,613 (total U.S. distributors), then multiplying that number by Annualized Commissions" (first column).

¹³⁴ Added to table by author. Calculated by dividing number from prior column by total commissions paid by Nu Skin in 2011.

Additional conclusions that could be extracted from Nu Skin data

Eliminate TOPPs (top-of-the-pyramid promoters) from the calculations of average earnings. In the fourth column of Exhibit 7c, I have calculated the total company payout to all participants at each level, and in the fifth column is shown the percentage of total payout to each level. The average for this column reveals a startling fact – 57.66% of company payout goes to only 113 Blue Diamonds – out of 80,613 current distributors, not including over a million who dropped out in the past ten years.

Because over half of company payout to Nu Skin participants goes to Blue Diamonds, the results for averaging purposes are extremely skewed to make averages appear larger than they really are for the vast majority of participants. *A more useful calculation of average income would exclude these TOPPs from the calculation. Then the loss rate approximates 99.9% - meaning that the chance of a new recruit profiting significantly from the Nu Skin program is approximately ZERO.*

Assuming only \$1,200 minimum “pay to play” purchases is subtracted for each “active Distributor (not counting operating expenses), the average net income/loss per participant for the year is figured as follows:

\$114,191,000 total distributor payout less \$65,840,580 to Blue Diamonds = \$54,421,480
 $80,613 - 113 \text{ Blue Diamonds} = 80,500$ distributors (who are not Blue Diamonds)

$\$54,421,480 / 80,500 = \676.04 average commissions per distributor

– (subtract) \$1,200 “pay-to-play” purchases = average income of **minus \$523.96** per distributor – and a far greater loss if you subtract operating expenses, “tools,” and other incentivized purchases from Nu Skin.

“Residual income” far more elusive than just “profits.” But how many earn the large “residual income” bragged about by Nu Skin promoters? (Minimum operating expenses would be much higher for levels higher than Executives.) We could speculate what level (rank) would pay enough after heavy recruiting expenses to constitute a significant income as TOPPs often suggest can be earned.

My close observation of Nu Skin’s top promoters when I was involved tells me that no one below Diamond level would be netting enough to qualify as significant income, and they constitute only 0.0022 (0.22%) of Active Distributors, or 0.00011 (0.01%) of all distributors over a ten-year period. Therefore, after eliminating Blue Diamonds, or TOPPs, at best *only one out of every 9,091 recruits could have received the “residual income” touted by Nu Skin promoters.*

All three statistical measures of averages are abysmal for Nu Skin (and other MLMs). There are three statistical measures of averages:

(1) the arithmetic mean, which would be the total amount divided by the number of participants,

(2) the mode, which is the number that appears most often, and

(3) the median, which is the figure that falls in the middle of the entire range of participants.

It is clear from a careful study of Nu Skin’s own data that the mode and the median are less than zero, and the arithmetic mean is a large minus figure. To call Nu Skin (or any other MLM) an “income opportunity” or “business opportunity” is a major misrepresentation.

For MLMs, the mode and the median are zero, and the arithmetic mean is a large minus figure. To call an MLM like Nu Skin an “income opportunity” is a major misrepresentation.

Results when backing off on assumptions. Even if an analyst accepts the MLM/DSA arguments that costs of participation and rate of attrition are far less than those used in this analysis, the results are not favorable for Nu Skin participation.

Let us assume that recruitment is much easier than I experienced (in a more virgin market, for example) and that total costs of incentivized purchases and of the recruitment campaign were only half of \$27,000, or \$13,500.

We might also assume that attrition was only 90% over ten years (a highly unlikely assumption and one that could easily be debunked if honest attrition data from Nu Skin was provided). Even with these assumptions, the loss rate would be high.

Lapis distributors and above exceed \$15,000 in commissions. Total percentage of distributors at levels of Lapis and above is 1.12%. And if 10-year attrition is 90%, retention is 10%. Therefore, $0.0112 \times 0.10 = 0.0012$, or 0.12%. *This means that at best only 1/10 of 1% of distributors would have earned a profit – even with such liberal assumptions about expenses in Nu Skin’s favor!*

In my one-year test of the Nu Skin program, I rose to Executive status and almost to the level of Gold Executive, placing me well in the top 1% of distributors (assuming all recruits were included). Yet I was losing over \$1,000 a month. Based on my personal experience and observations, as well as my analysis of Nu Skin’s own reports, I seriously doubt that distributors below Diamond Executives were reporting a profit on their taxes as Nu Skin distributors.

: My personal experience with Nu Skin. As described in Chapter 1, in 1994 I was heavily recruited into Nu Skin and finally decided to join and give it my all for a year to test its validity. Obviously, I would never have joined had I any idea these numbers were so abysmal – and neither would anyone else who had a rudimentary math background.

On the other hand, my Nu Skin experience was the beginning of a journey of discovery into the deceptive world of multi-level marketing. It has taken me years to fully debunk the many deceptions inherent in these schemes. Fortunately, my wide experience as a home entrepreneur, graduate business education, analytical and research skills, and desire to get at the truth have yielded this rich outpouring of key information which can be used to provide some consumer awareness where law enforcement agencies have failed to meet this challenge.

Less than 1/10 of 1% of Nu Skin distributors would have earned a profit – even with such liberal assumptions in Nu Skin’s favor!

Perform your own calculations.

Of course, anyone is welcome to challenge my calculations, although I believe they are as accurate as could be performed, given the obfuscated and deceptive financial reports provided by MLM companies, at least those I have been able to gather. For obvious reasons, none presented their information in a format that made it easy to see how unprofitable their programs were.

A person considering an MLM program would be wise to take the information furnished by the company and perform the same calculations as those done here with Nu Skin. If the company is unwilling to disclose average income data and percentages for the various levels, consider that a red flag in itself. In fact, given this analysis, one would be justified in asking any person recruiting for an MLM to provide a copy of the Schedule C on his or her tax return before considering their program.

Different realistic assumptions yield similar conclusions

In the calculations in Exhibit 7d, I assumed purchases and minimum operating expenses of half what I had experienced in my one-year test of the costs of conducting a successful recruitment campaign. It is interesting to note that when I did the same calculations, using the assumption of only 10% of my recorded expenses, the resultant loss rate still exceeded 99%.

Incidentally, the IRS provides another source of data to corroborate the high cost of MLM participation. Analysis of income statements for non-employer, non-store sole proprietorships shows average total business expenses of \$23,999¹³⁵. The Census Bureau estimates that 83.2% of non-store retailers are MLMs (“direct sellers”), so this figure of \$23,999 may be a close approximation of average expenses for MLM participation – including TOPPs (for “top-of-the-pyramid promoters”). Since

¹³⁵ <https://www.irs.gov/uac/soi-tax-stats-nonfarm-sole-proprietorship-statistics>

breakeven cost figures used in these calculations are approximately half that amount, they could be considered a conservative estimate of breakeven cost levels.

I also included dropouts in the population of participants in the statistical calculations. (See Chapter 6 for an explanation how dropout rates were estimated.) *And when one eliminates TOPPs from the population used for the average income statistics, one gets an average loss rate of close to 99.9% - which rounds off to a **100% loss rate for new recruits*** This would be reasonable because the outsized commissions paid to TOPPs skews the income distribution to the a very significant degree. This means that the chance of a new recruit profiting from coming in at the bottom of a pyramid in a highly leveraged recruitment-driven MLM like Nu Skin is essentially ZERO. Any qualified independent statistician who saw the huge differential between what TOPPs were paid and the average commissions paid to the rest of the distributor populations would surely agree with me on this point.

These conclusions on abysmal loss rates apply to all MLMs for which data was available.

Proponents of some MLM programs will likely argue that “while the numbers for Nu Skin (and other MLMs) are horrible, “our MLM is different. In fact, we offer one of the most generous compensation plans in the industry.” I have heard this type of argument so often, that it seemed important that I and those I hired to assist me spend considerable time gathering average earnings data from as many MLMs as would provide such data, however skewed (as explained above).

In Exhibit 7d, I show how one can work with this data to calculate average loss rates, which are abysmal, even giving the MLMs some benefit of the doubt on incentivized purchases, minimal operating expenses, and on retention rates.

With every MLM, where such data was available, and after debunking the deceptions in their reporting, the loss rate was at least

99%, as explained in this chapter. The average loss rate for the 50 MLMs reported here was 99.7%.

I believe it is safe to assume that MLMs for which promoters do not provide such data are not likely to be more profitable because if they were, at least some would have provided data for competitive advantage. So it is highly likely that others of the 600 MLMs that I have also found to be recruitment-driven and top-weighted (with the four causal and defining characteristics) in their compensation plans would likewise have such abysmal loss rates.

Carrying this logic a step further, since all (100%) of the MLMs for which I have been able to obtain an explicit compensation plan have the first four of five CDCs of a recruitment-driven, top-weighted MLM, hundreds of additional MLMs would have these same basic characteristics. This provides conclusive support for considering the MLM business model a fundamentally flawed system – applying to the whole industry. From all my research and from worldwide feedback, I can say confidently that as a general rule, the more a new recruit invests in an MLM program, the more he or she loses. The lucky ones are those who invested very little and walked away. This, of course, is true of any scam.

Even though MLM defenders may challenge these figures and assumptions, I have done my best to remove the deceptions in MLM reporting, and I firmly believe my conclusions drawn from this analysis to be as close to the truth as is possible.

If you eliminate TOPPs (top-of-the-pyramid promoters) from average income calculations, a new recruit's chance of profiting from coming in at the bottom of a pyramid of participants in a typical MLM is essentially ZERO.

Exhibit 7d

Profitability analysis of MLMs for which we have received earnings data

Based on my analysis of their compensation plans, using the four causal and defining characteristics (CDC's or "red flags")¹³⁶ as criteria, ALL (100%) of the 50 MLMs (including two defunct MLMs) included in this analysis are recruitment driven and top-weighted. This means that rewards are paid primarily for the aggressive recruitment of a large downline, not for retailing products; and most of the money paid by the company goes to participants at the highest levels. I have analyzed the compensation plans of over 600 MLMs and found that ALL (100%) are likewise recruitment-driven and top-weighted, so it seems justifiable to assume that the same results could be expected for other MLMs.¹³⁷ The first four of five CDC's are generic to MLM as a flawed business model.

These abysmal loss rates stand in sharp contrast to the implied promises of substantial full or part-time income held out to prospects on company web sites as recorded in Appendix 8A.

NOTES: These calculations are based on actual company reports and the best independent analyses used by the author, as explained in this and preceding chapters. Of course, anyone is welcome to perform their own calculations, but calculations using assumptions by analysts funded by the MLM industry should be questioned.¹³⁸ *Note also that I am giving these MLMs the benefit of the doubt, using only 50% of the amount of total costs of purchases and operating expenses in my one year test.¹³⁹ And I am doubling the estimated retention rate for 10 or more years to 10%, increasing it to 15% for five to nine years, and 30% for from two to four years – assuming ALL recruits are counted. (As these*

¹³⁶ See, Chapter 2 for these CDCs ("red flags")

¹³⁷ We have average income data for other MLMs besides those included in this analysis, but without adequate data to do this analysis.

¹³⁸ See Ch. 8: "MLM – a Litany of Misrepresentations"

¹³⁹ In the 2011 edition, a 10% figure was used for 30 MLMs, but the end result was essentially the same. As an overall average, 99.6% of participants lost money.

percentages are based on available evidence and 20 years' worldwide feedback we have received, I believe greater retention rates are unlikely.)

New MLMs are not included, as they may be in their momentum phase when patterns of data to establish long-term income and retention rates have not yet been established.

Some MLM defenders will claim that participants can conduct their business with a much lower investment than is reported here. While this may be true for those merely buying and selling a few products, in every case where participants rose in rank to where they were making enough money to actually experience significant net profits, they have spent a great deal of time and money getting there. As explained in Chapter 5, for a new recruit to conduct a successful recruitment campaign to advance up the pyramid of participants to where profits are being made is very expensive. So the figure in this column is now one-half of what Jon Taylor found was necessary to conduct a successful recruitment campaign. (Even still, the final result was about the same – 99.6% loss rate using the 10% figure last year.)

While some earnings reports may have been updated since this report was completed, it is not expected that the outcome would be materially different, as the pattern of losses has been consistent over time.

DISCLAIMER: These reports are intended purely to communicate information in accordance with the right of free speech. They do not constitute legal or tax advice. Anyone seeking such advice should consult a competent professional who has expertise in endless chain or pyramid selling schemes. Readers are specifically advised to obey all applicable laws, whether or not enforced in their area. Neither the Consumer Awareness Institute nor the authors assume any responsibility for the consequences of anyone acting according to the information in these reports.

Exhibit 7d, continued – MLM profitability analysis table:

(In the footnotes notes below, web sites for statistics are provided, where available.)

MLM company and year of average earnings report ¹⁴⁰	Estimated minimum annual costs for effective recruitment campaign. ¹⁴¹	Level at and above which net profits possible ¹⁴²	Approx. % of active participants at that level or above ¹⁴³	Maximum retention rate ¹⁴⁴	Approximate % of <u>all</u> participants that could have profited from participation ¹⁴⁵	Approx. % of all participants who lose money ¹⁴⁶
Advocare (2013) ¹⁴⁷	\$13,627	Gold	3.14%	10%	0.31% (0.0031) – 1 in 323 may profit	99.69% lose money
Ameriplan (2008) ¹⁴⁸	\$12,548	NSD	1.55%	10%	0.15% (0.0015) – 1 in 133 profits	99.85% lose money
Amway/Quixtar (2001) ¹⁴⁹	\$10,736	Platinum	0.905%	10%	0.09% (0.0009) – 1 in 1,111 may profit	99.91% lose money
Arbonne Int'l (2011) ¹⁵⁰	\$13,627	Regional Managers	0.4%	10%	0.04% (0.0004) – 1 in 2,500 may profit	99.96% lose money
Beach Body (2011) ¹⁵¹	\$13,627	Diamond	6.0%	10%	0.6% (0.006) – 1 in 167 may profit	99.4% lose money
Cyberwize (2006-2007) ¹⁵²	\$12,228	Senior Director	2%	10%	0.2% (0.002) – 1 in 500 may profit	99.80% lose money
Ecoquest (2005 – now Vollara) ¹⁵³	\$11,849	Managers in Training	N/A – see next column	Since 2000– 278,024 ¹⁵⁴ Dealers	0.72% (0.0072) – 1 in 139 may profit	99.28% lose money

¹⁴⁰ The most recent report available to the author at the time of the analysis.

¹⁴¹ Estimated minimum costs of conducting a successful recruitment campaign, based on the author's one-year test of a leading MLM. Costs include incentivized purchases plus minimum operating expenses, corrected by cost of living adjustment (based on Consumer Price Index) since company's founding – See Chapter 5. Here we use the liberal assumption that total costs were only 50% of those of the author's minimum expenses.

¹⁴² Estimated average net profits assume all expenses (including incentivized purchases and minimum operating expenses) are subtracted from income. This is the "pin level" at and above which profits would be possible.

¹⁴³ Referring to the level in the previous column – per MLM company reports. Since only "Active" participants were counted, we can safely assume that the numbers on the report represent only a fraction (including dropouts) of the total.

¹⁴⁴ See Chapter 6 for how approximate attrition (and retention) rates for MLMs are estimated. The inverse of attrition is retention, which is used to estimate the percentage who could profit. Retention is estimated to be a maximum of 10% if in business for under ten years, 5% for ten or more years. However, for this report, we use the liberal assumption of 15% for three to nine years and 10% for ten or more years. Newer MLMs are not included, as it was concluded that sufficient data to establish long-term income and retention rates has not yet been established.

¹⁴⁵ Percentage for which average income exceeded all expenses (second column) for a successful recruitment campaign.

¹⁴⁶ By losing money, we are referring to those who spent more than they received from the company, after subtracting all expenses, including products (whether used, given away, or sold). In calculating percentage who lost money, those who dropped out are included. This is using the assumption that participants who had arrived at such a high "pin level" that they were profiting would stay in the program – since they enjoy the "residual income" that promoters imply at opportunity meetings is possible.

¹⁴⁷ "2013 Advocare Income Disclosure Statement" –

<http://advocarecorporate.s3.amazonaws.com/microsite/downloads/pdf/incomedisclousurestatement.pdf>

¹⁴⁸ "AmeriPlan Independent Business Owner Income Disclosure Statement for 2008," Published by AmeriPlan. Not currently available on the web.

¹⁴⁹ "Average Income for IBOs in North America, 2001 Average Earnings in U.S. Dollars" – Copyrighted in 2002 by Quixtar, Inc. (now Amway again in U.S.) No more recent figures are available. Amway has resisted income disclosure in the FTC's Proposed Business Opportunity Rule. – http://www.amquix.info/pdfs/quixtar_income_2001.pdf

Note that based on the "Amway Average Incomes 2012" report – <http://www.thetruthaboutamway.com/amway-average-incomes-2012/>, the loss rate increased to 99.95% - using the same methodology for calculations.

¹⁵⁰ "2012 Independent Consultant Compensation Summary – U.S." (2012), published by Arbonne, Int'l. –

<http://www.arbonne.com/company/info/iccs.asp>

¹⁵¹ "Statement of Independent Coach Earnings" for the year ending 12/28/2011, Published by Team BeachBody –

<http://www.teambeachbody.com/incomechart.pdf>

¹⁵² "Cyberwize Income Disclosure Statement for 2006-2007" – http://www.cyberwize.myvoffice.com/pdf/en/USA_Opp_Presentation.pdf.

¹⁵³ "Income Disclosure Statement" – for 2005 provided by Ecoquest Int'l (acquired by Vollara in 2009)

¹⁵⁴ 2005 "Income Disclosure Statement" Ecoquest reported what all MLMs should report – the total population base of recruits since the company's founding, or the year during which the first TOPPs (that are included in the report) joined the system. So we did not need to estimate attrition rate.

MLM company and year of average earnings report	Estim. min. annual costs for effective recruitment campaign.	Level at and above which net profits possible	Approximate % of active participants at that level or above	Maximum retention rate	Approximate % of <u>all</u> participants that could have profited from participation	Approx. % of all participants who lose money
Empower Network (2012) ¹⁵⁵	\$13,913	\$10-20K income level	2.5%	15%	0.38% (0.0038), or 1 in 263 may profit	99.62% lose
Ex. Telecom. (1994) ¹⁵⁶ – no longer MLM	\$9,000	Rep's with ave. checks > \$9,000/yr.	4.4%	19%	0.44% (0.0044) – 1 in 227 may profit	99.56% lose
FHTM (2010) ¹⁵⁷ – Shut down	\$12,104	National Sales Mgr.	0.45%	15%	0.045% (0.00045) – 1 in 2,222 may profit	99.96% lose
FreeLife Int'l (2010) ¹⁵⁸	\$12,104	Star Director V	6.5%	10%	0.65% (0.0065) – 1 in 154 may profit	99.35% lose
Herbalife (2011) ¹⁵⁹	\$13,627	GET	8.8%	10%	0.8% (0.008) – 1 in 125 may profit	99.2% lose
Ignite –Stream Energy (2012) ¹⁶⁰	\$13,204	Executive Director	0.18%	10%	0.018% (0.00018) – 1 in 5,555 may profit	99.98% lose
Immunotec (2012) ¹⁶¹	\$13,913	Gold	6%	10%	0.6% (0.006) – 1 in 167 may profit	99.4% lose
iNet Global (2013) ¹⁶²	\$13,627	Diamond Executive	5.79%	15%	0.87% (0.0021) – 1 in 175 may profit	99.13% lose
Isagenix (2011) ¹⁶³	\$13,627	Star Consultant	5%	10%	0.5% (0.005) – 1 in 200 may profit	99.5% lose
It Works! (2013) ¹⁶⁴	\$14,122	Diamond	2.71%	10%	0.27% (0.0027) – 1 in 369 may profit	99.73% lose
Life Vantage (2012-3) ¹⁶⁵	\$13,913	Distributor Rank #5	1.35%	15%	0.2% (0.002) – 1 in 5,000 may profit	99.8% lose
Lyoness (2012) ¹⁶⁶	\$13,913	Career Level 3	0.35%	10%	0.035% (0.0035) – 1 in 2,857 may profit	99.96% lose
Mannatech (2010) ¹⁶⁷	\$12,104	Executive	3.5%	10%	0.35% (0.0035) – 1 in 286 may profit	99.65% lose
Melaleuca (2012) ¹⁶⁸	\$13,913	Director VI	0.68%	10%	0.068% (0.00068) – 1 in 1,471 may profit	99.93% lose

¹⁵⁵ "Income Disclaimer," March 17, 2014 - <http://www.empowernetwork.com/income>

¹⁵⁶ The company is not named here because the name has been taken over by a legitimate corporation that threatens to sue anyone that associates the name with an MLM business model. (Hint: the name begins with E. Those who have been reviewing this issue since the 1990s will know what company is referred to.)

¹⁵⁷ "Income Disclosure Statement," January 23, 2009 – January 20, 2010. FHTM in business since 2006. Shut down in 2013. Web URL – http://www.fhtm.net/documents/IDS_Form_3.pdf

¹⁵⁸ "2010 Annual Income Statistics" - published by FreeLife Int'l. Web URL – http://corporate.freelife.com/pdf/income_stats_us_en.pdf

¹⁵⁹ Herbalife: "Statement of Average Gross Compensation of U.S. Supervisors – 2011" –

<http://opportunity.herbalife.com/content/en-us/pdf/business-opportunity/AverageGrossCompensation-English.pdf>

(2012 report not used because hired survey showing 73% participation for personal consumption is questionable.)

¹⁶⁰ Ignite: "Income Disclosure" Jan. 1, 2012 – Dec. 31, 2012" – http://pdfs.streamenergy.net/pdfs/Disclosure_Page.pdf

¹⁶¹ "Immunotec: Income Disclosure – Calendar Year Ending 2012" –

http://www.immunotec.com/IRL/en/USA/IncomeDisclosureStatement_2010.pdf

¹⁶² "Income Disclosure Statement 2013" 1 Jan 2013 – 31 Dec 2013 (listed in Google as Asesse Marketing/Internet Marketing

Services) – <https://marketing.acesse.com/public/spage.php?p=IncomeDisclosureStatement>

¹⁶³ "Annual 2011 Midyear Isagenix Independent Associate Earnings Statement." Report deceptively classifies 84% as "product users." (similar to Melaleuca's reporting) – <http://www.isagenix.com/us/en/associateearnings.dhtml>

¹⁶⁴ "2013 Annual Income Disclosure Statement," published by It Works! – <http://www.myitworks.com/Legal/Income/>

¹⁶⁵ "LifeVantage Corporation Distributor Compensation Summary" – <http://www.lifevantage.com>

¹⁶⁶ "Lyoness Income Disclosure Statement – US" – <http://www.lyoness.us>

¹⁶⁷ "2010 U.S. Income Averages: Mannatech Career and Compensation Plan" – published by Mannatech. For 2009 report (with only 2.99% profiting after expenses but with 2010 report now offline), go to –

<https://mannatech2.s3.amazonaws.com/mtlibrary/35312722799704.pdf>

¹⁶⁸ "2010 Annual Income Statistics" – published by Melaleuca. This Melaleuca report is one of the most obfuscated reports I have analyzed. All buyers are designated "customers." A certain percentage are deemed "business builders," and percentages of these are in turn percentages of all customers, and a percentage of these are in "development" or "leader" status. Thus, those who are in the profit category are made to appear a much larger percentage than would appear in the report. I doubt that anyone looking at the numbers to decide on participation

MLM company and year of average earnings report	Est. minimum annual costs for effective recruitment campaign.	Level at and above which net may profit possible	Approx. % of active participants at that level or above	Maximum retention rate	Approximate % of all participants that could have profited from participation	Approx. % of all participants who lose
Momentum Plus (2006) ¹⁶⁹	\$12,228	Executive Directors	0.09%	15%	0.013% (0.00013) – 1 in 7,407 may profit	99.99% lose
Mona Vie (2010) ¹⁷⁰	\$12,104	Bronze Executive	3%	10%	0.3% (0.003) – 1 in 333 may profit	99.7% lose
Morinda – was Tahitian Noni Int'l (2007) ¹⁷¹	\$12,571	Diamond Pearl	0.14%	10%	0.014% (0.00014) – 1 in 7143 may profit	99.99% lose
MXI (Xocai Chocolate) (2010) ¹⁷²	\$12,104	Silver Executive	2%	10%	0.2%, (0.002) – 1 in 500 may profit	99.8% lose
Nikken (2007) ¹⁷³	\$12,571	Diamond	1.6%	10%	0.16% (0.0016) – 1 in 625 may profit	99.84% lose
Numis (2009-2010) ¹⁷⁴	\$13,204	Four Star Representative	03.2%	30%	0.96% (0.0096) – 1 in 104 may profit	99.04% lose
Nu Skin (2011) ¹⁷⁵	\$13,627	Lapis Executive	1.12%	10%	0.12% (0.0012) – 1 in 833 may profit	99.88% lose
Orenda International (2013-2014) ¹⁷⁶	\$14,122	Director	3.4%	10%	0.34% (0.0034), – 1 in 294 may profit	99.66% lose
Organo Gold (2012) ¹⁷⁷	\$13,913	\$8,001-20,000 level	3.8%	15%	0.57% profit (0.0057) – 1 in 175 may profit	99.43% lose
Reliv (2011) ¹⁷⁸	\$13,627	10-MDR ¹⁷⁹	0.42%	10%	0.042% (0.00042) – 1 in 2,381 may profit	99.96% lose
Renaissance (2000) – Shut down ¹⁸⁰	\$10,443	Emerald	0.18%	15%	0.027% (0.00027) – 1 in 3,704 may profit	99.97% lose
Rodan & Fields (2013) ¹⁸¹	\$14,122	Level III EC	2.1%	15%	0.31% (0.00315) – 1 in 317 may profit	99.69% lose

could get the true likelihood of profiting from the information provided. –

http://cdnus.melaleuca.com/PDF/BusinessCenter/Reference_Library/Download_PrintCenter/2012Incomestats_enUs.pdf

¹⁶⁹ “Earning Overrides and Bonuses Disclosure Chart” – published by Momentum Plus (Philippines), accessed June 27, 2008

¹⁷⁰ “Income Disclosure Statement Global 2008” – published by Mona Vie. Mona Vie calls those who made a purchase in the past 12 months but failed to meet four criteria are classified “wholesale customers,” lessening the percentage of distributors who would otherwise be considered customers. Web URL –

http://media.monavie.com/pdf/corporate/income_disclosure_statement.pdf

¹⁷¹ “Average Incomes of U.S. IPCs” – published in 2007 by TNI – now Morinda) –

http://morinda.com/en-us/morinda/company/average_incomes.html

¹⁷² “Xocai – Income Disclosure Statement – 2010” – published by MXI Corp., Reno, Nevada.

<http://us.fotolog.com/adampaulgreen/80795275/>

¹⁷³ “Average Consultant Income Sheet” – published by Nikken. Nikken has two sets of income statistics, one for sponsoring levels & one for leadership levels. I assumed leadership levels come out of & do not exceed the top level (Bronze).

¹⁷⁴ “U.S. Income Disclosure Statement” – published by Numis for the period July 1, 2009 through June 30, 2010. Just completing its second year – and period of momentum – the success rate could drop slightly in the next 2-3 years. – <https://www.securedcontent.net/numis/pdfs/US-Income-Disclosure-7-27-2010.pdf>

¹⁷⁵ “2011 Nu Skin Enterprises, Inc. Distributor Compensation Summary” – published by Nu Skin. (highlighted as example for chapter calculations. More recent data is available, but the 2011 data is used to conform with those calculations) <http://www.nuskin.com/content/dam/global/library/pdf/distarnings.pdf>

¹⁷⁶ Annual Income for the period 6/2010-5/2011, Published by Orenda International

¹⁷⁷ “Organo Gold Income Disclosure Statement,” Published by Organo Gold and posted on its web site –

<http://www.organogold.com/opportunity/compensation-plan/income-disclosure-statement/>

¹⁷⁸ “2011 Income Disclosure Statement” – published by Reliv and posted on its web site –

<http://content.reliv.com/old/editor/file/2011IncomeDiscloser.pdf>

¹⁷⁹ Reliv only lists earnings for Director and above, with six levels below all essentially losing money.

<http://content.reliv.com/old/editor/file/2011IncomeDiscloser.pdf>

¹⁸⁰ Shut down as an illegal pyramid scheme after a lawsuit brought by the State of Kansas and the U.S. Justice Dept. in 2001, in which Robert FitzPatrick and Jon Taylor acted as experts. Statistics extracted from court records.

¹⁸¹ “2013 USA Income Disclosure Statement,” Rodan & Fields

MLM company and year of average earnings report	Est. minimum annual costs for effective recruitment campaign.	Level at and above which net may profit possible	Approximate % of active participants at that level or above	Maximum retention rate	Approximate % of all participants that could have profited from participation	Approx. % of all participants who lose money
SendOutCards (2010) ¹⁸²	\$12,104	Executives	0.30%%	15%	0.045% (0.0045) – 1 in 2,222 may profit	99.95% lose
Sunrider (2009) ¹⁸³	\$12,996	Business Leader	7.6%%	10%	0.76% (0.0076) – 1 in 132 may profit	99.24% lose
Symmetry (2003) ¹⁸⁴	\$11,158	\$501-2,000/mo. income level	1.6%	10%	0.16% (0.0016) – 1 in 625 may profit	99.84% lose
Thirty-One Gifts (2013) ¹⁸⁵	\$14,122	Senior Director	0.65%	10%	0.065% (0.00065) – 1 in 1,538 may profit	99.93% lose
Tools for MLMs (Team, Life, etc. (2012) ¹⁸⁶	\$13,913	Leader	0.35%	15%	0.052% (0.00052) – 1 in 1,923 may profit	00.95% lose
Tupperware (2009) ¹⁸⁷	\$12,996	Director in Qualification	1.62% ¹⁸⁸	10%	0.16% (0.0016) – 1 in 625 may profit	99.84% lose
USANA (2010) ¹⁸⁹	\$12,104	Achiever	3%	10%	0.3% (0.003) – 1 in 333 may profit	99.7% lose
Vemma (New Vision) (2013) ¹⁹⁰	\$14,122	Platinum Leader	3.17%	10%	0.32% (0.0032) – 1 in 315 may profit	99.68% lose
Viridian Network (2010-2011) ¹⁹¹	\$13,627	Senior Director	0.6%	10%	0.06%, (0.0006) – 1 in 1,667 may profit	99.94% lose
Visalus Sciences (2011) ¹⁹²	\$13,627	Regional Director	1.28%	15%	0.19% (0.0019) – 1 in 526 may profit	99.81% lose
Wake Up Now (2013) ¹⁹³	\$14,122	Founder 4	Approx.. 0.5%	15%	0.075% (0.00075) – 1 in 1,333 may profit	99.92% lose
World Ventures (2010) ¹⁹⁴	\$12,104	Director	0.42%	15%	0.063% (0.00063) – 1 in 1,587 may profit	99.94% lose
Xango (2009) ¹⁹⁵	\$12,996	20K	1.33%	10%	0.133% (0.0013) – 1 in 769 may profit	99.87% lose

¹⁸² “2010 Income Disclosure” – published by SendOutCards https://www.sendoutcards.com/images/pdf/income_disclosure.pdf

¹⁸³ “Income Disclosure Statement: January 1 – December 31, 2009” – published by Sunrider. Web URL – http://www.sunrider.com/Contents/PDF/AverageIncome_Eng.pdf

¹⁸⁴ “Vision: Earnings Matrix Based on 2003” – published by Symmetry.– http://www.symmetrydirect.com/Opportunity/Op_EarningsMatrix.htm

¹⁸⁵ “Thirty-One Gifts LLD – Income Disclosure Statement 23013” – <http://www.thirty-onegifts.com/income-disclosure-statement/>

¹⁸⁶ “LIFE Income Disclosure Statement” – <http://amthrax.files.wordpress.com/2013/06/life-ids-analysis-screenshot.png>

¹⁸⁷ “2008 Income Disclosure Summary” – published by Tupperware, which appears to have changed their compensation plan in April of 2005 to provide greater rewards for high level participants (“Directors”). Reported in Presentation Summary, Q2 Sales Force Structure. Earnings Conference Call, Jan. 31, 2007.

¹⁸⁸ “Tupperware 2009 Income Disclosure summary.” Assuming at least 50% of participants earned no commissions, which Tupperware failed to report. – <http://order.tupperware.com/ccm-pdf/income-disclosure-CAD.pdf>

¹⁸⁹ “North American Average Total Earnings,” – published by USANA. Since 2008, USANA began selectively reporting only the most active of participants (“Associates”) and suggested their numbers represented average total earnings – a huge deception. Apparently the 2005 numbers did not look good enough, so they changed their reporting to make them look better. For more on USANA’s deceptive reporting, search “USANA” in The Fraud Files at – www.sequenceinc.com.

Web URL – <http://www.usana.com/media/File/Prospecting%20page/Tools/US/USANABusiness/US-AveIncome.pdf>

¹⁹⁰ “Vemma Income Disclosure Statement 2014”, published by Vemma.

¹⁹¹ “Earnings Disclosure Statement,” published by Viridian Network for the period November 2010 through March 2011. Web URL – http://www.viridian.com/assets/marketing/EDS_PR-2.pdf

¹⁹² Visalus Store web site, December 29, 2011

¹⁹³ “WakeUpNow Income Disclosure” Worldwide 2013. – <http://ethanvanderbilt.com/wakeupnow-income-disclosure/>

¹⁹⁴ “World Ventures Marketing. LLC: Annual Income Disclosure Statement”, published by World Ventures in 2010.

Recent web URL – <http://wvratpack.com/wp-content/uploads/2012/04/RATPackWINEnrollmentPacket.pdf>

¹⁹⁵ “Distributor Earnings Disclosure Statement: 2009 Average Monthly Earnings by Rank for All Markets” – published by Xango. Web URL – http://rs.xango.com/downloads/xango4.0/2009_Income_Disclosure_Statement.pdf

MLM company and year of average earnings report	Est. minimum annual costs for effective recruitment campaign.	Level at and above which net may profit possible	Approximate % of active participants at that level or above	Maximum retention rate	Approximate % of all participants that could have profited from participation	Approx. % of all participants who lose money
Yor Health (2012) ¹⁹⁶	\$13,913	Silver	13.4%	10%	1.34% (0.013) – 1 in 77 may profit	98.7% lose
Young Living Essential Oils (2013) ¹⁹⁷	\$14,122	Silver	3.65%	10%	0.365% (0.00365) – or 1 in 274 may profit	99.63% lose
Your Travel Biz (YTB-2007) ¹⁹⁸	\$12,571	Coach's Corner	0.35%	10%	0.035% (0.00035) – or 1 in 2,857 may profit	99.96% lose
Zamzuu (2009) ¹⁹⁹	\$12,996	Coach's Corner	0.79%	30%	0.23% (0.0023) – 1 in 435 may profit	99.77% lose
Approx. ave. loss rates of all participants in sample	N/A (not applicable)	N/A	N/A	N/A	0.29% (0.0029) – On average, approx. 1 in 357 may profit	An average, of approx. 99.7% lose money

NOTE: Several other MLMs provide at least some income data, but the reports lacked sufficient information or had not been in business long enough to perform the above analysis.

Concluding comments on the table in Exhibit 7d

In every case, using the analytical framework described above, the loss rate for all of these MLMs ranged from 99.04% to 99.99%, with an average of 99.71% of participants losing money. On average, one in 342 was likely to have realized any profits at all after subtracting expenses, and 997 out of 1,000 lose money – to say nothing of the time invested. And *if you eliminate TOPPs from the calculations, the loss rate is closer to 99.9%, which rounds (even closer) to 100%. In other words, the chances of a new recruit profiting from coming in at the bottom of a pyramid of participants in an MLM is ZERO – even worse odds than for a classic, no-product pyramid scheme.*

Perhaps even more significant is the fact that the “residual income” to provide “time freedom” from having to worry about money (touted by MLM promoters) becomes even more elusive from participation in MLM. Less than one person in many thousands achieves that level of income, and they are usually the founders and those who initiated the chain of recruitment in a new market.

The most liberal assumptions that could reasonably be used in favor of the MLMs were applied to the above table of MLM loss rates. We assumed that at least some of the dropouts had joined just to get the products (reflected in an inflated retention rate), even though they were priced far higher than at competing outlets.

We also allowed for the possibility that operating expenses were far lower than actual experience suggests. If we had used the more realistic assumptions discussed in prior chapters, (and eliminated TOPPs that horribly skew the income distribution) the average loss rate for these MLMs would have averaged no better than 99.9% - with less than one in 1,000 profiting significantly.

¹⁹⁶ “YOR Income Disclosure Statement” for 2007. (Total population of reps from beginning of company was reported to be 224,440.) Web URL – <http://www.yorhealth.com/downloads/legal/YOR-Income-Disclosure-Statement.pdf>

¹⁹⁷ “2013 U.S. Income Disclosure Statement” – http://www.youngliving.com/en_US/opportunity/income-disclosure/

¹⁹⁸ “Rep Earnings Report July 2007” – Published by YTB (associated with Zamzoo – and ytb Travel Site Owners)

¹⁹⁹ “Associate/Rep Income Disclosure Statement” – published by ZamZuu, Inc., 2010

http://www.yourtravelbiz.com/Policies_Procedures/IDS-US-Rep-Marketing-12pt-copy-v5.pdf

Why the breakeven point for expenses is so high before MLM participants can net any profits

“Pay to play” purchases to gain and maintain “pin level” can be very costly. While MLM promoters insist that there is little or no signup fee to join their MLM, this is just a ruse to deceive regulators and the public. Typically, they only charge for a “not-for-profit” starter kit of supplies that costs less than \$50. However, in order to qualify for any commissions or for rank advancement to various “pin levels,” stiff minimum purchase requirements must be met, often totaling hundreds, or even thousands of dollars over the course of a few months.

In Nu Skin, for example, no one really gets to a level where significant profits are possible without becoming an Executive, which requires purchases of at least \$4,500 over three months and group volume of \$3,000 per month after that. Each Executive must have five active distributors under him/her, each of whom is buying at least \$100 a month of products – typically sold on a subscription basis.

If the volume drops below the minimum for even one downline distributor, the Executive could lose all Executive commissions. Also, most commissions are paid to those who build deep in the compensation plan by having several front-line Executives under him or her. Then if even one of their front-line Executives fails to meet qualifications, they could lose commissions for a huge downline of hundreds or even thousands of distributors overnight! So there is a huge incentive for the Executive to buy products in the name of those who drop out or don't purchase the required amount of products, or who cancel automatic delivery.

I have spoken with at least one former Nu Skin Executive, a couple, whose income suddenly dropped from \$30,000 a month to just over \$700 a month for that reason. Another couple spent tens of thousands of dollars trying to meet minimum “pay-to-play” requirements for their downline to maintain qualification before finally dropping out, losing a small fortune. These were losses to them, but gains for the upline, since the sales and

distributors “roll up” to the next upline Executive. Of course, Nu Skin also benefits.

Recruitment expenses are also significant. In the above analysis, the minimum amount spent on purchases and operating expenses – about \$27,000²⁰⁰ – assume that the participant is conducting an aggressive recruitment campaign²⁰¹, such as I found necessary to climb the hierarchy of distributors at Nu Skin. Of course, MLM defenders argue that it is not necessary to do this and that it is a matter of choice whether or not one elects to be a “business builder,” to just sell products to meet more modest goals, or even to merely be a customer of the products because they love them so much. Hopefully, anyone who has read the foregoing will not buy this argument.

Review of rationale for high breakeven figure. In case a reader missed some critical information in this and prior chapters, I will reiterate some important findings in my research that justify such a high breakeven bar for those seeking to calculate the percentage of participants who gain or lose money – and average amounts of profits or losses at the various levels:

First, based on extensive comparative research, I identified four causative and defining characteristics of recruitment-driven MLMs, or product-based pyramid schemes.²⁰² (A fifth characteristic applies to most, but not all.) These are “red flags” that clearly separate MLMs from legitimate direct selling or any other business model. Coincidentally, these are the very same characteristics that lead to such huge loss rates for the continuing stream of new recruits who invest in the MLM and drop out, only to further enrich those at the top.

Second, I was able to establish an amount of minimum operating expenses for conducting a successful recruitment campaign²⁰³ from my one-year test of the Nu Skin program. Unless one were recruiting in a virgin market (outside the U.S.), I can assert that it would not be

²⁰⁰ In 2012 dollars

²⁰¹ See Chapter 5 for details.

²⁰² See Chapter 2:

²⁰³ See Chapter 5

possible to recruit successfully for much less than that, and in fact it is likely much more expensive for those at the higher levels in the hierarchy of distributors.

Third, using these defining characteristics, I was able to analyze the compensation plans of over 600 MLMs. (including some that folded or were shut down). (See Appendix 2E.) In every case, I found that the plans reward primarily TOPPs (top-of-the-pyramid promoters), who recruit large downlines of participants. All of those I analyzed could be said to be recruitment-driven and top-weighted.

Fourth, the MLM compensation plans do not reward those working part-time, seasonally, or with minimal commitment. Except for those initiating the endless chain of recruitment, participants who profit have to climb to a level where commissions and bonuses from the company exceed expenses. This requires aggressive and long-term recruitment, using the deceptive dialog necessary to get prospects to go along with them.²⁰⁴ Only a tiny few manage to recruit enough people to build a profitable downline.

The oft-repeated claim by MLM defenders that most new recruits join to get the products wholesale rings hollow if one objectively looks at the prices for MLM products. Comparisons of products sold through MLMs and through retail outlets show huge differentials – with MLM products often priced several times as high as those in retail outlets.²⁰⁵

It is an insult to the intelligence of MLM recruits to assume that all those who don't build a downline are merely "customers" because they are sold on the products and don't want to be "business builders." True, some fall for the "unique value of the products" hype of the MLM promoters, and others are buying from friends or relatives out of sympathy for them. But we cannot assume all "inactives" are so naïve as to pay exorbitant prices for products with no connection to the "opportunity."

Based on my analysis of all the MLMs in my research, at best only one in 1,000 achieve a level at or near the top of the pyramid of participants where they could

report a significant profit (more than a minimum wage) on their income taxes. And far less earn the amounts of money that are thrown out to prospects at opportunity meetings as possible to attain. Of course, MLM promoters protect themselves by saying there are no guarantees the new recruits will earn that much. *They would be much more honest saying that it is virtually guaranteed that they will not earn those huge paychecks – but will in fact lose money.*

When these numbers are properly understood, losses from MLM fraud easily exceed all other classes of "work from home" or "business opportunity" fraud combined.

"Party plans." The only class of MLMs in which there may be exceptions is in-home demonstration programs, or "party plans," which may reward enough for sales to non-participants to be profitable. However, compensation plans that I have been able to obtain for these companies clearly show a top-weighted reward system in which commissions for TOPPs far exceed those at the bottom levels. We do know that those sponsoring such parties must pay a significant amount for samples and product literature. So whether or not a party plan is profitable for low level participants would depend on the volume of sales to non-participants. The companies have not been able or willing to provide such information, and until they do, It is probably safe to assume that the same abysmal loss rates apply to party plan programs.

Even if we assume lower expenses and attrition, loss rates are still abysmal.

Even though MLM defenders may argue that in my calculations I exaggerate estimated expenses and attrition rates, when one assumes much lower expenses – even half of what I spent – and far higher retention rates of 15% for four to nine years (or 10% for ten

²⁰⁴ A whole litany of these deceptions are listed in Chapter 8.

²⁰⁵ See Chapter 4

years or more, the resulting loss rates are still over 99%.²⁰⁶) And the percentage of participants that achieve the large incomes shown as possible in opportunity meetings are but a tiny fraction of one percent. Probably less than one in 25,000 new recruits will ever achieve the substantial “residual income” touted at opportunity meetings.

MLM loss rates are not comparable to those for legitimate small businesses, including franchises.

MLM promoters often claim that the failure rates of small businesses are in the range of 90-95%. They say this to excuse the widely recognized failure rate in MLMs. What they fail to do is quote statistics from reliable organizations not affiliated in any way with MLM. So let's debug that myth once and for all.

For example, the SBA (Small Business Administration) found that *44% of small businesses survive at least four years, and 31% at least seven years*²⁰⁷. Also, *according to the NFIB (National Federation of Independent Business), one nationwide survey of small businesses*²⁰⁸ *showed that over the lifetime of a business, 39% are profitable, 30% break even, and 30% lose money. Cumulatively, according to this study, 64.2% of businesses failed in a 10-year period.*

The following quote from an article in *Journal of Small Business Management*²⁰⁹ is highly relevant here:

When aspiring business owners compare the options of franchise versus independent business ownership, an important consideration is the relative risk of business failure. To date, the primary referent for examining franchise failure rates has been surveys conducted by Andrew Kostecka (1988)(1) under the auspices of the U.S. Department of

Commerce, which indicate that less than 4 percent of all franchises fail each year. This figure compares favorably with various estimates of independent small business failures (e.g., Dun and Bradstreet 1989).

If only 64.2% of businesses failed (or terminated) in ten years, this totally refutes the argument of MLM defenders that “MLM is just like any business. Those who work at it succeed. Most fail because they didn't really try.”

My research – and that of other independent (non-MLM) analysts – leads to the conclusion that MLM does not qualify as a legitimate business. If less than 1% profit and 95% or more quit in ten years across the entire MLM industry, there must be something fundamentally wrong with MLM as a business model.

Incidentally, MLM participants seeking loans for an MLM “business opportunity” like Amway do not qualify for SBA loans, SCORE assistance, or other small business funding and assistance programs.²¹⁰ Banks also refuse loans for MLM participation.²¹¹

The fundamental deception of MLM is that of selling it as an “income opportunity” or as a “business opportunity.” For a graphical depiction of how loss rates for no-product pyramid schemes, and gambling compare with MLM, see Exhibits 7i and 7j.

MLM does not offer a part-time or seasonal income option. DSA/MLM defenders, often justify small payments to participants by claiming they are merely seeking part-time income or a little spending money for Christmas or to pay off debts, etc. But because the rewards in any of the hundreds of MLM compensation plans I have analyzed are heavily stacked in favor of building huge downlines, after subtracting significant “pay-to-play” purchases, it is not likely they will net any part-time or seasonal income from them. Again, *part-timers and seasonal participants are not profiting, but are merely contributing to TOPPs and the coffers of the company founders.*

²⁰⁶ See Exhibit 7d.

²⁰⁷ “Frequently Asked Questions.” SBA, Sept. 2008. U.S. Dept. of Commerce, Bureau of the Census.

²⁰⁸ William Dennis, Nat'l Federation of Independent Businesses, reported by Karen E. Klein in *Business Week*, September 30, 1999.

²⁰⁹ Franchise failure rates: an assessment of magnitude and influencing factors. By Castrogiovanni, Gary J., Justis, Robert T., and Julian, Scott C. (April 1, 1993)

²¹⁰ From SBA (SCORE), banking, and Internet sources.

²¹¹ This was explained to me in about 1998 in Kaysville, Utah, by former bank official James Farmer..

How does MLM participation compare with gambling? Comparisons of odds of profiting from gambling with MLM participation have shown conclusively that participants in many games of chance fare far better than in MLM.²¹² In an earlier analysis, I found *the odds of winning from a single spin of the wheel in a game of roulette or roll of the dice at craps in Las Vegas was over 20 times as great as the odds of profiting from Amway, Nu Skin, or Melaleuca.*²¹³

Referring to the Utah tax study discussed above, an interesting fact emerged. Wendover, Nevada, is on the border between the two states and a gambling mecca for some visiting Utahns. I called 16 tax preparers in Tooele County, Utah, which borders Nevada. While *none of them had any clients who reported profits from MLM* (6% of the population was active in MLM), *they recalled over 300 clients who reported profits from gambling!*

MLM does not qualify as a legitimate business any more than gambling. In fact, gambling is more honest because gambling establishments do not promote participation at gaming tables as a “business opportunity.” Also, each gambler has an equal chance, whereas in MLM the first to join enjoy a huge advantage.²¹⁴

BUSINESS OPPORTUNITY?



One can do better in Vegas!

²¹² See “Shocking Statistics” report on our web site – www.mlm-thetruth.com

²¹³ Statistics published for Caesar’s Palace in Las Vegas, April 6, 2001. Calculations are based on MLM average earnings statistics at the time.

²¹⁴ See Chapters 2 and 3.

Does MLM participation qualify for tax write-offs?

Many MLM promoters tout MLM participation as an opportunity to write off many household and travel expenses as business expenses. But expenses from a business that does not produce profits for more than three years may not qualify for business expense deductions, but are more likely classified as “hobby losses.”²¹⁵ And as suggested above, MLM is far less profitable than some games of chance at gambling casinos. Gamblers can only deduct expenses from winnings in any given year.²¹⁶

If MLM losses were treated as “hobby losses” – or in the same way as gambling for tax purposes – the IRS could gain billions in tax revenues it is now losing. Actually, in this sense all of us as taxpayers are paying for this abuse of our tax system promoted by the MLM industry.

Do MLM company stocks make good investments?

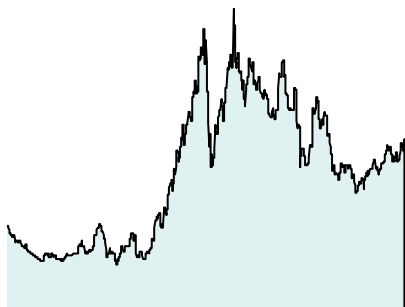
Publicly traded MLMs often show periods of rapid growth, unlike legitimate companies traded on the stock market. Such hyper-growth is to be expected of any company dependent on highly leveraged endless chain recruitment. They can be extremely viral at the outset, as is true of any pyramid scheme, product-based or not. Then they level out or decline as their market becomes saturated, as illustrated below.²¹⁷ This has been labeled “pop and drop” by some. (See Chapter 3.)

Then – to prevent eventual collapse – they must expand into other markets. This is not real growth, as these MLMs are merely replacing large numbers of dropouts to prevent eventual collapse. I have labeled this phenomenon “re-pyramiding” – a process widely engaged in by MLMs over time.

²¹⁵ “Instructions for Schedule C: Profit or Loss from Business”

²¹⁶ Op .Cit.

²¹⁷ Five-year history of an MLM reported in Market Watch – <http://www.marketwatch.com/investing/stock/MED>



MLM's "pop and drop" phenomenon

Thus, by "re-pyramiding,"²¹⁸ an MLM can continue indefinitely by going from country to country to establish new pyramids – and by introducing new product divisions and cycling the same distributors through them, such as Nu Skin has done with several divisions. The survival and growth of MLMs like Nu Skin and Herbalife enhances their image of legitimacy.

So it appears that most MLM stocks are safe from regulatory action in the short term. However, anything can happen long term. If an MLM were shut down by law enforcement, the stock price would tank and some investors could suffer huge losses.

Stock prices can also be affected when a related stock is featured in the headlines for some regulatory action or other market event, such as news items in Exhibit 7f. . Headlines affecting one stock will affect similar stocks. This happened to Nu Skin when its stock dropped about 30% after hedge fund manager Bill Ackman attacked Herbalife in a presentation given to investors on December 20, 2012, in which he bet on target price of zero for Herbalife's stock when the company was shut down or folded – which sparked a lively battle between those shorting the stock and those going long, with hundreds of millions of dollars at stake. And again, price changes for one stock can have a noticeable effect on similar stocks.

Given the rapid growth of some MLMs, it should be no surprise that some publicly-traded MLMs draw investors' attention. An investment advisor could find some of the

stocks worth considering for portfolio recommendations. Examples can be seen in the list of publicly traded MLMs furnished by one MLM information source in Exhibit 7e.

I often get calls from investment advisors, asking for insights and recommendations on specific stocks. Often, they want to know just how vulnerable the stocks are to action by state or federal regulators. I may tell them that it is quite unlikely that any action will be taken any time soon. However, I think it is important to recognize that virtually all MLMs are violating laws against unfair and deceptive practices or other proscriptions in state and federal rules and statutes as explained in Chapters 10 and 11.

If and when the political climate changes towards stronger regulatory efforts, this situation could change rather quickly. It could also change if officials with the skill and the will to take action are installed, and if they are provided with the resources to do what needs to be done to protect consumers.

This reminds me of a hedge fund consultant who traveled across the country to review the data I had gathered on the MLM industry and was astounded at what he discovered. As I drove him back to the airport, he was shaking his head all the way, as he exclaimed something like this:

Now let's see. This is an industry with few if any real customers and that is totally dependent on a network of tens of thousands of distributors, 99% of whom lose money! How is it possible for such an industry to continue to exist in America?

When MLMs (requiring endless chains of recruitment) came along and introduced unique and exotic products with complicated pay plans, charismatic leaders, palatial home offices, and donations to influential political candidates and charitable causes; promoters were able to dupe regulators, legislators, the media – and investors – into believing that they were legitimate "direct selling companies."

²¹⁸ "Re-pyramiding" is explained in Chapters 2 and 3.

Exhibit 7E: MLM STOCK WATCH

Partial report from – WWW.MLMLEGAL.COM (November 2014)

Compiled by VideoPlus (1-800-752-3030)

Leading Supplier to the Direct Selling Industry of Fulfillment, Packaging, Distribution and Communication Technologies.

Company Name (Public Name)	Exchange	Symbol	Type of Sales	2013 Return	PE Ratio	EPS	52 Week High	52 Week Low	Oct Month Close
AVON PRODUCTS, INC	NYSE	AVP	DS	19.9%	NA	0.83	18.12	9.32	10.40
BLYTH INDUSTRIES, INC. (PARTYLITE, VISALUS)	NYSE	BTH	PP	-30.0%	1.59	3.7	12.81	5.65	8.39
CVSL, INC (LONGABERGER, YOURINSPIRATION AT HOME, AGEL)	OTCQX	CVSL	NM	163.3%	NA	NA	19.85	11.26	0.83
EDUCATIONAL DEV CORP (USBORNE BOOKS AND MORE)	NASDAQ	EDUC	PP	-19.4%	35.76	NA	5.00	2.88	4.37
FOREVER GREEN	OTCBB	FVRG-U	NM	566.7%	17.02	NA	2.00	0.70	0.95
HERBALIFE LTD.	NYSE	HLF	NM	138.9%	12.63	5.91	83.51	36.97	52.46
LIFEVANTAGE CORP.	OTCBB	LFVN-U	NM	-24.7%	11.34	0.15	2.67	1.10	1.35
MANNATECH	NASDAQ	MTEX	NM	201.8%	9.42	NA	28.04	11.51	14.40
MEDIFAST, INC (TAKE SHAPE FOR LIFE)	NYSE	MED	NM	-1.0%	17.8	1.69	36.06	24.04	31.74
NATURAL HEALTH TRENDS	NASDAQ	NHTC-5	NM	216.8%	10.31	NA	21.99	2.81	9.95
NATURE'S SUNSHINE PRODUCTS	NASDAQ	NATR	NM	19.6%	16.11	1.05	19.56	12.91	14.90
NUSKIN ENTERPRISES, INC	NYSE	NUS	NM	273.1%	9.55	4.1	140.50	38.12	52.83
PRIMERICA, INC	NYSE	PRI	NM	43.0%	16.9	3.25	53.43	39.12	51.15
RBC LIFE SCIENCES, INC	OTCBB	RBCL-5	NM	1450.0%	NA	NA	1.85	0.46	1.40
RELIV INTERNATIONAL	NASDAQ	RELV	NM	114.5%	74.44	0.20	3.50	1.14	1.21
TUPPERWARE	NASDAQ	TUP	PP	47.5%	15.48	5.24	97.14	61.5	63.75
USANA, INC	NASDAQ	USNA	NM	129.5%	19.89	5.88	118.84	55.01	113.98
AI INTERNATIONAL (YOUNGEVITY)	OTC BB	YGYI	DS	29.7%	83.33	0	0.34	0.14	0.20

Exhibit 7f

Examples of news that could significantly affect the price of an MLM stock – even if the bad news is only about a similar MLM.

“We Have Never Seen Anything Like Bill Ackman's Dizzying Takedown Of Herbalife,” *Business Insider*, Dec. 20, 2012 NOTE: This development affected not only Herbalife stock price, but also others with similar offerings, especially Nu Skin Enterprises.

“For many Herbalife recruits, lost money and dashed dreams”

Herb Greenberg, *CNBC.com*, Jan. 10, 2013

“USANA Health Sciences: A Bad Case of MLM?” *Seeking Alpha* (3-22-2007)

“Immunotec Inc. – Trading Halt – to announce bad news,” *Stockhouse* 3-27-2000)

“Nu Skin and the short-sellers,” CNN report about an article by Peter Elkind with Doris Burke, *Fortune Magazine*, October 2012

Go to the Pershing Square web site – www.factsaboutHerbalife.com for PYRAMID SCHEMES: A PRIMER and some excellent reports and videos about Herbalife and the efforts of Bill Ackman and his associates to expose and bring the stock's price down to zero. Much of the information applies to other MLM stocks as well.

The Network Marketing Payout Distribution Study

In 1999, I gathered the data I had, together with feedback I was receiving from tax accountants, and issued a challenge that continues to this day. I wrote the presidents of 60 of the most prominent MLMs at the time, challenging them to prove me wrong in my conclusions – that network marketing companies were in fact pyramid schemes, with most of the money that is paid to participants going to those at the highest levels, and almost everyone else losing money, after subtracting incentivized purchases and minimal operating expenses.

These presidents were supplied forms that could be used to break down money paid out to participants in various percentiles with money they paid in to the company for products and services in order to conduct their “business.” My challenge to these executives was to “Prove me wrong” by furnishing this data as requested.

The response from most of these company presidents was interesting. Most did not bother – or dare – to respond. Company communicators from about a half dozen of the MLMs said they would get back to me with a response, but when they ran the challenge by top executives, the answer in every case was negative. They apparently did not want the truth to get out – which is no surprise, given the damning reality of the numbers, as reported here.

This challenge has been posted since that time on either my web site or on the Pyramid Scheme Alert web site. To this day, no MLM company president has met the challenge. Details of the *Network Marketing Payout Distribution Study* can be found in Appendix 7E.

These conclusions about MLM are confirmed in other studies.

I am not alone in coming up with these abysmal odds of success for MLM programs. I have already mentioned the Wisconsin study of Amway tax returns, showing the *average income of the top 1% of Amway distributors in Wisconsin to be minus \$900*. Another revealing study is the "*The Myth of*

'Income Opportunity' in Multi-level Marketing," by Robert FitzPatrick, sponsor of the web site pyramidschemealert.org. He used different assumptions than those used here – not attempting to correct the deceptions in the reporting of the 11 MLM companies he analyzed. But he still concluded – based on the companies' own reports – as follows:

A statistical analysis of income disclosures made by 11 major multi-level marketing (MLM) companies and the largest of all MLMs, Amway/Quixtar, reveals that, on average, 99% of all participants received less than \$10 a week in commissions, before all expenses. Additionally, the report shows that on average no net income is earned by MLM distributors from door-to-door "retail" sales. .

The data analyses prove that virtually all MLM participants never earn a profit and that MLM claims of a broad-based MLM "income opportunity" are false. The report reveals that the majority of all commission payments are awarded only to a small group of promoters at the top. More than 50% of all commission payments were transferred to the top one-percent in ten of the eleven companies. In several cases, more than 70% of all commissions were paid to the top one percent. The top-loaded pay plans of the MLM companies are based on "endless chain" recruiting in which the investments of the latest recruits are transferred to the earliest ones, and the vast majority of all participants are always situated at the bottom levels of the chain, where profit is impossible.²¹⁹

Comparing MLM to other options, it is safe to say that that *MLM is the most unfair and deceptive, and the most viral and predatory of all business practices and should be illegal per se, as are pay-to-play chain letters and no-product pyramid schemes*.

Therefore, to promote as a “business opportunity” an endless chain or pyramid selling activity (MLM) that in fact leads to almost certain loss for all but the founders and TOPPs (who are enriched from the purchases of victims/recruits), is a misrepresentation of the facts, and can lead to the defrauding of large numbers of participants. MLM is the epitome of the type of business activity the FTC is pledged to protect against – “unfair and deceptive acts or practices.”

MLMs candlestick income distribution. When I first became interested in the abysmal numbers associated with MLM profit/loss rates, I was struck with a phenomenon I had

²¹⁹ FitzPatrick, Robert, *The Myth of "Income Opportunity" in Multi-level Marketing*, 2008.

never seen in decades of analysis of financial and entrepreneurial business models. When I spoke at conferences and workshops for law enforcement personnel, I attempted to display on a graph the distribution of income across the entire spectrum of MLM participants.

On an income distribution chart I would show a tiny few making huge sums of money on the left of the horizontal axis and the balance losing money on the right side. The problem was that no display media was wide enough to display the huge disparity between winners and losers. Those who made money would be less than a half inch in width, while those who lost money (after incentivized purchases and expenses) would spread across the length of the entire building in which we were meeting – if not the whole block.

In the UK's case against Amway²²⁰, this extremely unfair income distribution was aptly described as a "candle stick." The following description by the finder of fact is very revealing. If you have the patience to read it and the statistical background to understand it, you will be rewarded with some very useful insights in just how incredibly unfair MLMs can be. (Conversions from pounds to dollars will vary, but you can still grasp the comparisons from the relative size of the numbers.)

Having set out the structure I turn to my findings of fact as to what, in truth, this structure produces for individual IBOs. The case for the Secretary of State is that the reality of the Amway business is that the nature and rewards of becoming an IBO and participating in that business are such that only a very small number of IBOs make any significant money from their participation. In fact, *the substantial majority of IBOs make no money and indeed by reason of their payment of the registration fee and the annual renewal fees, lose money from their participation.*

In its Points of Defense, Amway does not assert that this is not so, nor does it run any positive case. It merely puts the Secretary of State to proof. The Secretary of State proves the case by statistical analysis. For the period from 2001 to 2006 (a) 95% of all bonus income was earned by just 6% of

the IBOs; and (b) 75% of all bonus income was earned by less than 1.5% of IBOs. In 2005-2006 there were 39,316 IBOs who shared a bonus pot of £3,427 million. But of this total, 27,906 IBOs (71%) earned no bonus at all, and 101 IBOs (0.25%) shared £1,954 million between them. That leaves a group of 11,309 IBOs to share a bonus pot of £1,473 million. Within that category there was a group of 7,492 IBOs (earning 3% commission) who between them shared £101,400. This gave them an average annual bonus income of just over £13.50, a sum less than the annual renewal fee of £18.00.

(I do not, of course, overlook the "retail margin" earned on product purchased. from Amway and not self-consumed: but *the 3% commission is earned when the monthly point value is 200 PV, so the total retail margin, allowing for self-consumption, and even assuming full-price sales, will be low.*)

If one were to represent this bonus distribution on a graph with, a central vertical axis containing the commission bands (with 0% at the base and 21% at the top), and the horizontal axis calibrating the number of people in the class, then *the bar graph would resemble not a pyramid but a candle stick, with a large solid base of IBOs who earned nothing or virtually nothing and a thin column of IBOs arising out of it who earned 6 to 21% commission.*

A feature of that graph would be that the group at the top of the candle would be those who had been IBOs longest. So, Trevor and Jackie Lowe earned a total bonus of £141,000 (having been IBOs since 1979). Of that bonus only £1,788 related to commission on their personal volume (which suggests that they had personally purchased about £8500 worth of product in a year for on-sale to their own customers). £30,000 was attributable to the differential bonus earned on sales made by their down line, and the rest was attributable to the higher awards scheme to which I have referred.

The Stranneys earned a total bonus of £59,142. They too had joined in 1979. The bonus payable on their personal purchases was £ 1,963. The differential bonus earned on sales by their down line was £15,660. The balance was made up of the higher awards to which I have referred. The Melvilles earned a total bonus of £32,058. They joined in 1980. The bonus earned on their personal volume was £788. The differential bonus earned on sales by their down line was £20,078. The balance was made up of the higher awards. On the other

²²⁰ Approved Judgment: The Secretary of State for Business Enterprise and Regulatory Reform v. Amway (UK) Limited May 14, 2008. §42-43

hand at the base of the candle stick are almost all the recent joiners together with a very considerable number of people who have been IBOs for years, but not made a financial success out of their business.

The picture can be presented in a variety of ways: but it is consistent. Between 2001 and 2006 the proportion of IBOs not earning any bonus income varied between 69% and 78%. In year 2004/5 only 74 out of 25,342 IBOs earned over £10,000 by way of bonus. In that year only 4,076 IBOs earned enough bonus to cover the annual renewal fee: 21,266 did not even cover their most basic running cost from bonus payments (though there may be retail margin).

If very modest business expenses are factored in (say £1 00 on petrol or the purchase of BSM) the picture is even starker, with only 1,820 IBOs making sufficient from bonus payments to cover those expenses and 23,521 IBOs failing to do so. In the period from 2000 to 2005 Chris and Sharon Farrier's bonus-income ranged from £21,495 to £7,971 and averaged £12,850. Over the same period the income of Dr. Anup Biswas ranged from £137 to £433 and averaged £306. *These are the people whose testimonials said respectively that they were earning "the equivalent of good executive size income", or was deriving an income that "continue[d] to climb to replace my full professional salary".*

I would add that – as bad as these numbers are – they do not account for all expenses. So the loss rate is actually far worse than described above. I would also like to emphasize that the extremely unfair distribution of income described above does not apply just to Amway, but to all MLMs for which I have been able to obtain data on average earnings of participants. It is not just a few MLMs that are conducting unfair and deceptive marketing practices, but virtually all of them, as all MLMs are built on a fundamentally flawed system of unlimited recruitment of endless chains of participants as primary customers.

My explanation for the extremely unfair income distribution in MLM

Early in my research, something unique about MLM jumped out at me because of my extensive experience with sales commissions for sales persons and markup

practices in retail or direct sales settings, where the seller gets the lion's share of the commission share of the marketing margin of the retail price. In publishing, for example, the book seller may get 20-40%. The district or regional wholesale representative may only get 15%, but he gets that amount from many retailers. There may be a higher level national distributor who only gets 2-5%, but he gets that from the whole country.

Conversely, in MLM, distributors close to the actual sale may get an override commission of only a small percentage (3-6%, etc.) on the price of the product – no more than those at the top. The average person sees this as fair: "Everyone gets their 5%, which is their fair share – right?" Wrong. Because the person on the front line may get a personal or "group" commission of only 5-15%, there is little incentive to retail products, which are usually way too overpriced to sell at suggested retail. So they earn little if anything selling at retail and in fact usually sell at wholesale to friends and relatives to meet "pay-to-play" requirements for commissions and rank advancement.

Though commissions may be only 5% for several levels (as was the case for six levels of breakaways with Nu Skin), a high level distributor with thousands of persons in his/her downline can earn thousands of dollars every week. So the compensation plan clearly is weighted in favor of those who build a large downline from whom they can garner commissions from the purchases of thousands of participants, rather than attempting to sell them one at a time to non-participating customers.

RVE → EIDI. I have advanced a micro-economic MLM axiom, or company payout characteristic, that sets MLM apart from all other business models in its deceptive appeal – appearing fair, but probably the most unfair and deceptive of all business models. The axiom is as follows: RVE → EIDI – or relative vertical equality in commission structure results in extreme inequality in distribution of income to the network of distributors (thus the "candlestick income distribution"). I have found this characteristic in all of the 600 MLMs I've analyzed.

Look carefully at Exhibit 7g. Note that in a standard retail operation the retailer gets the lion's share of any commissions paid by the producer. This is fair because they expend the resources to make the actual sale happen. This means providing the store space, stocking the product, hiring a sales clerk, etc.

In the case of legitimate direct selling²²¹, the sales person does the hard work of finding the prospects and persuading them to buy. In contrast, the person who acts as wholesaler or manufacturer's rep will get a much smaller share of the retail sales price than the retailer but will have many retailers from whom to earn overrides. In legitimate direct selling, the sales manager above him or her will likewise get a much smaller commission, but will have many salespersons from whom to collect overrides. And there will not be more levels of sales managers than are functionally justified.

Now look at the bottom of Exhibit 7g – using Nu Skin's "breakaway" system as an example. Everyone in the upline and downline may get about the same payout from the company per sale. I call it *relative vertical equality* because – while the commissions may vary some – they may be relatively the same, whether the upline is one or five levels above you. In fact, in some MLMs, the amount paid to those at the higher levels is actually greater than that paid to the person making the sale. The new recruit may be encouraged to sell to (recruit) those with whom a prior relationship has been established – her "warm market." This has been called "spending one's social capital."

There is little correlation between the effort made in making the sale and the amount paid – except for position in the pyramid of participants. In fact, in at least two states it was at one time illegal to pay a person override commissions on sales to which that person made no contribution.

Now look at Exhibit 7h.²²² This is an actual example (from Nu Skin's statistics) of how unfairly the income is distributed. The number of distributors at each of the levels is represented by the size of the circles. The number of participants who actually earn a

significant profit is so small that it would take a microscope to see the circles for their respective levels. The active distributors who failed to earn a check are clearly the vast majority of distributors. And if you had a page 20 times the size, you could represent those who dropped out of the program with a circle 20 times that large.

When an objective observer comes to understand how MLM compensation plans actually work, it becomes apparent that MLM is not only an unfair and deceptive practice, but extremely viral and predatory.

Two fundamental flaws in MLM as an "income opportunity"

So when we put all of this together, it becomes apparent that there are two fundamental flaws in the core business model that we call multi-level marketing:

1 . All MLMs are built on unlimited recruitment of endless chains of participants as primary customers. Their compensation plans assume infinite markets, which do not exist in the real world. They also assume virgin markets, which do not exist for long. They are constantly in a state of impending market collapse. To survive and grow, they must continually be recruiting – or churning through – a revolving door of new recruits. Any losses from market shrinkage are borne by new recruits, who buy products to participate in the potential of "unlimited" or "residual" income held out to them. And when a market becomes saturated, they must of necessity re-pyramid through other markets.

2 .As just explained, relative vertical equality is presented as a fair system of remuneration, when in reality it is a system that leads to extreme inequality in distribution of income across the entire network of distributors – making MLM extremely unfair. MLM compensation plans are upside-down from legitimate retailing or direct selling, in which the bulk of the rewards go to the person or organization selling the product – and there are not more levels of sales management than are needed to manage the sales function.

²²¹ Note that I do not include MLM in the category of legitimate direct selling. I have done both, and I know the difference.

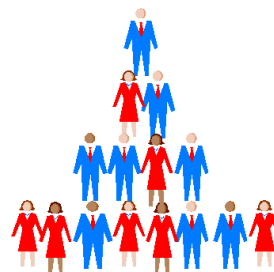
²²² Figures extracted from Exhibit 7c.

MLMs are the most unfair and deceptive of all packaged business opportunities and the worst class of pyramid schemes.

In the original FTC v. Amway ruling in 1979, the “retail rules” supposedly used by Amway to assure that products were sold and not just stockpiled are based on the questionable assumption that even though Amway was structured as a pyramid scheme, retail sales would serve as a mitigating factor to minimize the harm. But since the loss rate is so much higher for product-based pyramid schemes (MLMs) than for classic, no-product schemes, this assumption should be challenged as totally untenable.

In a classic 1-2-4-8 no-product pyramid scheme all the money from 14 downline participants goes to the person at the top. That person would leave and recruit another pyramid of participants. Those on the second level of the original pyramid would move up to the number one position, and those on the

bottom level would each move up a level in the new pyramid and recruit another two persons for the bottom level. Those at the top would cash out and go on to form other pyramids, in an endless chain of recruitment of new participants into an ever growing number of pyramids. [See Appendix 7B for profit and loss rates for such pyramid schemes.]







Classic, 1-2-4-8 pyramid scheme

In contrast, MLMs frequently have hundreds of thousands of victims involved, over 99% of whom lose money – many times the losses suffered by victims of no-product pyramid schemes. MLM is clearly an unfair and deceptive practice.

Exhibit 7g

Compared with retail/direct selling (top), relative vertical equality in MLM commission structures (bottom) results in extreme inequality in payout to participants.

Example of Retail/Direct Selling Commission Distribution

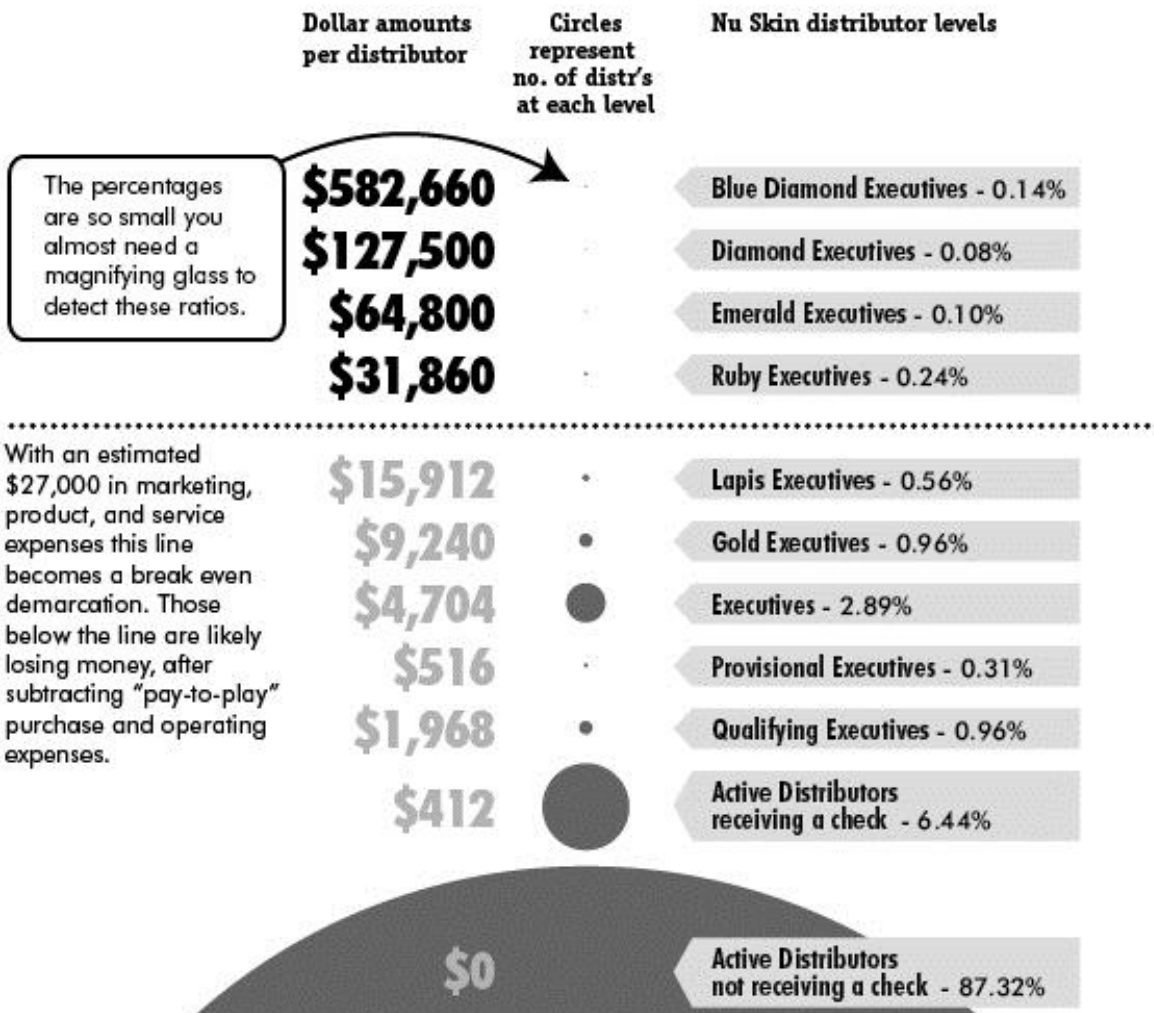
National Manager		1-2% of national sales revenues
Regional Managers		5-7% of regional sales revenues
District Managers		10-15% of district sales revenues
Salesmen/women		20-40% of each sale

Example of MLM Commission Distribution

Level 7		5% of sales for levels 1-6 (tens of thousands of downline participants)
Level 6		5% of sales for levels 1-5 (thousands of downline participants)
Level 5		5% of sales for levels 1-4 (hundreds of downline participants)
Level 4		5% of sales for levels 1-3 (dozens of downline participants)
Level 3		5% of sales for levels 1-2 (several downline participants)
Level 2		5% of sales for levels 1 (few in downline participants)
Level 1		Commissions only on personal sales

Exhibit 7h

% of Nu Skin Distributors at Each Level—and Their Annualized Commissions



The income inequality is actually far more extreme than what is displayed here, because distributors who drop out are not represented in this illustration. A separate circle representing dropouts would be 20 times as large as this circle—and consequently would require a graphic 20 times this size.

Source: The numbers displayed here are from the 2011 Nu Skin Distributor Compensation Summary.

The inevitable result of such pyramid schemes is that eventually recruitment will dry up as the market becomes saturated or law enforcement steps in and stops it. In any event, when the pyramid ceases, the vast majority of participants are guaranteed to be in a losing position at the bottom.

In a typical product-based scheme, or MLM, like Amway or Nu Skin, investments are disguised or laundered through product purchases. Revenues from product sales are channeled through a large infrastructure, with not even half of the money going back to those who generated it. And instead of going to the top person of the 14 participants in a no-product scheme, company payout must be shared with tens of thousands, or even hundreds of thousands of participants – most of it going to those at or near the top levels; i.e., the TOPPs (top-of-the-pyramid promoters) who are the driving force behind product-based pyramid schemes. So only a tiny amount is paid back to lower level participants – almost all of whom lose money.

Thus the loss rates for MLM participants (averaging at least 99.7% as shown in Exhibit 7d) is far greater than for participants in classic pyramid schemes, which is approximately 90%. And if you eliminate TOPPs (top-of-the-pyramid-promoters) from the calculation, the loss rate is closer to 99.9% for new recruits. So the chance of new recruits profiting from the scheme is essentially ZERO!

Put another way, *the odds of profiting from a classic 1-2-4-8 no-product pyramid scheme (close to 10% depending on how many continue) is in the range of ten to 100 times as great as the likelihood of profiting from a typical MLM program (less than 1%). MLMs (or product-based pyramid schemes) are the worst class of pyramid schemes by any measure – loss rate, aggregate losses, or number of victims.*²²³

MLM is a mathematical trick played on the unwary. MLM promises significant rewards to those who invest time and money in an MLM, but delivers losses to all but those at or near the top of a large pyramid (or beginning of the chain) of participants – who profit from the failed investments of those beneath them in the pyramid. As explained above, adding products to a pyramid business model does not mitigate the harm, but greatly increases it.

Based on figures released by the Direct Selling Association, aggregate losses amount to tens of billions of dollars and are suffered annually by tens of millions of victims worldwide. Of course, the DSA refers to MLM revenues as “sales,” when in fact with a 99% loss rate, such “sales” represent losses for the vast majority of participants.

In this regard, the following comment from the trier of fact in the UK’s case against Amway²²⁴ is instructive:

. . . In my survey of the evidence I have recorded some instances of those who did have some success. But *they are the equivalent of one in many thousands*. If the reality of an opportunity is fairly presented, members of the public are free to try and free to fail; and the mere fact that some do fail would not compel the conclusion that the opportunity was not being fairly presented. But if *almost all* do not achieve then I think the inference is fairly raised that the disparity between expectation and experience arises from a failure to make a fair presentation of the actual (as opposed to the theoretical or exceptional) chance of success.

All of the foregoing supports the obvious conclusion with which any rational analyst would agree. There exists a critical need for adequate disclosure of information crucial to an informed decision by an MLM prospect on whether or not to participate.

²²³ Again, for a chart comparing no-product with product-based pyramid schemes (MLMs) – and with legitimate income options, see Exhibits 7g and 7h.

²²⁴ Approved Judgment: The Secretary of State for Business Enterprise and Regulatory Reform v. Amway (UK) Limited May 14, 2008. §54 (c)

Exhibit 7i

See explanations in Exhibit 7j.

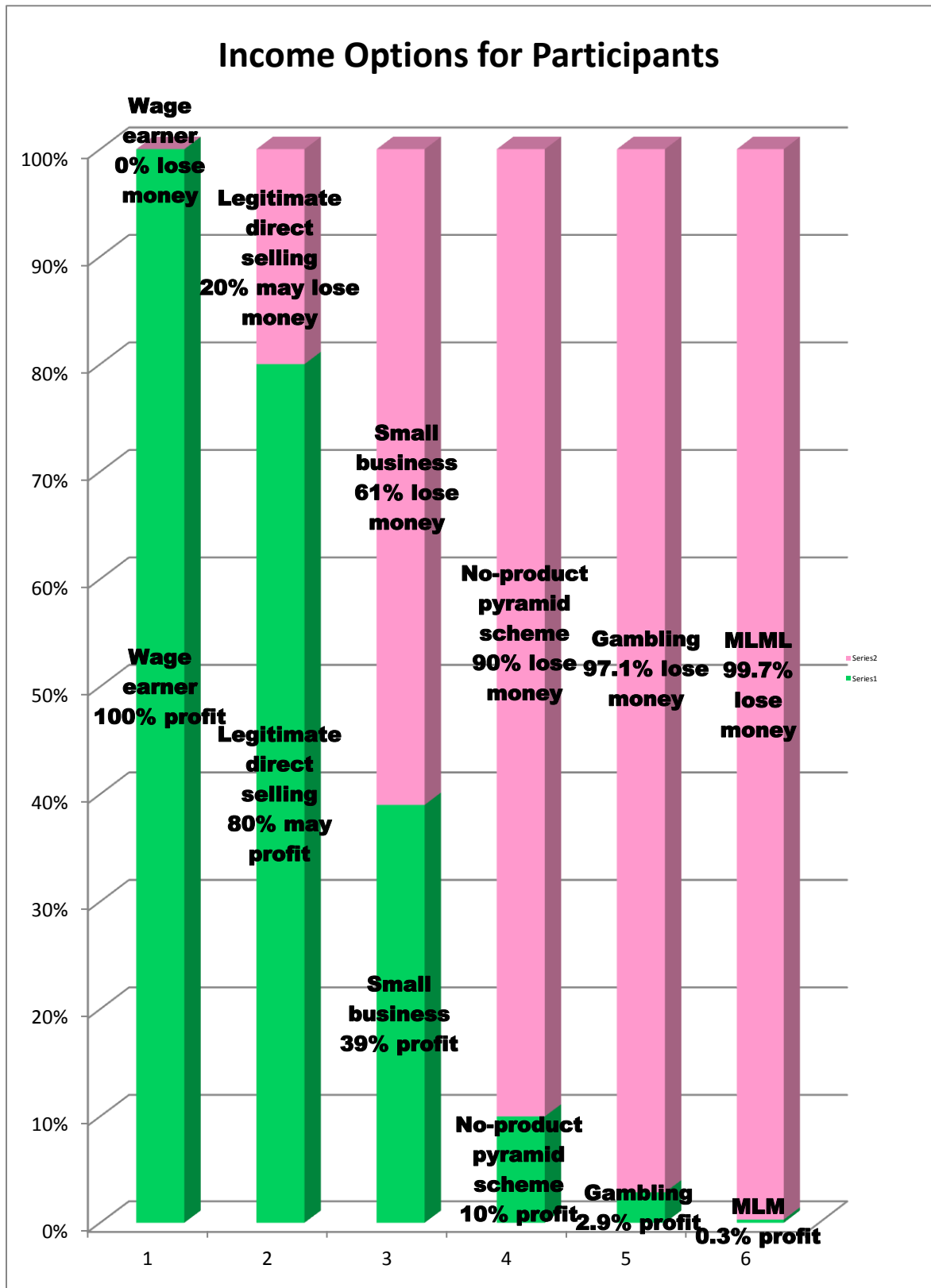


Exhibit 7j: MLM Profit and loss rates vs. various income options

By Jon M. Taylor, MBA, Ph.D.

	Wage earner	Legitimate direct selling	Small business	Classic no- product pyramid scheme	Gambling - roulette at Caesar's Palace in Las Vegas	Product- based pyramid schemes, or MLMs
Approx. % of participants who may have profited after expenses	100%	80%	39%	10%	2.9%	0.3%
Approx. % of participants who lost money after expenses	0	20%	61%	90%	97.1%	99.7%

NOTES - explaining each option:

Wage earners typically do not have out-of-pocket expenses that are not reimbursed by employer, so they typically do not lose money.

Legitimate direct selling (not MLM) profitability rates vary widely. Direct selling has largely been replaced by discount retail outlets and the Internet. However, some direct selling does occur, such as some insurance and investments. I spent many years in direct selling and would not consider a sales opportunity for which I could not sell 80% of pre-qualified prospects. In legitimate direct selling programs with which I have been familiar, salesmen are not required to buy the products or to pay for sales training. So they would only rarely lose money, except for unreimbursed travel, etc. (When I sold encyclopedias, I did not have to buy a set, and when I sold insurance, I did not have to buy what I sold. For this report, I am arbitrarily using what I consider a "safe" profitability figure of 80% for a trained salesman.

Small business failure rates are not as high as MLM promoters claim. A study by the NFIB (National

Federation of Independent Business), using U.S. census figures in 1999, found that approximately 39% of small businesses are profitable over the lifetime of the business.

Classic no-product pyramid schemes are usually 8-ball (or 1-2-4-8) schemes in which some participants recycle into new pyramids of participants repeatedly, while some drop out. Approximately 10% profit from the schemes, ranging from approximately 7%-13%, depending on whether or not they recycle into new pyramids.

Gambling - Odds cited are for a single bet on one number at the roulette wheel at Caesars Palace in Las Vegas (Statistics provided by Ceasar's Palace April, 2001)

Product-based pyramid schemes, or MLMs. The percentage of people who may have profited is so low (0.003, or 0.3%) that it does not show on the chart. For more information on the abysmal numbers for MLM participation, go to mlm-thetruth.com for statistical reports.

MLM as a business model is the epitome of an “unfair and deceptive act or practice” that the FTC is pledged to protect against. . .

Given MLMs’ abysmal numbers, for promoters to present MLM as a “business opportunity” or “income opportunity” is a misrepresentation. Some would say it is simple fraud.

FTC’s Business Opportunity Rule survey revealed self-deception is common in MLM

After the FTC issued its Business Opportunity Rule (BOR) in December of 2011, exempting MLM from compliance, a group of us consumer advocates requested identifying information for the 17,000 persons who filed comments, mostly objecting to including MLM in the Rule. All we had was names and states, and the FTC’s Freedom of Information Act office refused our request. So we selected a sample of very unusual names we could locate through a Yahoo People Search.

By telephone, we were able to reach 275 persons who had comments filed in their name. We found that most did not approve of the exemption for MLM – when its true purpose was explained to them. They had been misled to believe that the FTC wanted personal financial information and information of friends and family as references, which could violate personal privacy, etc.

Some had not submitted the comments seeking the MLM exemption and claimed they would never do so. Apparently, in these cases someone from the company submitted comments in their name without their approval. Pressured by their companies or upline, most simply forwarded comments written by the MLM company and added a few comments of their own.

We asked them if they were still active in their MLM and learned that most had been with the company for several years and appeared to be protecting their turf in seeking the exemption.

We then asked if they were profiting from their participation. Nearly all said “yes” and that they were reporting a profit on their taxes. When we asked if the MLM was their sole source of income, only eight of them answered “yes”. Then when we asked if they received from the company more in commissions than they paid to the company for products and services, most of them balked, said they didn’t know, or suggested “That’s pretty personal, don’t you think?” – or “I won’t disclose that information.”

It became apparent that most were not honest with themselves about the amount of money they were spending on products and services compared to what they were being paid by the company. They had deceived themselves into thinking that they were making money²²⁵ even when they were spending more than they were getting.

It was also disconcerting to hear their answers when we asked if they would have joined their MLM if they had known that 99% of participants lose money. Most said “yes” – for they knew people who were making money. I call this the “lottery mentality.” Though the odds are next to zero, some will still spend money betting on the extremely slim possibility of being a winner.

The “lottery mentality” – Though the odds are next to zero, some will still spend money betting on the extremely slim possibility of being a winner.

The critical need for adequate disclosure is herein underscored.

Persons who are considering buying into an MLM are surprised to learn that the numbers are so abysmal. A typical reaction is “I knew that few people make any money, but I had no idea MLM was *that* bad.” Even

²²⁵ Of course, this included personal consumption, but the products are typically far more expensive than comparable products from retail outlets. Many are “pay-to-play” purchases. (See Chapters 2 and 4.)

consumer advocates say that it is far worse than they imagined. And of course, those who have already invested money in MLM are sickened by the awareness of the scam they have fallen into, saying, “If I had only known.”

While the DSA/MLM lobby has mounted a fierce resistance to providing transparency in MLM reporting that could provide some protection for consumers, it should be clear from these studies that adequate disclosure is absolutely essential. The argument the FTC used for exempting MLM in its Revised Business Opportunity Rule was that it would be “too much of a burden” for participants to hand out a one-page document of disclosures to prospects. Apparently anticipating the outcry of consumer advocates, the FTC pledged to deal with MLM abuses by using Section 5 of the FTC Act. The problem is that the FTC admitted to prosecuting only 14 MLM companies in the preceding ten years. Since virtually all MLMs are violating Section 5, as clearly demonstrated here, this would require that the FTC increase its staff at least twenty-fold just to handle the MLMs just commencing, not to mention the hundreds that are still operating.

A rule requiring adequate disclosure may be the only cost effective way for the FTC to handle the hundreds of deceptive MLMs. This problem began when the FTC ruled that Amway was not a pyramid scheme in 1979, assuming compliance with some exculpatory “retail rules,” which have never been adequately enforced – and probably never could be. Besides, they only address behavior of participants, not underlying flaws in the business model – or the compensation plans which actually discourage a retail emphasis.

In one of my many comments to the FTC, I suggested a disclosure form that could be very helpful in making more transparent to consumers what the MLM opportunity is – or is not. For the form I proposed, see Appendix 7C. *Note that I was suggesting MLMs disclose more to prospects than was initially proposed with the Business Opportunity Rule – net payout to participants, after subtracting purchases from the company.*²²⁶

²²⁶ See my report titled – “REGULATORY CAPTURE: The FTC’s Flawed Business Opportunity Rule”

MLMs as “pay more” buyers’ clubs

Perhaps I am too harsh in my judgment of MLM as an unprofitable – even fraudulent – system. Actually, I could accept any MLM continuing to operate, so long as its promoters do not present it as an “income opportunity” or as a “business opportunity.” If they want to call it a “buyer’s club,” where participants are told they get to pay *more* for some good – and some questionable – products, and that they will likely lose money from participating, that would be fine with me.

MLM is likely one of the greatest consumer scams in history.

As an independent business analyst who is informed on the topic of consumer fraud, I found the total losses suffered by MLM participants to be staggering. This is demonstrated in Appendix 7D with simple calculations using statistics provided by the DSA. Based on this information, it is safe to say that since the 1979 FTC v. Amway decision, hundreds of millions of victims have lost hundreds of billions of dollars from MLM participation – making MLM likely one of the greatest – if not the greatest – consumer scam in history.

Hundreds of millions of victims have lost hundreds of billions of dollars from MLM participation – making MLM likely one of the greatest – if not the greatest – consumer scam in history.

Conclusions

This book presents the most thoroughly researched independent analysis ever done of the viability and profitability of MLM as a business model. It has been long overdue, as it is information that is vital for consumer awareness and for regulatory rule-making. This would have to include the FTC's Business Opportunity Rule, for which comments received from MLM spokesmen and participants (with the encouragement of MLM promoters) were full of the misrepresentations discussed in this book.

With every MLM, where such data was available, and after debunking the deceptions in their reporting, the loss rate was at least 99%, using liberal assumptions relating to retention and cost of participation. The average loss rate for the 50 reported here was 99.7%. And if you eliminate TOPPs (top-of-the-pyramid-promoters) from the calculation, the loss rate is closer to 99.9% for new recruits – with essentially zero chance of profiting.

I believe it is safe to assume that the hundreds of MLMs (with the four causative and defining characteristics in their compensation plan)²²⁷ that do not provide such data are not likely to be more profitable because if they were, at least some would have provided data for competitive advantage.

This means that at best less than one in 300 participants in all MLMs make a clear profit, and at least 99 out of 100 participants actually lose money! And a much smaller percentage realize the earnings held out as possible at opportunity meetings – which is usually those who joined very early in the chain of recruitment. Newer recruits are being sold a ticket for a flight that has already left the ground.

As indicated above, one can do much better at the gaming tables in Las Vegas. And a person need not risk his or her social capital – treasured relationships with friends and family one has spent a lifetime cultivating. (NOTE: I am NOT promoting gambling.)

The fundamental flaws discussed in this chapter and in Chapter 2 are confirmed with this analysis. At the very least, it is safe to

conclude that MLMs are not legitimate income opportunities, but are truly scams.

As a business model, MLM is likely the most successful con game of all time. The very people who are out recruiting are themselves victims until they run out of money and quit. And because victims seldom file complaints, law enforcement rarely acts. It is a vicious cycle: No complaints, no action by law enforcement. No action by law enforcement, no complaints. So the game goes on.

Referring back to the hypothesis at the end of Chapter 2, this data and the calculations performed on them provide conclusive evidence to confirm the hypothesis that MLM is a flawed business model and an unfair and deceptive business practice that is profitable for only a few at the top of the pyramids of participants at the expense of a revolving door of recruits at the bottom – who become its hapless victims.

Carrying this a step further, considering the abysmal odds of success in MLM, we could hypothesize that to cover this fact, MLM promoters engage in a plethora of deceptions to cover the reality of their flawed and fraudulent programs. This will be confirmed in Chapter 8: “A Litany of Misrepresentations.”

²²⁷ See analysis of causative and defining characteristics of product-based pyramid schemes in Chapter 2.

Appendix 7A: Methodology validated by financial experts

NOTE: The comments below apply to this book and to its precedent *The Case (for and) against Multi-level Marketing*, as the methodology and calculations are identical in both books.

The author, Dr. Jon Taylor, has a two-year MBA with two years of coursework in statistics, accounting, economics, finance, and analysis of business enterprises prior to his research training in his PhD program and his experience evaluating the research of others in administrative positions at two universities and in his consulting work. Plus – these analyses and calculations have been validated by independent experts in fields requiring much sophistication in statistics, finance, and accounting, as follows:

Validated by CPA & Certified Fraud Examiner²²⁸

The methodology used by Dr. Taylor to calculate profit and loss rates in multi-level marketing companies is sound. Sadly, calculations like this require estimates because MLMs refuse to release the data necessary to calculate these items. Dr. Taylor's estimates and assumptions are reasonable, and his calculations are conservative, likely underestimating the true failure rates of distributors.

- Tracy Coenen, CPA, CFE

Validated by statistician²²⁹

As a point of introduction, my name is Paul McKee and I have over 20 years of experience as an Applied Statistician and Manager as well as a degree in Statistics from Brigham Young University. I became aware of Dr. Taylor's work as a result of my wife being invited to a "Business Opportunity" meeting by a friend of hers. I looked into the name of the company that my wife was being introduced to and determined that it was a Multi-level Marketing (MLM) company. I had always been suspicious of their claims but had never done an in-depth analysis of any MLM. While I was researching this MLM, I became aware of Dr. Taylor's research and started reading information on his website.

²²⁸ "Calculating loss and failure rates in multi-level marketing schemes," article by Tracy Coenen, posted on May 11, 2012 in "The Fraud Files" at – <http://www.sequenceinc.com/fraudfiles/2011/05/12/calculating-loss-and-failure-rates-in-multi-level-marketing-schemes/>

²²⁹ Letter from Paul McKee to FTC dated January 13, 2011. Subject: "Validity of data represented in Chapter 7 of the text "A Case (for and) Against Multi-level Marketing"

I have read, studied most of his text and analyzed in detail the cases presented in Chapter 7 in the text *A Case (for and) Against Multi-level Marketing*²³⁰ by Jon M. Taylor. The primary case in this chapter details data noted in [Exhibit 7c]²³¹ "Average earnings statistics for Nu Skin Enterprises, Inc. – Extracted from Nu Skin's '2008 Distributor Compensation Summary'". After a detailed analysis I have found that the data that he has presented is statistically accurate, given the assumption that his base data is accurate from the source. He has made a number of assumptions that generally are favorable to the MLM but do describe what I would consider unreasonable odds of success. I base the reference of "Unreasonable Odds of Success" on the comparison of what was presented to my wife and also the independent research I completed on the internet from MLM company websites.

In my over 20 years of experience working in the largest and smallest corporations in America I have never seen a sales opportunity that was represented with such emotional and perceived potential but actually resulted in such abysmal results. In fact, Dr. Taylor demonstrates that recruits of MLM companies experience personal financial loss occurring in over 99% of the cases

- Paul McKee, Statistician

Validated by actuary²³²

I was introduced to MLM as a youth, as my parents were distributors with Amway. Though my parents failed to profit from this, I did not personally suffer from their misfortune. However, their experience left a distinct impression on me and ever since I have paid close attention to individuals who involve themselves in MLM. It has been over 25 years since my first exposure to MLM, but I have yet to know someone who has successfully built and sustained a profitable business in MLM. One could justify that as poor peer group selection on my part,

²³⁰ Now titled *Multi-level Marketing Unmasked*

²³¹ Exhibit 1 in early edition.

²³² Letter from John Ashby to FTC, dated January 18, 2011. Subject: "Multi-level Marketing (MLM)" Actuaries are highly qualified statisticians who calculate insurance risks and premiums for insurance companies. John Ashby is an actuary for an insurance company

but I find it statistically difficult to conclude that MLM is a viable industry, as very few, if any, actually profit.

Given my interest with MLM, I have found the research of Jon M. Taylor to be astounding. I have a background in statistics with a BS degree in mathematics from Utah State University and a fifteen year career as an actuary. I find Mr. Taylor's work to be supportable and credible. Mr. Taylor's work on MLM is extensive, but I base my conclusions on my personal review of Chapter 7 in Mr. Taylor's e-book *A Case (for and) Against Multi-level Marketing*.²³³ While I have not reviewed the basis for the assumptions made by Dr. Taylor (which seem to fairly represent the MLM) or the source data from his case study of Nu Skin, I have examined the calculations in [Exhibit 7c]²³⁴ of Chapter 7 – MLMs Abysmal Numbers. His calculations are materially correct and support his argument that over 99% of recruits to MLM companies will fail – compelling evidence, indeed.

– John Ashby, Actuary

Validated by Certified Financial Planner²³⁵

Please share these comments with any and all who may benefit.

I have spent the last 30 years actively involved in the insurance, investment, and general financial services industry. I have been involved as a supervisor, securities principal, and compliance officer. As such I have and still do find it amazing that having lived in such a compliance, and consumer protected industry, that the MLM industry has little or no regulations. If we were to try and market any of the MLM programs I am aware of to our clients we would immediately be fined and censured. In fact our Broker dealer forbids any registered representative from participating in any MLM activities.

I would strongly urge all of you to take a serious look at this industry and try and not be swayed by the hype, but look at the facts.

Dr. Taylor has done a suburb job of balanced research and reporting. If he had time I would encourage a comparison of the dollars lost in the MLM industry to the fraud we experience in the financial services world. My guess is that there would be found many multiples more lost in the MLM world than in our highly regulated financial services industry. It just does not get the press coverage.

– Calvin D. Welling, CLU, ChFC, CFP

Validated by Asset Valuation Expert²³⁶

My first introduction to MLM was as a young college student. I responded to an ad in the newspaper for a job opportunity but instead unintentionally attended a recruiting seminar. With no other exposure to MLM, I had two major concerns upon completion of the seminar:

First, why did the recruiter only briefly mention the product being sold and spent the vast majority of time talking about building a downline?

Second, I was told that all that success in MLM requires is the motivation to make a lot of money. This promise was intended as a sale pitch but came across to me as relieving the MLM of any responsibility if I failed – because if I did fail, I obviously did not want to make a lot of money.

My professional experience constitutes nearly ten years as an asset valuation expert. Professionally, I have provided valuation opinions for a multitude of assets including physical assets as well as income producing assets for financial transactions, risk management, underwriting, and expert witness court testimony. All valuation services I provide are as an impartial expert.

Under this same criteria, I have analyzed Dr. Taylor's research, most specifically in Chapter 7 of his book *A Case (for and) Against Multi-Level Marketing*.²³⁷ Essential to asset valuation is the proper accounting of income and expenses. In my opinion, Dr. Taylor reasonably accounts for anticipated expenses of participants. As a result, the analysis convincingly supports the conclusion that investing in the MLM programs analyzed is not likely financially feasible nor a viable investment opportunity because of the low probability of making a net profit. Under the assumption that the data used by Dr. Taylor is sound, I have no other option than to concur with Dr. Taylor that the basic MLM structure is flawed.

Additionally, given the risk of failure is disproportionately high relative to other direct selling opportunities, I can find no logical reason why any person would participate assuming full disclosure on an MLM programs part.

Unfortunately, full disclosure is not required. Therefore, in light of Dr. Taylor's research, I can only assume that MLM programs exist due to a participant being uninformed, unrealistic, unintelligent, or unethical. The reality is likely a combination of several, if not all.

– Andrew Schneider, Asset Evaluator

²³³ Op cit

²³⁴ Exhibit 1 in early edition.

²³⁵ Letter from Calvin D. Welling, CLU, ChFC, CFP, to FTC dated January 12, 2011. Subject: "MLM marketing practices"

²³⁶ Letter from Andrew Schneider, July 18, 2012

²³⁷ Op cit

Comments about my research from other professionals:

From a licensed private investigator:

You guys rock!!

I can't tell you how useful your site is. Thank you so much for proving that ethics, moral standards and common sense are not lost. I have a friend who gets involved with the newest MLM every time a recruiter asks him to come to a meeting. It has become such an issue that it has affected our friendship. I will refer to your website often to counter the nonsense and unethical behavior that traps people like my friend. I commend and thank you for your efforts in helping people who truly are victims of this economic cancer.

I am a local licensed private investigator that would love to help you in any way I can and if I have the time. (My time would be free of charge) Please let me know if there is anything I can do to help further your cause. I will do anything to help the public see these for what they are, because *in one way or another they affect all of us.*

—Jake Allred, Licensed Private Investigator

Analyst uses web site to debunk the deceptions in one MLM and in MLM as a business model.

Hi Jon –

I found your paper on the internet – the five red flags to identifying product based pyramid schemes. Very informative. I have some friends who are caught up in the Arbonne scheme.

It definitely meets the five red flags and as you said the compensation structure is the key. It has the emphasis on recruiting, you have to pay to play in personal retail volume, there are 6 levels of payout, and the “promotions” are based on recruiting rather than by appointment.

The products can supposedly be sold at retail for a higher consultant commission but this is unrealistic because everyone signs up as a non-active consultant for \$29 and can order over the internet at “wholesale”. If you want to be “active” you have to do \$100 per month retail volume (\$65 with consultant's discount) and at the bottom commission rung of 4% you have to sell to quite a number of customers to recoup your required minimums – so then the emphasis becomes on recruiting.

To jump to the 8% commission level a \$1,000 in personal retail investment is involved to qualify within a certain time frame – so they have the opportunity to stick you for this more than once because you buy kits to get started. They pay on 6 levels – they have a width/depth structure.

I forwarded my friends your paper and tried to get them to understand that what they are involved in is unethical at a minimum...but they just sent me back the published hype – all the typical things you referred to in your paper. I think one of these people got in early enough in the scheme that she may be making some money. *These [MLM] companies seem to prey on housewives who don't understand the basics of market supply and demand. They are so naïve that they cannot see the forest for the trees.*

Thank you,
Susan S, MBA

Susan wrote later:

Yes, it was an interesting learning experience for me. I had never been approached by something like this. I also didn't remember covering these schemes in any of my course work in my undergrad or MBA marketing classes.

It was the compensation structure that got me suspicious - when I realized that these minimum purchases were involved I started doing a little breakeven analysis and realized how much I'd have to sell at these low commission rates to just make back the money they have you spend as monthly minimums. It really does not become clear until you start to calculate how many people you have to sell to just to break even! Then it became clear to me that you had to recruit people to make any money. I thought this was very fishy – and so I jumped on the internet and found your article...and then it all really clicked in my brain.

– Susan S., MBA

To present MLM as an “income” or “business opportunity” is misleading.” However, it may be acceptable to sell it as a “buyer's club,” where participants get to pay more for some good – and some highly questionable – products.

Appendix 7C
A simple form that would disclose crucial information to prospects
Average payments to – and purchases from – all WealthPlus¹ participants
who had enrolled² within the past three years

[For footnotes, see “Explanatory Reference Notes for FTC Officials” on the following page.]

Total number of participants³ recruited during the three-year period of the report 100,000

Total of all purchases⁴ of products and services for the past year from WealthPlus by
(the same group of) participants who were enrolled and authorized to recruit \$60,170,000

Total payments in commissions to these participants for the past year \$24,300,000

Percentage of participant-generated revenue rebated to these participants (payout) 43.9%

Average purchases of products and services⁵ by these participants from WealthPlus \$601.70

Average commissions and bonuses paid by WealthPlus to each of these participants \$243.00

Average net payout to participants in this group of participants **(minus \$358.70)**

Percentage of participants who received more money from the company than they
paid to the company = 0.106% – which equates to 0.001, or about **one out of a thousand**

NOTE: Losses can be far greater when operating expenses (travel, Internet, etc.) are subtracted.

<u>Range of annual Commissions⁶ received by participants from WealthPlus</u>	<u>Average payments to participants at each level</u>	<u>Average purchases by participants from company for each level</u>	<u>Net average receipts/purchases from company for each participant*</u>	<u>Number of participants</u>	<u>% of total participants</u>
Over \$500,000	\$1,500,000	\$20,000	\$1,480,000	1	0.001%
\$250,000-\$499,999	\$700,000	\$18,000	\$682,000	5	0.005%
\$100,000-\$249,999	\$300,000	\$16,000	\$284,000	10	0.01%
\$50,000-\$99,999	\$70,000	\$14,000	\$56,000	50	0.05%
\$25,000-\$49,999	\$30,000	\$12,000	\$18,000	100	0.01%
\$10,000-\$24,999	\$12,000	\$10,000	\$2,000	300	0.03%
\$5,000-\$9,999	\$7,000	\$8,000	(\$1,000)	500	0.05%
\$1,000-\$4,999	\$1,000	\$2,500	(\$1,500)	2,000	2.0%
\$1-\$999	\$100	\$2,000	(\$1,900)	7,000	7.0%
Participants who made purchases but did not qualify for commissions ⁶	\$0	\$400	(\$400)	80,000	90%

Explanatory Reference Notes for FTC Officials:

¹ WealthPlus International, Inc. is merely a fictitious name used for illustrative purposes. Also, all of the numbers used in this chart are fictitious and for illustration only.

² Enrolled participants are persons who signed a contract allowing them to buy products at discounted or wholesale prices from the company and authorizing them to recruit other persons into the company, from which the enrolled participant could profit (in commissions, bonuses, etc.) from sales to said persons.

³ These statistics include ALL persons who contracted with the company as participants within the past three years (or other designated time period). This is to correct the typical deceptive reporting practice of MLM firms of counting only “active distributors” in the past year (or other limited time period). They eliminate the recruits that dropped out. Their base for comparison thus represents only a small slice of the total recruits. Note that while eliminating participants that contracted to join and then dropped out, this small base of participants is compared with participants who may have been with the company for five to twenty years at a certain level – often from the beginning of the chain of recruitment. The statistical results are extremely skewed, making the MLM “opportunity” appear to be profitable for more recruits than is actually the case. The above form would help correct these deceptions. Those that had been with the company for longer than three years would not be included in this disclosure.

⁴ This number must include ALL purchases from the company, including products, training, sales aids, telecommunications and other electronic aids, etc. This makes it possible for recruits to see if it is likely that more money will be received from the company than is paid to it. It also will help determine if the company is a legitimate business opportunity or merely uses the

“business opportunity” as a ruse to get participants to buy products – with few real customers outside the network of participants. NOTE: Because only participants recruited in the past three years are counted, the percentage payout is unusually low, even for an MLM. This is because the early entrants, who joined at or near the beginning of the recruitment chain and who are harvesting a disproportionate portion of the commissions, are not included in this figure.

⁵ Additional expenses would include any “sales tools” sold by upline participants – and normal operating expenses, such as travel and telephone and Internet costs

⁶ Instead of reporting income by designated payout levels (Blue Diamond, Diamond, Ruby, etc.) these dollar categories make possible comparisons between MLM companies and make transparent the income distribution that hitherto has been obfuscated by complex compensation plans that are difficult to compare. Note that the breakdown of payments includes some very high income levels. This is to validate the claims of some MLM promoters of huge incomes.

⁷ Listing persons who bought products but got no payout from the company makes transparent the persons who did not “qualify” for commissions due to failure to buy (sell) a minimum number of products in order to qualify for commissions or to advance in the scheme.

NOTE ON SIMPLICITY AND PRIVACY –

Companies today use computers that would make the processing of this information fast and relatively simple. It would not be a burden for them and none to individual participants. And no person would need to have his/her information associated with his/her name, so privacy should be of no concern.

Appendix 7D

Losses suffered by MLM victims in the USA and worldwide make MLM likely the greatest consumer scam in history.

When you look at the aggregate losses suffered by MLM victims since the 1979 Amway decision, the amounts are staggering. For these statistics, we are indebted to the Direct Selling Association, which provides estimates of MLM activity. While the DSA has rebranded MLM as form as a form of “direct selling,” it does acknowledge a difference between single level pay plans and multi-level plans, And though DSA statistics are slanted towards their industry, we will use at least some of their estimates in our calculations of MLM activity in the U.S. and abroad.

Total number of MLM victims:

On a DSA-sponsored website²⁴¹ providing information about the direct selling industry, the DSA claims that there are currently 15.8 million direct sellers in the USA. The DSA estimates that its 250 members account for about 90% of direct selling in the USA, which would suggest that their statistics would be fairly useful in estimating direct selling activity.. The DSA also indicates that 94.2% of their members use an MLM model. So according to DSA statistics, the number of MLM distributors (a.k.a., associates, agents, representatives, etc.) can be calculated as follows:

15.8 million direct sellers
X 0.942 = (approximately) 14.9 million MLM distributors.in the U.S.

As was demonstrated in this chapter, approximately 99.7% of MLM participants lose money – or 99.9% if TOPPs, (for top-of-the-pyramid promoters who get most of the commissions) are left out of the calculations of average incomes. **So the chance of new recruits profiting is approximately ZERO.** Since MLM promoters present their programs as profitable income opportunities, they are deceiving new recruits, who are almost

certain to lose money; i.e., to spend more for products and services (and other business expenses) than they receive in commissions. Approximately 99.7% of participants can thus be considered victims. Therefore –

14.9 million X 0.997 = **14.86 million MLM victims per year**

The DSA estimates there are over 74 million “direct sellers worldwide, which would suggest that **tens of millions of victims overseas suffer losses every year.**

Total aggregate losses from MLM participation:

From the same web site, we are informed that total sales in 2010 totaled \$28.56 billion. They further estimate that 97.1% of that (at least among their members) is sold through MLM. Therefore –

\$28.56 billion X 0.971 = **\$27.73 billion aggregate sales through MLM per year**

The DSA also estimates that annual direct sales worldwide exceed \$117 billion!

Based on MLMs typical misrepresentations and loss rates²⁴² and on DSA statistics, we can conclude that *tens of millions of MLM victims lose tens of billions of dollars every year.* And since the flawed 1979 Amway decision, it is likely that *hundreds of millions of victims of MLM fraud have suffered hundreds of billions of dollars in aggregate total losses. This makes MLM likely one of the greatest consumer scams in history!*

²⁴¹ www.directselling411.com, accessed December 7,2012

²⁴² See Chapter 8: “MLM: a Litany of Deceptions” and Chapter 7: “MLM’s Abysmal Numbers.”

APPENDIX 7E: Network Marketing Payout Distribution Study – Letter to Presidents of 60 Prominent MLM* Companies – which yielded no positive responses

May 13, 1999

ATTN: _____, President
Company name & address

Dear Mr./Ms. _____:

For the past two years I have researched the field of network marketing (a.k.a. multi-level marketing or “MLM”²⁴³) and have interviewed hundreds of people who had been involved in a wide variety of programs. My research, while initially positive, uncovered more and more very unsettling problems with MLM.

When speaking on the subject of MLM to local groups I have received much feedback from participants and critics of MLM. One tax accountant who was a principal of H&R Block in northern Utah stated that over the years he and his staff had prepared thousands of tax returns, and of the several hundred of these who he knew had been involved in MLM, he could remember only one who had ever reported a net profit on his return.

Though I already knew that the actual success stories were far less than one would be led to believe from attending a typical MLM opportunity meeting, this tax man’s report was shocking to those of us who heard it. So I called tax accountants and preparers in other areas to see if their experience was the same. Each of them claimed similar experiences with their clients over the years. Others who work with peoples’ money, such as certified financial planners, insurance underwriters, and bankers, have relayed similar feedback.

I will soon be publishing this information for the benefit of consumers, educators, legislators, and regulatory agencies who have an interest in this topic. The page that follows presents the essence of my conclusions, which unfortunately are not favorable for the MLM industry. So I felt it only fair to allow for rebuttal from you and others who may have an interest in seeing a balanced treatment of the subject. So I am offering you that opportunity and the format for doing so.

Your assistance in gathering objective information will be greatly appreciated. I am not interested in anecdotal material, which may be no more valid than stories of persons who won a lottery or a sweepstakes. And vigorous arguments to the contrary will not help – I believe I’ve heard them all. What will carry weight is data which breaks down the distribution of payouts to your distributors, extracted from your data base of distributors. The information you provide must be verifiable by independent audit, as consumer protection agencies and legislators may choose to validate this material. Following this letter are instructions for providing the information.

You should be able to access this information readily from your database. However, if you prefer not to provide this information because it won’t reflect well on your program, I can certainly understand your reluctance. But such refusal will be interpreted to be an answer in itself. I shall be looking forward to your response.

Appreciatively,

Jon M. Taylor, Ph.D., President
Consumer Awareness Institute

²⁴³ Originally, “NWM” (for network marketing) was used in the letters, instead of “MLM” (rev. 6-30-06)

Letter to MLM Presidents, page 2

Network marketing has wide appeal.

Network marketing (aka “multi-level marketing,” or “MLM” for short) offers the opportunity for an individual to conduct a business without having to bother with expensive resources such as physical plant or retail storefront, warehousing, employees, advertising, or other costs typically associated with running a business.

MLM promoters claim that with MLM, large (leveraged) incomes can be produced by recruiting a downline (network) of multiple layers of distributors upon which a distributor can draw commissions and bonuses, the amount depending on the type of compensation plan and the size and character of one’s “downline.” Such an organization can be built from one’s own home without the expenses and complications typically associated with other types of businesses.

MLM promoters claim that MLM offers not only financial independence with minimal investment, but a level playing field in which anyone can participate, regardless of sex, age, education, or financial resources. Other advantages include the social benefits and recognition of building one’s own organization and the backing of a MLM company that provides the products and infrastructure necessary for success.

Network marketing poses problems for most participants, resulting from pyramidal concept, motivation, and effects.

When the Federal Trade Commission ruled in 1979 that Amway was not an illegal pyramid scheme—mainly because legitimate products were offered, the floodgates were opened and multi-level marketing programs began to proliferate. But what is often ignored is the fact that MLM programs are still pyramid schemes, modified by a variety of compensation systems that change the character of the pyramid, but **not the essential pyramidal concept, motivation, and effects.**

The pyramid concept in MLM is seen in multiple layers of distributors, with lower level distributors contributing income to an “upline” who may have little to do with a given sale. This is distinguished from the typical retail scenario in which a retailer may get two or three times the return per sale as the wholesaler, whereas with MLM the upline distributor may get as much or more of a return per sale (in commissions and bonuses paid by the company) as the front line distributor who actually sells the product.

Because MLM compensation systems reward front line distributors only a small commission (usually less than 10% - not counting assumed resale of expensive products at retail markup) for selling products, recruiting to gain income from downline distributors is vital to earning a significant income. This is distinguished from other direct sales programs, in which the person selling and servicing the product typically is paid commissions from the company of from 20% to 50% of the sale – enough incentive to concentrate on the end user as a valued customer.

The motivation of most MLM is the opportunity to make large amounts of income for a minimal investment of time and money. One of the primary appeals of MLM is the concept (touted at MLM opportunity meetings) of “time freedom” or “leveraged income,” which allows a person to gain an income flow from the efforts of others without having to work directly for one’s own income. But because of MLM compensation systems, this requires success at recruiting a downline, more than on selling the products directly.

Critics complain that many MLM distributors place too much emphasis on the “opportunity” as opposed to the product, thus blurring the distinction between the product and the opportunity. As I mentioned, this can be accounted for by the reward structure of MLM compensation systems, which benefits primarily top upline distributors – who may receive extremely large commissions from their aggregate downline. An inordinate appeal to greed often becomes the primary motivation.

A most troubling aspect of MLM is its effects on people. Because the compensation plans are heavily weighted to reward upline distributors for their recruitment efforts and because of the pyramidal nature of these systems, extraordinary income differentials are created between upline and downline distributors. In fact, after deducting expenses for building and maintaining a network, only a tiny fraction of MLM distributors ever report a positive income on their income taxes.

Letter to MLM Presidents, page 3

And if products purchased from the company (that likely would not have been purchased were they not participants in the program) are subtracted, far less than one out of 100 distributors earns more than a minimum wage for their efforts. A high percentage of distributors lose money – much higher than most other legitimate business and income pursuits.

Careful examination of most MLM programs reveals a pattern of exorbitant incomes accruing to relatively few top distributors at the expense of hundreds and even thousands of downline distributors who – even with diligent effort – come away empty-handed. In this respect MLM is akin to illegal (no-product) pyramid schemes.

It is interesting to compare the odds of success of MLM schemes with legalized gambling in Nevada. It appears that on average one could do better at most any of the gaming tables or slot machines in Las Vegas – without investing all that time and placing valued relationships at risk.

Some zealous MLM distributors will mortgage their homes or max out their credit cards (buying MLM products and other expenses) to finance their ambition to achieve top levels in their organization—which is seldom achieved. Others focus so much on recruiting to meet escalating volume requirements for higher distributor levels that they ignore the needs of spouse and family members.

Sometimes the recruiting practices of MLM distributors are deceptive and overbearing. Often MLM distributors will alienate friends and family members they endeavor to recruit for what seems to them a self-centered pursuit of a vaporous dream.

Summary and invitation for rebuttal

In summary, with network marketing, what appears on the surface to be a fair and enabling marketing system for participants is in reality a pyramid scheme with characteristics of concept, motivation, and effects similar to those of clearly illegal no-product pyramid schemes.

You are invited to prove me wrong—at least for your company. This can best be done by providing full disclosure on payout distribution to your distributors on the attached form. For the purposes of this study, this information must be broken down by percentiles, not by distributor level.

Please note that I am not asking you to reveal sensitive information, such as individual distributor incomes or even your annual profits, which you may wish to keep confidential. It is average payout to distributors by percentiles (as indicated on the attached form) that will satisfy the objectives of this study for the benefit of consumers.

Please also note that I am offering two options for your response – an easy one (Option A) and a more comprehensive one (Option B). It is assumed that Option A could be completed quickly and easily from your existing accounting system. **Option B requires a more extensive breakdown, but would offer to those interested more conclusive evidence that your company does or does not base its compensation to distributors on a pyramidal structure, as discussed above. For the purposes of this study, Option B would be much preferred, if you can return such data to us within a month or so.**

We are not making any assumptions about how much effort was put into any given MLM program or compensation system, as it relates to success of failure of any specific distributor or program. So it is important that all participants in your MLM program for the year be included, even those who only bought a distributor starter kit or set of samples—whether or not they have done anything with it.

Please mail completed form to:

Network Marketing Payout Distribution Study
Consumer Awareness Institute
(Address withheld in this report)

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**OPTION A: Distribution of Payout to Distributors for the Most Recent Fiscal Year
Beginning _____ and Ending _____**

Company name _____ Address _____

City, state, zip _____ Contact person _____ Tel. no. (____) _____

Please check () one:

- ___ a. We are willing to provide the information below and have it made available to the public.
- ___ b. We are providing the information below with the understanding that it may be used for compiling industry statistics but not identified with our company in published reports.
- ___ c. We are not willing to provide the information requested. We realize that in refusing to do so we may be tacitly conceding the conclusions drawn in the preliminary two-page report, entitled, "Network Marketing Payout Distribution Study."

If you are interested in receiving information on the completed report when it is done, please check here _____
(This research report is to be sold for a reasonable price—yet to be determined—to recover costs.)

Important instructions: For purposes of analysis, distributors are to be broken down by distributor payout percentiles, not company-established distributor levels. Also, it is important that every person who has enrolled as a distributor (i.e., purchased starter kit or samples, or signed a distributor agreement) be included in these statistics, including those who have not sold anything or quit, even after one day.

Percentile break-down in payouts to distributors (by percentile, <u>not</u> distributor level)	Total number of <u>all</u> of your distributors at this payout level	Average total company payout per distributor (all commissions <u>and</u> bonuses paid by the company, but <u>excluding</u> retail margins)	Less: average total dollar amount per distributor of purchases of goods and services from your company	Average net payout* per distributor – deduct total products & services distributors purchased from your company, from total commissions you paid them
Top 1/10 of the top 1% of distributors	_____	\$ _____	\$ _____	\$ _____
Bottom 9/10 of the top 1% of distributors	_____	\$ _____	\$ _____	\$ _____
Next 9/10 of the top 10% of distributors (the 2nd to the 10th percentiles)	_____	\$ _____	\$ _____	\$ _____
Bottom 90% of distributors	_____	\$ _____	\$ _____	\$ _____
	(Total 100%)			

*It is recognized that net income reported here does not take into account operating costs to distributors for conducting their MLM business. Such costs may include, travel, postage and shipping, long distance and other telephone costs, advertising, rental of meeting rooms and/or office space, fees for company conferences or retreats, supplies, sales materials, and other expenses.

THANK YOU FOR YOUR HELP!

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Letter to Presidents of 60 Prominent MLMs, page 5

**OPTION B: Distribution of Payout to Distributors for the Most Recent Fiscal Year
Beginning _____ and Ending _____**

Company name _____ Address _____

City, state, zip _____ Contact person _____ Tel. no. (____) _____

Please check () one:

- ____a. We are willing to provide the information below and have it made available to the public.
- ____b. We are providing the information below with the understanding that it may be used for compiling industry statistics but not identified with our company in published reports.
- ____c. We are not willing to provide the information requested. We realize that in refusing to do so we may be tacitly conceding the conclusions drawn in the preliminary two-page report, entitled, "Network Marketing Payout Distribution Study."

If you are interested in receiving information on the completed report when it is done, please check here _____
(This research report is to be sold for a reasonable price—yet to be determined—to recover costs.)

Important instructions: For purposes of analysis, distributors are to be broken down by distributor payout percentiles, not company-established distributor levels. Also, it is important that every person who has enrolled as a distributor (i.e., purchased starter kit or samples, or signed a distributor agreement) be included in these statistics, including those who have not sold anything or quit, even after one day.

Percentile break-down in payouts to distributors (by percentile, <u>not</u> distributor level)	Total no. of <u>all</u> of your distributors at this payout level	Aver. total company payout per distrib. of all commissions and bonuses paid by the company – <u>excluding</u> retail margins)	Less: average total dollar amount per distributor of purchases of goods and services from <u>your</u> company	Average net payout* per distributor – deduct total products & services distributors purchased from your company, from total commissions you paid them
Top 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Second 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Third 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Fourth 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Fifth 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Sixth 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Seventh 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Eighth 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Ninth 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Bottom 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____

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After breaking down average payout per distributor for the top 1% by tenths of a percent, please break down the next 10% by whole percentiles:

Percentile break-down in payouts to distributors (by percentile, <u>not distributor level</u>)	Total no. of <u>all</u> of your distributors at this payout level	Aver. total company payout per distributor all commissions <u>and bonuses</u> paid by the company <u>-excluding retail margins</u>	Less: average total dollar amount per distributor of purchases of goods and services from <u>your company</u>	Average net payout* per distributor – deduct total products & services distributors purchased from your company, from total commissions <u>you paid them</u>
Second 1%	_____	\$ _____	\$ _____	\$ _____
Fourth 1%	_____	\$ _____	\$ _____	\$ _____
Fifth 1%	_____	\$ _____	\$ _____	\$ _____
Sixth 1%	_____	\$ _____	\$ _____	\$ _____
Seventh 1%	_____	\$ _____	\$ _____	\$ _____
Eighth 1%	_____	\$ _____	\$ _____	\$ _____
Ninth 1%	_____	\$ _____	\$ _____	\$ _____
Tenth 1%	_____	\$ _____	\$ _____	\$ _____

After breaking down average payout per distributor for the top 10% by whole percentiles, please break down the next 90% in groups of 10% each:

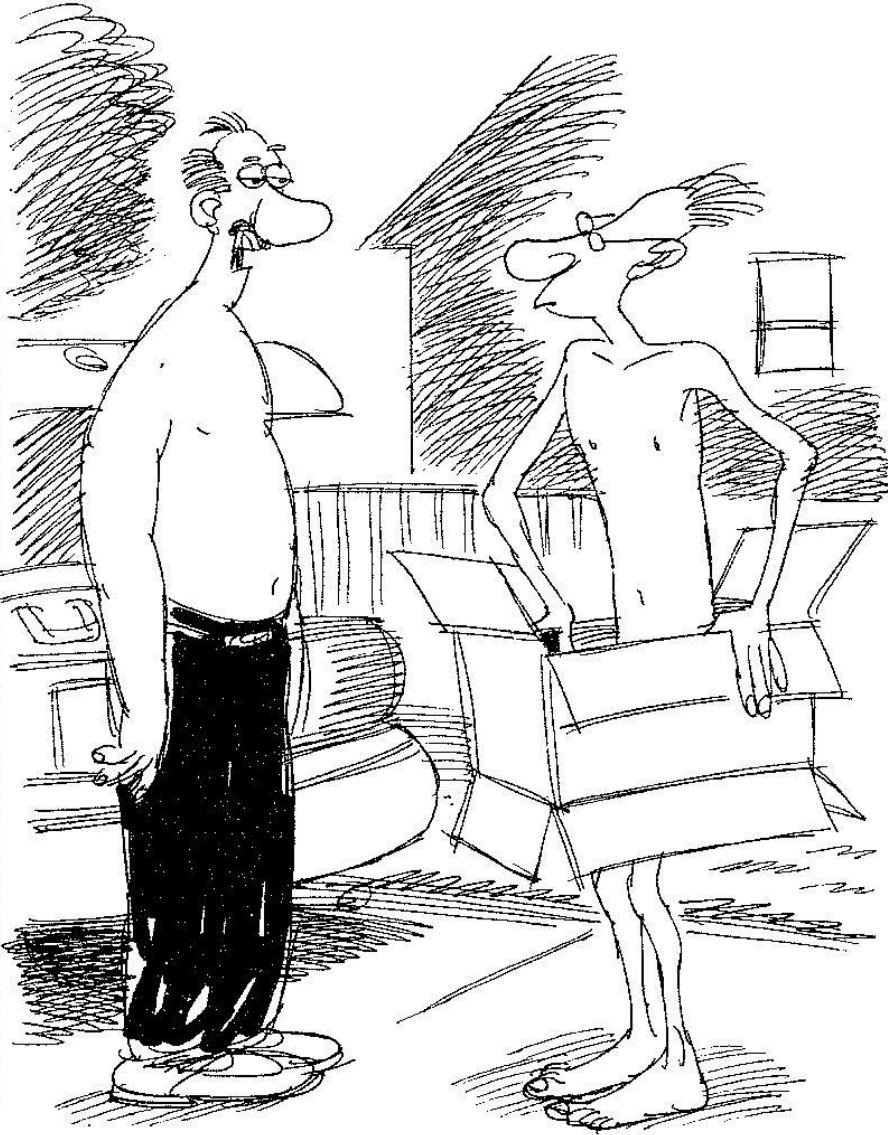
Second 10%	_____	\$ _____	\$ _____	\$ _____
Third 10%	_____	\$ _____	\$ _____	\$ _____
Fourth 10%	_____	\$ _____	\$ _____	\$ _____
Fifth 10%	_____	\$ _____	\$ _____	\$ _____
Sixth 10%	_____	\$ _____	\$ _____	\$ _____
Seventh 10%	_____	\$ _____	\$ _____	\$ _____
Eighth 10%	_____	\$ _____	\$ _____	\$ _____
Ninth 10%	_____	\$ _____	\$ _____	\$ _____
Bottom 10%	_____	\$ _____	\$ _____	\$ _____

(Total 100%)

*It is recognized that net income reported here does not take into account costs to distributors for conducting their MLM business. Such costs may include, travel, postage and shipping, long distance and other telephone costs, advertising, rental of meeting rooms and/or office space, fees for company conferences or retreats, supplies, sales materials, and other expenses.

THANK YOU FOR YOUR HELP!

Cartoon by Cal Grondahl. From the book THE NETWORK MARKETING GAME. ©1997 by Jon M. Taylor.



" I went to Las Vegas and lost my shirt.
How's your Multi-level Marketing going? "

Chapter 8: MLM – A LITANY OF MISREPRESENTATIONS

**Are MLMs fair and honest – or unfair and deceptive?
In this chapter, we find MLM to be a composite lie, made up of
a whole litany of misrepresentations.**

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In a 1974 ruling, the FTC found in the very structure of “multi-leveling” or “pyramid selling” [now called multi-level or network marketing, or MLM] “an intolerable capacity to mislead.” This chapter proves it.

Introduction and summary

FTC officials warned that “multi-leveling” poses “an intolerable capacity to mislead.” MLM is the direct descendent of classic, no-product pyramid schemes. With expansive pay plans and a whole network of endless chains of recruitment, MLM assume an infinite market, which does not exist in the real world. They also assume virgin markets, which don’t exist for long – which means they either collapse or re-pyramid into new markets. MLM is therefore inherently flawed, deceptive, and profitable primarily for those at or near the top of their respective pyramids – who are usually the first ones in.

As powerfully demonstrated in Appendix 8A, in all of the MLMs for which average income data was presented in Chapter 7, the “income opportunity” is blatantly misrepresented to prospects. And as reported in Appendix 8B, deception is the name of the game in MLM, as at least 111 misrepresentations used to promote and defend MLM are presented and debunked.

In fact, in a 1974 ruling, *the FTC found in the very structure of “multi-leveling” or “pyramid selling” (now called multi-level marketing, or MLM) “an intolerable capacity to mislead.”*²⁴⁴ As you will see from reading

²⁴⁴ Holiday Magic, Inc., Docket No. 8834, slip op. pp. 11-14 [84 F.T.C. 748 at pp. 1036-1039] (Oct. 15, 1974); Ger-Ro-Mar, Inc., Docket No. 8872, slip op. pp. 8-12

this and the other chapters, this statement has proven to be very prophetic. Unfortunately, the FTC backed off from that finding in its 1979 Amway case, which opened a Pandora's box of pyramid selling. In fact, about 40 years' experience has proven the 1974 ruling to be correct.

Unfortunately, the FTC backed off from that finding in its 1979 Amway case, which opened a Pandora's box of pyramid selling. In fact, over 40 years' experience has proven the 1974 ruling to be correct. As a researcher of business opportunities for over 40 years myself, I find it inconceivable that there could exist any income or business opportunity that is more deceptive than MLM.

However, it is my observation that both MLM officials and TOPPs (top-of-the-pyramid promoters) do not engage in theft by deception deliberately. They are victims of their own self-deception and must of necessity justify their flawed programs.

It is not only spokespersons for the MLM firms that concoct and spread clever rationale for their fundamentally flawed and deceptive programs. Spokespersons for the DSA, their chief lobbying organization, are under enormous pressure to create arguments justifying their members' programs. They even have a "Code of Ethics" which supposedly prevents the worst abuses. However, the rules have gaping holes in them, and most MLMs manage to circumvent these rules.

MLMs routinely misrepresent potential earnings

I have analyzed the compensation plans of over 600 MLMs, using the four (and usually five) causative and defining characteristics of recruitment-driven MLMs, or product-based pyramid schemes. For every MLM examined so far (100% of them), I have found them to be recruitment-driven and top-weighted. This means that income is derived primarily from building a large downline, not from retailing products to consumers. Also, most of the commissions and bonuses paid by the

company to participants go to a relatively small number at the top of the pyramid of participants. As such, they are extremely unfair and deceptive.

Also, in all (100%) of the MLMs for which I was able to obtain average earnings data, the loss rate was abysmal, with an average of 99.7% of all participants losing money (using liberal assumptions in their favor), after subtracting "pay-to-play" purchases and minimum operating expenses. And the loss rate is even worse for new recruits.

These MLMs are listed in Appendix 8A, along with typical earnings misrepresentations. The loss rates for these MLMs, as I calculated them, are included in Exhibit 7d of Chapter 7.

Deceptions by the DSA

It is not just individual MLM promoters that misrepresent the MLM "opportunity" it is an industry-wide practice. Recently, on the web site "Direct Selling 411," a representative of the Direct Selling Association (DSA), the lobbying organization for the MLM industry, published an article entitled "Top 10 Myths & Facts About Direct Selling,"²⁴⁵ in which she supposedly states facts to counter what she claimed were ten myths a few of us consumer advocates have communicated over the web. Here is just a sampling of the counter arguments she gave to some of these "myths," together with my brief response (**JMT**) to each:

MYTH #1 (per DSA): 99.9% of direct sellers lose money; people are afraid to drop out for fear of looking like a failure.

FACT (per DSA): More than half of direct sellers report that their net income from direct selling, after taxes and expenses, is positive. In addition, a positive net income is reported by nearly half of new direct sellers - those representing their current company for less than a year - and by nearly half of direct sellers who say that they are not very likely or not at all likely to continue in direct selling in the future.

[84 F.T.C. 95, at pp. 145-149] (July 23, 1974), rev'd in part 518 F.2d 33 (2d Cir. 1975).

²⁴⁵ The web site was registered by Amy Robinson of the Direct Selling Association and is posted at the following web address:
<http://www.directselling411.com/for-sellers/myths-facts/>

JMT: She follows this with research²⁴⁶ showing high rates of satisfaction for direct sellers. Note that the researchers fail to separate MLM from legitimate direct selling, but lumps them all together. This makes MLM look better than it is. She continues:

This myth is also quite interesting because it essentially asserts that 15.2 million people in the US and 60 million people around the world continue as direct sellers despite losing money. Are we to believe the 5% of the US population would continue in a business where they are losing money? Simply put, most people do not lose money in direct selling.”

JMT: Anyone who reads Chapter 7 of this book or the report by Robert FitzPatrick²⁴⁷ will see how blatantly false is this last statement.

MYTH #2 (per DSA): Most direct selling companies are pyramid schemes that are doomed to fail.

FACT (per DSA): There's a big difference between legitimate direct selling companies and pyramid schemes. Pyramid schemes seek to make money from you (and quickly). Legitimate direct selling companies seek to make money with you as you build your business (and theirs) by selling real products and services. In fact, legitimate direct selling companies work hard to protect consumers from pyramid schemes.

JMT: She then touts the DSA Code of Ethics and suggests questions a person should ask before joining a program. She presents some good ideas that have merit, such as avoiding large startup costs in the beginning I applaud her for this. However, she does not address the usual MLM practice of bleeding people slowly with product subscriptions, web services, etc.

And the “big difference between legitimate direct selling companies and pyramid schemes.” Oh please. The implication here is that MLM is the same as legitimate direct selling. Anyone who reads Chapter 2 of this book will see that while this statement may be true for legitimate direct selling, MLM is a different animal. Rigorous comparative research on 600 MLMs shows that MLM and pyramid schemes represent a

distinction without a difference – except that in MLM, products are offered. This does not mitigate the harm. Our research shows MLMs are the most harmful of the two classes of pyramid schemes (product and no-product), by any measure – loss rate, aggregate losses, number of victims, etc.

MYTH #3 (per DSA): Recruiting is the key to success in direct selling; sales to end-users of the products and services are minimal

FACT (per DSA): There's no doubt – recruiting is an important element of direct selling – just as expansion is important to any business that wants to grow. For direct sellers looking to build a business, recruiting others and mentoring them so they, too, can achieve their goals is important. But, recruiting is not a requirement for individual success in direct selling, and compensation must always be based on the sale of products and services – whether your own sales or the sales made by your recruits.

JMT: Read Chapters 2 and 5. The author has apparently not studied very many MLM compensation plans to see where the primary rewards are focused – on recruiting a huge downline or on retailing products. As psychologists learned decades ago, *you get the behavior you reward*.

MYTH #4 (per DSA): The vast majority of new recruits quickly drop out.

FACT (per DSA): Nearly four in five (78%) direct sellers who are in direct selling for less than a year report that they are very or extremely likely to continue as a direct seller in the future. In addition, in a survey of former direct sellers, only 34% of them had a tenure in direct selling of less than one year at the time they dropped out from direct selling.

JMT: MLMs scrupulously avoid publishing total attrition or retention rates. And again, the DSA fails to separate MLM from legitimate direct selling. Read Chapter 6 for a far more accurate picture on attrition rates than that presented by the DSA.

MYTH #5 (per DSA): Direct selling is an outdated method of buying and selling.

FACT (per DSA): More and more people are getting involved in direct selling because they enjoy the personal service that accompanies shopping this way. In fact, direct sales have increased 79% in just over a decade from \$17.94 billion in 1995 to \$32.18 billion in 2006.

²⁴⁶ 2002 National Salesforce Survey, Research International, Inc.)

²⁴⁷ “The Myth of ‘Income Opportunity’ in Multi-level Marketing,” by Robert FitzPatrick Go to web site – pyramidsschemealert.org

JMT: Read Chapters 2 and 7, as well as this one. These sales figures the DSA brag about represent losses for the vast majority of MLM participants. These are numbers that should cause the DSA to hang their heads in shame because, at least for MLMs, such sales represent losses for participants who were deceived into thinking they were buying a “business opportunity.” The ones who benefit are founders, executives, and TOPPs (top-of-the-pyramid promoters). From their own reports, after subtracting expense (especially “pay to play” purchases), we learn that 99% of all MLM participants lose money.

MYTH #6 (per DSA): Direct selling products are overpriced

FACT (per DSA): The consumer market won't sustain products that are overpriced for long. Competition is a powerful force and products that aren't competitively priced won't sell and can't last.

But for direct selling, there's a bit more to the price equation than might immediately meet the eye. The decision to sell a product through direct selling is often based on very specific factors. For example, products that require demonstration to convey the finer points of their operation are ideal for direct selling because a knowledgeable salesperson can personally conduct that demonstration for every customer. In a traditional retail setting, consumers might not understand the product's unique qualities based on appearance or packaging. It's true that some direct selling products are priced at the upper end of the retail market's acceptance level, but there is higher acceptance based on the value-added incentive of the demonstration and personal service. Lexus brand cars are also at the upper end of the retail market acceptance level, but superior performance and service after the sale make that higher price reasonable. Each customer needs to weigh the price, quality and desirability of a given product and make a purchasing decision accordingly.

JMT: There is some merit to these arguments. But \$88 (including shipping) for a month's supply of vitamins for one person - or \$320 for a family of four? A bottle of fruit juice for \$50, and a case for \$300? And a set of cookware priced from \$4,000 to \$10,000? Come on. Please read Chapter 4.

Without quoting the DSA's rationalizations, I will just make brief comments on the rest of the “myths the DSA spokesperson presents:

MYTH #7 (per DSA): Direct selling companies are unregulated

JMT: MLMs are technically violating both federal and state laws and rules, such as against unfair and deceptive practices. But because of lack of resources and political influence of DSA/MLM lobbyists, the laws are seldom enforced.²⁴⁸

MYTH #8 (per DSA): Most companies require inventory purchasers; direct sellers who drop out are stuck with the inventory they purchased.

JMT: While they may not require inventory purchases, the “pay to play” requirements to qualify for commissions and for rank advancement are often steep, and participants soon discover that it is easier to buy than to sell. They may stockpile products, give them away as samples, or buy in the names of family or friends in order to maintain qualification.

MYTH #9 (per DSA): If you attend a direct selling party you are expected to buy something

JMT: Attendees may not be expected to buy something, but party sponsors are powerfully incentivized in the compensation plan to do so.

MYTH #10 (per DSA): Everyone who gets involved in direct selling wants an easy way to make money

JMT: This is the way MLM is often sold, and it is a major misrepresentation.

In this chapter the reader will find a list of at least 111 misrepresentations typically used in MLM recruitment campaigns, paired with my debunking of each of these deceptive claims. These deceptions are also used to persuade some participants to continue spending on a program that can become a major money trap for them.

As many as 111 typical misrepresentations are used in MLM recruitment campaigns.

All of the MLM compensation plans I have analyzed are recruitment-driven and top-weighted. In order for them to appeal to prospects, a litany of misrepresentations

²⁴⁸ See Chapters 10 and 11.

(including the income misrepresentations in Appendix 8A) is used to get people to sign up – and to defend them against critics. So I would have to say that MLMs are also deception-dependent. This is because if prospects were clearly told the truth about them, few if any would sign up.

Appendix 8B Includes ten categories of the typical misrepresentations (including those related to income) used to lure new recruits into joining and continuing to invest in an MLM – and to dupe regulators into accepting their abuses.²⁴⁹ Included are some I have personally observed, some that have been reported to me, and some that have appeared on websites or publications of the MLMs. Surely there are dozens more.

After examining these, one might be tempted to label MLM as “theft by deception.” However, my observation of MLM leaders and spokesmen is that MLM promoters don’t deliberately go about seeking ways to deceive people. Instead, a lot of self-deception exists among these people, many sincerely believing the falsehoods they are spreading. There seems to be cult-like twisting of truths to fit any situation and an eagerness to share the latest justifications for the most outrageous claims, especially those related to income potential.

In other words, it is not the people or the products that are the problem, but the underlying system. It bears repeating that all MLMs are built on unlimited recruitment of a network of endless chains of participants. Such a fundamentally flawed system is extremely unfair – profitable primarily for founders, TOPPs (top-of-the-pyramid promoters, and those who enter the chain of recruitment near the beginning – all at the expense of a revolving door of new recruits, who become its victims.

The alternate world of MLM

When a person enters an MLM program, he or she enters an alternate world of marketing, in which one must exit the normal world of legitimate business

²⁴⁹ Primary source materials for this list are listed at the end of the chapter.

practices.²⁵⁰ Again, one must suspend the realities of supply and demand and assume an infinite market, which does not exist in the real world. They also assume virgin markets, which don’t exist for long – which means they either collapse or re-pyramid into new markets. With MLMs unlimited recruitment of a whole network of endless chains of recruiters, markets soon become saturated, so that in order to succeed, participants must join a chorus of deceit to convince prospects to believe otherwise. In the MLM industry, laws of supply and demand are ignored, and unfair and deceptive practices are the norm.

To be successful in MLM, one must not only work hard, but one must also –

- 1. Be deceived*
- 2. Maintain a high level of self-deception*
- 3. Go about deceiving others*
- 4. Maintain denial of the harm done to those recruited into the pyramid of participants.*

Warning to readers

If you are investigating MLM, and you read this chapter – including both appendixes – with an open mind, you are not likely to be able to look at MLM as a credible class of business opportunities. At the very least, all of the over 600 MLMs I have analyzed can be classified as unfair and deceptive practices (UDAP). And all (100%) of those for which I was able to obtain average earnings data are misrepresenting the possible earnings of participants. This would suggest a general pattern of UDAP for MLM as a business model and for the industry as a whole.

²⁵⁰ See classic article by Dean VanDruff titled “What’s Wrong with Multi-level Marketing” at – <http://www.vandruff.com/mlm.html>

Conclusions

After studying the compensation plans of over 600 MLMs, I can say with confidence that virtually all MLMs are dependent on deceptive recruitment of a network of endless chains of participants as primary (or only) customers. Incentivizing endless chain or unlimited recruitment within a limited marketplace, MLM is not only inherently flawed, unfair, and deceptive; but is also extremely viral and predatory – rapidly expanding and deluding the most vulnerable among us. While many or most participants are not deliberately deceiving recruits, they are unwittingly drawn into the complex web of deceptions such as those listed above – since to tell the truth would lead to failure in their recruiting efforts.

The appeal in MLM promotions and the typical MLM reports of earnings of participants are dependent on a host of misrepresentations and deceptive sales practices. To be successful in MLM, one must not only work hard, but one must also –

1. Be deceived
2. Maintain a high level of self-deception
3. Go about deceiving others
4. Maintain denial of the harm done to those recruited into the scheme

The degree of deception (and even total amounts in aggregate damages by MLMs as a group) exceeds the deceptions reported in the Bernie Madoff scandal and in the Enron stock scandal (plus WorldCom and Global Crossing). However, in the case of MLM, participants engage in self-deception as much as in deliberate misrepresentations. In short, the typical MLM is a composite lie, dependent on endless chains of recruitment into a mega-pyramid of participants who unwittingly engage in massive theft by deception.

It appears that the following warning that was also cited at the beginning of this chapter has proven to be prophetic and has been fulfilled to the letter:

. . . in a 1974 ruling, the FTC found in *the very structure of “multi-leveling” or “pyramid selling” [now called multi-level or network marketing, or MLM] “an intolerable capacity to mislead.”*

Primary sources for this chapter

Primary source materials used in compiling the above lists include the following:

- My one-year test of Nu Skin's' program
- *Report of violations of the FTC Order for Nu Skin to Cease its Misrepresentations of Distributor Earnings*, Jon Taylor, 2003
- “*Top 10 Myths & Facts about Direct Selling*,” posted at Directselling411.com
- “*Typical Misrepresentations Used in MLM Recruitment*,” “*Who profits from MLM? Preparers of Utah tax returns have the answer*,” and numerous other reports, by Dr. Jon M Taylor, all posted on the web site – mlm-thetruth.com
- “*Ten Myths of ‘Income Opportunity’ in Multi-level Marketing*,” by Robert FitzPatrick, President, Pyramid Scheme Alert. Available from pyramidschemealert.org
- “*The Mirage of Multi-level Marketing*,” by Stephen Barrett, MD, at mlmwatch.org
- “*Four Lies about MLM*,” by John Milton Fogg, author, publisher, consultant & trainer in network marketing. Posted in 2002 on mlmwatch.com
- “*Top 10 Myths & Facts about Direct Selling*,” posted on the DSA-sponsored web site – directselling411.com
- Web site for Direct Selling Assn. – dsa.org
- DSA comments to the FTC on its proposed Business Opportunity Rule, 2006, and Revised BOR, 2008 – and rebuttals of comments by DSA/MLMs
- Advanced Google search of the top references, using search terms “MLM” combined with the terms “misrepresentations,” “lies,” and “deceptions”
- Analysis of the compensation plans of over 600 MLM programs, resulting in numerous analytical reports cited in this book.
- Analysis of 50 MLMs that have released average earnings statistics (Ch. 7)
- 20 years of worldwide feedback from thousands of MLM participants

Appendix 8A: MLM companies promise what they cannot deliver – quotations from MLM company communications and their misrepresentations as income or business opportunities

By Jon M. Taylor, MBA, Ph.D., Consumer Awareness Institute

The statements in italics are direct quotes from MLM company web sites or promotional literature. **[My comments are bracketed in bold type.]** Read Chapter 7 to see how I calculated a 99.7% loss rate for the 50+ MLMs with available average earnings data, most of which are included here to show what was being sold.

Advocare

*“AdvoCare offers a proven vehicle for success. You can earn income quickly and take advantage of a business opportunity that can last a lifetime.”*²⁵¹

[Advocare fails to disclose that approximately 99% of all Independent Advocare distributors lose money.]

“With AdvoCare, you have the opportunity to earn unlimited income through product sales as an Independent AdvoCare Distributor.”

[Unlimited income? This claim is mathematically impossible and therefore false and misleading.] *“Because the products are consumable, you have a business that offers residual income every two weeks! Your earning potential is based solely on your efforts.”* **[and willingness to deceive others with the same falsehoods]**²⁵²

Ameriplan

[Average annual income²⁵³ is disclosed for “Active IBO’s” – but with no indication of what percentage of the total of all IBOs signed up is still active. Ameriplan also fails to disclose that approximately 99% of all IBOs lose money after subtracting “pay-to-play” and minimum operating expenses.]

²⁵¹ <https://www.advocare.com/opportunity/default.aspx>

²⁵² From an Advocare-approved posting by one of their distributors, Mary Myers, of Amarillo, TX at - <https://www.advocare.com/10047016/default.aspx>

²⁵³ <http://www.ameriplanusa.com/disclaimer-broker.html>

Amway (was “Quixtar” in the USA from 1999 to 2009)

“How Amway Works”

“Amway believes that hard work should be rewarded.” **[It is not disclosed that hard work is seldom rewarded in Amway.]**

“Put simply, the Amway Independent Business Owners Compensation Plan rewards you for selling products and for sponsoring others as Independent Business Owners who do the same.” **[Amway does not disclose that approximately 99% of all IBOs lose money.]** *“You earn income from:*

“Retail markup on product sales to customers.”* **[It is not disclosed that because of high prices, it is rare for this to occur. A recent California class action showed that less than 5% of products are sold at retail.]** *“Monthly performance bonuses ranging from 3% to 25% of business volume depending on your monthly productivity.”* **[It is not disclosed that few get to more than 6% bonus.]** *“Monthly and annual leadership bonuses and other cash awards and business incentives based on group”*

From *“Simple Steps to Success”*²⁵⁴

“Step 2: Retail. As your product knowledge increases, you will discover people all around you who need what you have to offer through your Amway business. Retail selling is the easiest way to make money through your Amway business.” **[This statement is a blatant misrepresentation, as a recent California class action showed that less than 5% of Amway’s overpriced products are sold at retail.]** *“Step 3: Sponsor. For some of your friends, products provide the solution they seek. For others, the Amway business opportunity will have strong appeal as they seek a business that can help them achieve their goals.”*

[But again, Amway does not disclose that approximately 99% of all IBOs lose

²⁵⁴ <http://www.amway.com/en/start-a-business/how-amway-works>

money.] “When you sponsor them, you can be rewarded for the business volume they generate. It’s that easy. Sign up for your own Amway business today.”

Arbonne Int’l

(Referring to Arbonne’s network marketing system) “It’s an incredibly effective system that cuts the cost paid to the “middle man” ... offering you a higher earning potential.”²⁵⁵

[This statement is a blatant misrepresentation. Arbonne fails to disclose that network marketing, or MLM, is actually incredibly ineffective (at least unfair and deceptive), creating instead thousands of “middle men” – and that approximately 99% of all participants lose money.]

Beachbody

*Beachbody Coach Income Potential*²⁵⁶
What kind of income can you make by becoming a Beachbody Coach? That is a very good question. It really is going to depend on the amount of work that you are going to put in to your Beachbody Coach business. The sky is the limit. If you want to get in the best shape of your life, help other people do the same – then this really is a great opportunity for you to make a great Beachbody Coach income. **[“The sky is the limit.” This statement would only be true if markets were infinite, which they are not.]**

Cyberwize

“The First Tier Salespeople”
“This is the entry level of the MLM, where salespeople start. These people are usually drawn to the MLM by the promise of good money and flexible schedules.”²⁵⁷

[Cyberwize fails to disclose that approximately 99% of all participants lose money.]

Ecoquest (now Vollara)

“Our Opportunity²⁵⁸ - Unleash Your Future”™
“. . . Imagine the freedom you can have when you become your best self. Imagine the freedom you can have when you have the tools, the systems and the power to reach beyond hope, to imagine beyond dreams, to make it all real; when you have products you can count on, systems and support that nurture you and a financial opportunity that has virtually no limits. Vollara has been crafted skillfully with the purpose of giving you the power to have an unlimited future, to confidently march forward down the path of your imagination and dreams.” **[No limits? Unlimited future? This would only be true in infinite and virgin markets, neither of which exists in the real world. Also, Vollara fails to disclose that approximately 99% of all participants lose money.]**

Fortune Hi-Tech Marketing (FHTM)

“Why FHTM?”²⁵⁹
“. . . FHTM provides an opportunity for those willing to work to achieve their financial goals and life dreams by providing a diverse lineup of competitively priced, exceptional products and services. Independent Representatives of FHTM have the opportunity to earn a residual income over time by acquiring loyal customers and introducing the FHTM opportunity to others.”
[FHTM fails to disclose that approximately 99% of all participants lose money. And therefore the promises of an “opportunity for those willing to work to achieve their financial goals and life dreams” and of a “residual income” are misrepresentations.]

NOTE: On January 28, 2013, the FTC announced that at the request of the states of Illinois, Kentucky, and North Carolina, a federal court would shut down FHTM as an alleged pyramid scheme, pending trial.

²⁵⁵ http://www.arbonnemarketing.com/PDF/opportunity/2010_US_EN_OpportunityBrochure.pdf

²⁵⁶ <http://work2benefit.com/tag/beachbody-coach-income>

²⁵⁷ <http://www.cyberwizehealth.com/understanding-mlm-tiers-and-cyberwize/>

²⁵⁸ <http://www.vollara.com/join-us/why-vollara>

²⁵⁹ <http://www.fhtm.net/whyfhtm.aspx>

FreeLife International

“The Opportunity”²⁶⁰ - Create A Business that Gives You Freedom”

“People across the world have changed their lives with FreeLife’s lucrative business opportunity.” [Lucrative? Perhaps it is for a few at the top.]

“With our scientifically validated breakthrough health products and powerful Compensation Plan, you can embark on a life-changing journey rich with the opportunity of improved health, significant income, and far more freedom to do the things you enjoy most.” [FreeLife fails to disclose that approximately 99% of all participants lose money.]

Herbalife

“Herbalife Business Opportunity”

“Welcome to the Herbalife opportunity website.²⁶¹ Read more about the outstanding opportunity that becoming an Herbalife Independent Distributor can offer. Learn how you can help make other people’s lives better through weight management and good nutrition, while at the same time earning an extra income.”

[Herbalife suggests that an “extra income” is possible, without disclosing that their compensation plan is recruitment-driven and top-weighted, making actual net profits from part-time participation extremely unlikely.]

“Becoming an Independent Distributor allows you to enjoy the benefits of a lucrative Herbalife Distributor compensation plan.” [Lucrative? Perhaps it is for a few at the top, but Herbalife fails to disclose that approximately 99% of all Independent Distributors lose money.]

Ignite –Stream Energy

[Ignite’s “Turning Energy Into Income”²⁶² video portrays Ignite as a great income opportunity, but nowhere is it disclosed that approximately 99% of all of its Independent Associates lose money.]

²⁶⁰ <http://corporate.freelife.com/international/usa/index.cfm/opportunity>

²⁶¹ <http://www.herbalifeopportunity.com/>

²⁶² <http://igniteinc.com/ig/>

Immunotec

“Build the Business You Want with Immunotec”²⁶³

“Immunotec offers a proven business and compensation plan so you can build a business that serves you — whether it’s earning a few hundred dollars a month or creating full-time income. [Immunotec’s compensation plan is recruitment-driven and top weighted and does not lend itself to part-time income.] “With Immunotec “Independent Consultants” purchase products directly from the manufacturer and sell directly to customers, doing away with two levels of costs and markups and creating more profit for all those involved.”

[The compensation plan actually has at least 7 levels or ranks and up to G8 on the top level. Immunotec also fails to disclose that approximately 99% of all Independent Consultants signed up earn no profits at all, and in fact lose money.] *“In addition, with our ImmunoDirect program you have the opportunity to build residual income from all of the customers who join you on auto-ship, creating an ongoing stream of income for you. You do the work once but continue to get paid for it.”*

[This would only be true for as long as consultants in one’s downline stay with the company. This residual or ongoing stream of income touted by Immunotec is a myth for at least 99% of all those sign up.]

“Unlike other jobs, where you trade ‘hours for dollars,’ you have your own business and a team of people working and earning money for you. . . The income earned through the Immunotec compensation plan is determined by the number of Consultants that you have, the amount of their purchases, and your ability to share the opportunity with others who in turn gather and support their own customers and Consultants. Immunotec pays commissions and bonuses based on products purchased, not for the recruiting of Consultants.” [Yet their recruitment-driven, top-weighted compensation plan clearly rewards the building of a huge downline, not the sale of products. In fact, their web site refers to “The Power of Geometric

²⁶³ <http://www.immunotec.com/IRL/Public/en/CAN/compplan.wcp>

Progression” in terms that tout the benefits of recruiting a downline.] “ . . . an Immunotec business offers a significant residual income potential (an annuity of sorts.)” [This “annuity” or “residual income” claim is very misleading, especially since they fail to disclose that approximately 99% of all Consultants lose money and the vast majority of Consultants abandon the business.]

iNetGlobal

“The iNetSurf Advantage”²⁶⁴

“We Reward you for the time you spend actively surfing the iNetSurf Pay Per View™ Rotator. We will also Reward you for the sites your direct referrals (people who enter your Member ID when they sign up) Surf and for the sites extended referrals (people referred to iNetSurf by your direct referrals and people referred by your extended referrals up to 6 Levels Deep) Surf with us. There is no limit to the number of referrals you can get paid for!” [There IS a limit to the number of people on the earth, making this a misleading and hollow promise. Also, they fail to disclose that approximately 99% of all participants in their scheme lose money.]

Isagenix

“Compensation Plan”²⁶⁵

“Learn about the most generous compensation plan in Network Marketing history from Isagenix’s Co-Founder, Kathy Coover.” [If this is true, then it is a condemnation of the entire MLM industry, since independent analysis shows approximately 99% of all Isagenix participants lose money. This is not disclosed by Isagenix.]

Mannatech

“One of the Industry’s Healthiest Compensation Plans”

“The purpose and success of Mannatech are directly affected by the hard work and spirit of our Associates. We reward our Associates with the chance to gain financial freedom

simply by building a Mannatech business through the distribution of our premium wellness products.

While we’re known the world over for our products based on Real Food TechnologySM solutions, our award-winning compensation plan also gains plenty of attention.

Recognized specifically by the Direct Selling Association in 2005, our Career and Compensation Plan is one of the most lucrative in the industry.” [This doesn’t say much for the industry because our analysis shows approximately 99% of all Associates lose money.]

Melaleuca

“Melaleuca is on a Mission.”²⁶⁶ See how we’re helping:

“Stay-at-Home Moms

‘Would you like... to stay at home with your children? . . . contribute to your household income? . . . have time for what is most important? You can! Thousands of moms have discovered how Melaleuca can make that possible.”

“Business Professionals

“Want more time freedom? Want to build your own business and your own future? Want to decide when and how much you work? Then, a Melaleuca business can be your solution.

“People Wanting a Secure Retirement

“Finding security in retirement is a lost hope for many people in today’s economy. But, at Melaleuca, we’re helping families secure their retirement, pay for children’s education, get out of debt and find security in the second half of their life.

“Families Trying to Get out of Debt

“At Melaleuca, our focus is helping families got out of debt. We talk about, reward and teach important money management principles. More importantly, we not only encourage better m money management, but we provide a way for families to increase their income and pay off their debts. Getting out of debt at Melaleuca works because a Melaleuca business works!”

[Melaleuca fails to disclose that approximately 99% of all participants lose money and therefore get further behind financially because of their participation.]

²⁶⁴<http://www.inetglobal.com/inetsurf/index.php?pid=iNetSurf:Index>

²⁶⁵http://www.isagenix.com/us/en/opportunity_overview.dhtml

²⁶⁶<http://www.melaleuca.info/?culture=en-us>

Momentum Plus

“My Momentum Plus – Become a Distribution Agent”²⁶⁷

“As a Sales Agent, you will earn income from the sales of each and every phone sold along with a commission on the monthly calling plan of your customer. The Momentum Plus Sales Agent Program is unique and offers a very rewarding opportunity for financial freedom.”
[“Financial freedom” is one of the most common – and deceptive – lures of MLM.]

Mona Vie

“Opportunity Overview”

“Is it time that you want, or more time? Health, or better health? An income, or a bigger income? Freedom, or greater freedom? Whatever your goals are, MonaVie can help you achieve them.”

[Mona Vie fails to disclose that approximately 99% of all participants lose money, which does little to further the goals of anyone but those few who are reaping the benefits.]

MXI Corp. (Xocai)

“Compensation Plan”²⁶⁸

“Learn how you make money with MXI Corp. Go step by step, at your own pace, though the easy-to-navigate video. Learn the 8 ways to earn bonuses in the most lucrative compensation plan in the industry.”

[MXI fails to disclose that approximately 99% of all participants lose money]

Nikken

“No boundaries.”²⁶⁹

“In today’s world, you can’t expect to achieve financial security by working for someone else.

Compare that to Nikken, where you have complete flexibility and unlimited opportunity.” **[Unlimited opportunity??]**

“Earn extra money part-time, or develop a new career. Build your own business and create a steady source of income. We give you the tools, the support, the guidance from experienced professionals. Life as an

Independent Nikken Consultant gives you the freedom to live as you wish. To earn as much as you deserve.” **[Nikken’s compensation plan does not reward part-time effort with even enough money for bubble gum, after subtracting expenses. And doesn’t a new recruit deserve to earn a profit from reasonable effort? Yet Nikken fails to disclose that approximately 99% of all participants lose money. And would it not be another deception to assume that 99% didn’t try!]**

Numis Network

“Create Wealth, Collect Wealth and Preserve Wealth with Numis Network”²⁷⁰

“Success means different things to different people. Many dream of being their own boss, setting their own hours, and enjoying true freedom. Others have a great desire to start their own business and have earnings that match their efforts. It’s been said that true financial freedom is being able to do the things you want to do, when you want, with whom you want, and without worrying about the costs.

“Whether it is complete financial freedom you desire, or simply the chance to earn a few hundred dollars per month to enjoy some extras in life, Numis Network offers a business that can help you fulfill your goals. Our compensation plan and career path provide a simple 1-2-3 system for creating financial success.” **[“earnings that match their efforts” – “true financial freedom” – “without worrying about the costs” – “simple 1-2-3 system for creating financial success.” They all sound good – and are myths!]**

Nu Skin

“Financial Rewards”²⁷¹

“Nu Skin’s Sales Compensation Plan is very simple, but innovative and highly rewarding.”

[Rewarding for whom? Nu Skin fails to disclose – even on its “average income of distributors” reports – that approximately 99% of all distributors lose money.]

²⁶⁷ http://www.mymplus.com/index.php?option=com_content&view=article&id=95&Itemid=186

²⁶⁸ <http://www.mxicorp.com/compplan/>

²⁶⁹ <http://www.nikken.com/opportunity/>

²⁷⁰ <https://www.numisnetwork.com/content.asp?content=opportunity.html>

²⁷¹ http://www.nuskin.com/en_US/opportunity/financial_rewards.html

“Did you know?”

“Nu Skin has paid over \$6 billion in distributor commissions in only 25 years of operation?”

[This is very misleading because Nu Skin fails to disclose that the vast majority of the \$6 billion went to less than 1/10 of 1% of all distributors.]

Orenda

“The Heart of The American Dream”²⁷²

“Network Marketing is the greatest source of grassroots capitalism. You learn how to take a small bit of capital-which is time – and another small bit of capital-which is money – and start the American Dream.” ~Quote (on Orenda web site) by Jim Rohn, Speaker and Author **[MLM as great source of grassroots capitalism is a dream – a pipe dream.]**

Reliv

“Become a Reliv Distributor.”²⁷³

Experience life on your own terms — starting now!

“Ready to take control of your health, your finances and your future? Want to be on the leading edge of an exciting entrepreneurial opportunity poised to experience explosive growth? Then don’t hesitate – become a Reliv Distributor today!

“Limitless Income Potential – Five separate avenues of income make Reliv’s compensation plan one of the most lucrative in the direct sales industry.

[“Limitless income potential” is mathematically impossible and is therefore misleading.]

“Your opportunity is here. Your time is now. Your future is Reliv! **[These are misleading statements, especially when Melaleuca fails to disclose that approximately 99% of all participants lose money]**

SendOutCards

“Receive Compensation By Sharing SendOutCards”²⁷⁴

“SendOutCards is all about improving lives, and a big part of that is financial freedom. Our income opportunity provides you with

exactly that. Here’s a look at how you can earn an income by sharing SendOutCards with others:

“Residual Income from Cards & Gifts Purchased”

“As you build an organization of preferred customers and other licensed entrepreneurs, you’ll earn a retail profit on points purchased towards cards and gifts according to [SendOutCards’ Compensation Plan](#). “With the potential to have an organization of thousands, imagine the residual income you can create in only a few years!” **[But SendOutCards does not disclose that after expenses (and depending on attrition, which is also not disclosed) as many as 99% of all participants actually lose money.]**

Sunrider

“Since 1982, Sunrider International has helped people around the world achieve success and financial independence with our rewarding business opportunity.”

[Sunrider fails to disclose that approximately 99% of all participants lose money]

Symmetry

“Could you stand having more money in your pocket? It’s easier than you think to have more money coming in every month. And it’s the kind that keeps coming in. What we’re talking about is a residual income that comes in long after you stop working. You can do the work once and keep getting paid on it for years to come. Only a select few in the world can have a residual based income like this. It’s usually reserved for creative artists and authors. But you’re about to discover how you can create one yourself without any special skills or previous experience.”

[To talk about such “residual income “for years without disclosing the high attrition rate of participants in an MLM is misleading. Also, Symmetry fails to disclose that approximately 99% of all participants lose money]

²⁷² http://www.orendainternational.com/content.asp?page_id=4

²⁷³ <http://www.reliv.com/US/EN/Become+a+Distributor.html>

²⁷⁴ https://www.sendoutcards.com/cgi-bin/tmcustomer.pl?income_opportunities:

Tahitian Noni International

“Want an extra \$500 a month? This home based business is the answer!”²⁷⁵ “Looking for a solid and reputable home based business? Tahitian Noni International’s Independent Product Consultants work part time to create lasting residual income using remarkable Noni fruit products.” **[To talk about such “lasting residual income” without disclosing the high attrition rate of participants in an MLM is misleading. Also, Tahitian Noni International fails to disclose that approx- imately 99% of all participants lose money]**

Take Shape for Life (Medifast)

“Make Money While You Sleep Anywhere in the World”²⁷⁶ “As a Medifast representative you know Medifast has a great opportunity for you earn a substantial amount of income and to help other joining Medifast to do the same. eSig Marketing can be one of those tools that take your Medifast business viral.” **[Make money while you sleep – or residual income – is a myth except for those at or near the top of the hierarchy of representatives.]**

Tupperware

“Opportunity – Tupperware, the Perfect Fit.”²⁷⁷

“Imagine life on your terms—complete with more time for family, friends and fun, more flexibility and more financial freedom. “The lifestyle of Tupperware leaders is nothing less than wonderful! Trips, diamonds, cars and cash bonuses are just a few of the perks you can *Find In Tupperware*.”

“Whether you're looking for a little extra money to spend on your family or yourself, or you would like a chance to build a career on your own terms, Tupperware can help you make it happen.” (In video on web site, “earnings of \$1,000 a month for six hours per week are suggested.”) **[Tupperware, with a long-standing reputation for fair**

²⁷⁵ Tahitian Noni International Independent Product consultant web site (likely approved by TNI) at - <http://www.nonijuiceint.com/TahitianNoniHomeBusiness.aspx>

²⁷⁶ <http://www.networkmarketingvideoconferencing.com/Network-Marketing-Companies-Distributor-Tools/Medifast/index.htm>

²⁷⁷ http://www.tupperware.com/pls/htprod_www/tup_oppo rtunity.opportunity

dealing in the past, seems to have converted in April 2005 to a more highly leveraged compensation plan they call the “Tupperware Breakthrough Plan,” that provided greater rewards to high level participants (“Directors”).²⁷⁸ The company does not disclose that net profits after expenses for part-time work are unlikely and that (depending on attrition, which is also not disclosed) as many as 99% of all participants could be losing money. Based on their current compensation plan and their 2008 Income Disclosure Summary, the suggestion of \$1,000 a month for six hours per week seems very misleading.]

USANA

“Compensation”²⁷⁹

“USANA’s innovative pay plan puts you in control of your commission check with six ways you can make money. Learn how smart entrepreneurs leverage their time and effort to create a thriving, profitable business.” “Six Ways to Create the Wealth You Want”²⁸⁰

“USANA’s unmatched Binary Compensation Plan gives you several ways to earn generous commissions every week in direct proportion to your ability to sell USANA’s products to your customers and build an organization of Independent Associates who do the same.” **[USANA fails to disclose that approximately 99% of all participants lose money]**

Viridian

“Referral Program – Your potential is significant.”²⁸¹ “For many Associates, Viridian is the vehicle to sustainable, long-term, residual income. Our unique compensation plan rewards hard work and dedication, enabling you to create a powerful business and a wonderful future for yourself.”

[Residual income is a myth, except for TOPPs (top-of-the-pyramid promoters), and even they can be moved around in

²⁷⁸ Reported in Presentation Summary, S2Sales Force Structure.Earnings Conference Call, Jan. 31, 2007.

²⁷⁹ <http://www.usana.com/dotCom/opportunity/index>

²⁸⁰ <http://www.usana.com/dotCom/opportunity/comp>

²⁸¹ <http://www.viridian.com/Oppportunity.aspx>

arbitrary fashion and lose their income, as happened to at least one top recruiter.]

Visalus Sciences

“Discover Prosperity”²⁸²

“Welcome to Financial Freedom” (sign at top of page). “Discover Prosperity.”

“As a Visalus Independent Distributor, you’ll have the opportunity to work when and how you want to make a real difference in people’s lives. Imagine yourself:

- A successful entrepreneur
- Working your own schedule
- Having more time for family and friends
- Living the lifestyle of your dreams”

[Prosperity and financial freedom via MLM is a myth except for TOPPs (top-of-the-pyramid promoters)].

World Ventures

“World Ventures Highlights – Marketing”²⁸³

“In November 2007 we gave away a brand new 2008 Mercedes C-300 Sports Sedan. In March 2008 we gave away a brand new 2008 Porsche Cayman. In November 2008 we gave away a brand new 2009 Mercedes C-300 Sports Sedan. In March 2008 we launched a brand new Premium Service Program (PSP), featuring Video. [etc.]”. **[All this sounds exciting, but World Ventures fails to disclose that approximately 99% of all participants lose money]**

XANGO

“Compensation Plan”²⁸⁴

“The XANGO compensation plan provides a clear and simple road to accomplish everything you’ve ever dreamed. A full 50 percent of commissionable volume on each XANGO product sold goes straight back to commission payments. No tricks. No fuzzy math. No hidden changes to your earnings (breakage). Just wide-open opportunity and products that demand attention.” **[However, XANGO fails to disclose that approximately 99% of all participants lose money]**

²⁸²http://visalus.com/sites/default/files/docs/corporate/D1047US_CompPlanBook.pdf

²⁸³<http://www.worldventures.com/new/wv-highlights.php>

²⁸⁴<http://www.xango.com/opportunity/compensation-plan>

MLM Loss rates are extraordinary – at least 99% for all of the MLMs for which I have been able to obtain relevant data. This in itself would not be so bad, except that MLM is promoted as an “income opportunity” – or even as a “business opportunity” – a major misrepresentation in itself. It is certainly unfair and deceptive.

Yor Health

“Take Charge of Your Success”²⁸⁵

“At YOR Health, we have a unique opportunity. . . . With our incredible product line, we make it simple for even the average person to become an entrepreneur and take control of their own financial well-being. . . . Here at YOR Health you will [be] building towards your financial freedom and living a healthy lifestyle. The momentum we carry and the direction we are headed, in this devastating economic atmosphere, make this a once in a lifetime opportunity to hopefully make lots of money. . . . After all, money has no value when there’s no health. Wouldn’t it be good to have both?” **[Yor Health fails to disclose that approximately 99% of all participants lose money]**

Your Travel Biz (YTB)

What is YTB?²⁸⁶ . . . In 2004 YTB signed on just over 8,000 of these independent contractors, called RTAs (Referring Travel Agents). That number jumped to over 60,000 in just two years and currently YTB has over 130,00 RTAs worldwide with hundreds of RTAs earning well over a million dollars a year from their own home-based business. . . . YTB’s innovative and ground breaking concept of giving everyday people the opportunity to generate enormous residual incomes from the hottest industry on earth by referral marketing is certainly behind much of this extraordinary growth. **[YTB fails to disclose that approximately 99% of all participants lose money]**

²⁸⁵<http://www.yorhealth.com/opportunity/letter-from-the-founder.aspx>

²⁸⁶<http://www.ytbpositivethinking.com/>

Appendix 8B: Misrepresentations regarding MLM as a business model – compared to legitimate direct selling, pyramid schemes, etc.

MLM misrepresentations	The truth
<p>MLM is a form of direct selling, which has a long history of independent selling by “door-to-door salesmen” and of selling to friends, neighbors, and family members. It is this person-to-person relationship selling that is one of its great strengths.</p>	<p>MLM should more properly be considered chain or pyramid selling, as few sales are made to customers outside its network of distributors. MLM promoters have sought legitimacy with the “direct selling” label by joining the Direct Selling Association (DSA), which lobbies to promote the interests of MLM. We should not accept an MLM as a legitimate direct selling company when compensation plans reward huge payouts to TOPPs (top-of-the-pyramid promoters) for recruiting a large downline, while paying only a pittance for selling to non-participants. This would be true of recruitment-driven MLMs that are members of the DSA.</p>
<p>Network marketing is the most popular and effective new way to bring products to market. Consumers like to buy products on a one-to-one basis in the MLM model.</p>	<p>From Robert FitzPatrick: <i>If you strip MLM of its hallmark activity of continuously reselling distributorships, . . . you encounter an unproductive and impractical system of sales upon which the entire structure is supposed to rest. Personal retailing is a thing of the past, not the wave of the future. Retailing directly to friends on a one-to-one basis requires people to drastically change their buying habits. They must restrict their choices, often pay more for goods, buy inconveniently, and awkwardly engage in business transactions with close friends and relatives. The unfeasibility of door-to-door retailing is why MLM is, in reality, a business that just keeps reselling the opportunity to sign up more distributors.²⁸⁷ In other words, it's easier to sell an “opportunity” than to sell overpriced products.</i></p>
<p>MLMs are not pyramid schemes, but legitimate direct selling programs. People that work hard can reap the rewards for the rest of their lives.</p>	<p>MLMs, or product-based pyramid schemes, have been found to be the most extreme of all the types of pyramid schemes, by any measure - loss rates, aggregate losses, number of victims, and degree of leverage. MLM loss rates (approx. 99 %) – are far worse than for no-product schemes, or even than most gambling casino games. These catchwords are used by MLM promoters to appeal to the desires for “easy money” that keeps on growing and providing for the comforts of life – and the resources to do what we want, when we want. However, one of the stark realities of MLM is an extremely high attrition rate. Available statistics suggest that 90-99% of recruits terminate or are inactive within a few years of joining. Those few who “succeed” must be constantly recruiting others to replace a revolving door of hapless victims of these deceptions. This can become totally consuming, leaving little time or energy for anything else.</p>

²⁸⁷ “Ten Myths of ‘Income Opportunity’ in Multi-level Marketing,” by Robert FitzPatrick. Available from pyramidschemealert.org

<p>What's all the fuss about pyramid schemes, anyway? Almost all major organizations are organized like pyramid schemes, with many (even thousands of) workers at the bottom, two or more levels of middle managers, some vice-presidents, and then the president or CEO at the top. Even the federal government could be said to be a pyramid scheme.</p>	<p>This observation shows an almost total lack of understanding of what makes a pyramid scheme an unfair and deceptive practice, to use FTC terminology. It isn't the pyramidal structure that is the problem, but the endless chain of recruitment of participants as primary customers. Persons are not appointed to ascending levels in the pyramid, but must recruit their way up. And in the case of recruitment-driven MLMs, the compensation plan rewards TOPPs (top-of-the-pyramid promoters) the bulk of the commissions, which drives them to place almost total effort on recruitment and not on selling products to non-participants. Primary income from commissions on sales to downline participants makes it a money transfer scheme, transferring money from those at the bottom to those at the top.²⁸⁸</p>
<p>MLM is the most powerful marketing methodology ever developed. It's possible to get quite wealthy and earn your life back with an MLM business and to do good for your friends and community in the process.²⁸⁹</p>	<p>MLM is the most unfair and deceptive marketing methodology ever developed. Its power is also its inherent flaw – the endless chain of recruitment, which uses the same principle as a chain letter or classic pyramid scheme. A few do get wealthy at the expense of a multitude of victims who lose money investing in an exploitive system.</p>
<p>Any MLM that offers legitimate products is by definition not a pyramid scheme.</p>	<p>The most extreme and harmful pyramid schemes are product-based pyramid schemes by any measure – loss rates, aggregate losses, number of victims, etc. In fact, the introduction into a pyramid scheme of products which must be purchased in order to qualify for commissions or advancement in the scheme (“pay to play”) increases the number of people defrauded because downlines are far larger than for no-product pyramid schemes. And just because a law in a particular jurisdiction excludes MLM in its definition of a pyramid scheme does not negate the losses suffered by participants. Any MLM may still qualify as simple fraud or as a deceptive sales practice. Robert FitzPatrick of Pyramid Scheme Alert wrote: <i>The sale of products is in no way a protection from anti-pyramid scheme statutes or unfair trade practices set forth in federal and state law. MLMs that sell useful, quality products have been successfully prosecuted under anti-pyramid scheme laws by state and federal officials. MLM is a legal form of business only under certain rigid conditions set forth by the FTC and state Attorneys General. Many MLMs are currently in gross violation of these guidelines and operate only because they have not been prosecuted. Federal regulators have used a 70% rule to determine an Mm's legality. At least 70% of all goods sold by the MLM company must be purchased by non-distributors. This standard would place most MLM companies outside the law. The largest of all MLMs acknowledges that only 18% of its sales are made to non-distributors.</i>²⁹⁰</p>

²⁸⁸ See Chapter 2

²⁸⁹ “MLM Lies, Exaggeration, and BS,” by John Zehr at johnzehr.com

²⁹⁰ “Ten Myths of ‘Income Opportunity’ in Multi-level Marketing,” by Robert FitzPatrick. op cit.

<p>There's a big difference between legitimate direct selling companies and pyramid schemes. Pyramid schemes seek to make money from you (and quickly). Legitimate direct selling companies seek to make money with you as you build your business (and theirs) by selling real products and services. In fact, legitimate direct selling companies work hard to protect consumers from pyramid schemes.</p>	<p>It is true that there are big differences (plural) between legitimate direct selling companies and pyramid schemes. But the difference as stated by the DSA is misleading, because it fails to mention important structural differences. Legitimate direct selling is NOT driven by huge rewards for recruiting an endless chain of recruitment of participants as primary customers. Even the last sentence is misleading, as legitimate direct selling companies in the DSA actually support DSA efforts to protect product-based pyramid schemes (MLMs). They support these predatory schemes by their silence and willingness to be included in the same association with them.</p>
<p>In some MLMs, including Amway, an active participant is called an "IBO" for "Independent Business Owner."</p>	<p>Participants in an MLM are not independent, as anyone who has sought to work with any other MLM while with an MLM like Amway can testify. It is not a business, unless one considers odds of success far below gambling a real business. And IBO's don't own anything, as anyone who tries to leave Amway and take their downline (that they spent years building) with them can testify. They don't even own the promised residual income because the high attrition rate assures them that they cannot count on those residuals.</p>
<p>Sure, many fail at MLM and leave the business, just like in any business. In fact, statistics show that 90-95% of all small businesses fail.</p>	<p>These kinds of statistics are bandied about by MLM defenders who supposedly have valid data to back them up. But they are way off on their statistics. Failure and loss rates for MLMs are not comparable with legitimate small businesses, which have been found to be profitable for 39% over the lifetime of the business; whereas less than 1% of MLM participants profit. Cumulatively, according to a study by the NFIB (Nat'l Federation of Independent Business) and reported by the SBA (Small Business Administration), 64.2% of businesses failed in a 10-year period.</p>
<p>"This MLM is not a pyramid scheme because you can make more than the people above you.</p>	<p>While there may be instances where the income of someone at a lower level exceeds the income of some above them in the pyramid of participants, this does not negate the reality of top-weighted programs where the compensation plan rewards those who build large downlines at the expense of those beneath them. Those at or near the top get the lion's share of the rewards.</p>

Misrepresentations comparing MLM to the job market, or to the stock market and other investments – even gambling:

MLM misrepresentations	The truth
<p>"You can't count on an employer to offer any stability." MLM offers reliable, leveraged, long-term, permanent, residual income."</p>	<p>MLM is far more risky than the job market. There is no real security in MLM comparable to a typical employment arrangement, however unstable. With 99.7% loss rate and over 90% attrition within a few years, long-term residual income from recruiting a downline is a myth for new MLM recruits. (see Chapters 6 & 7)</p>
<p>Unlike dead-end jobs, MLM offers everyone an unlimited opportunity to earn what they want. With MLM, you are only limited by the time, effort,</p>	<p>This is one of the biggest lies of MLM promoters. Think about it – an unlimited MLM income assumes an unlimited market, which does not exist. In fact, markets quickly</p>

and money you put into it.	<p>become saturated, as fewer and fewer suckers can be found who have not been inundated with MLM offers, been burned by prior participation, or have family members who have been victimized.</p> <p>Perhaps even more important than time and effort is the willingness and skill to deceive prospective recruits into believing the same falsehoods you are being fed. And as a general rule, with MLM, the more you invest, the more you lose – with the exception of (1) the founders, (2) those who joined at the beginning of the endless chain of recruitment, and (3) TOPPs (Top-of-the-Pyramid Promoters), or “kingpins” - often all three of whom are the same persons.</p>
People who “punch a time clock” working for someone else just “don’t get it.” By building a downline in a good MLM program, you’ll never have to work for someone else for the rest of your life.	I’ve heard this argument repeated over and over at MLM opportunity meetings. Careful analysis of average earnings data shows the falseness of this “easy money” claim by MLM promoters (see Chapter 7). And for those who choose not to do MLM, is there anything immoral about hard work for honest rewards?
Investing in this (MLM) business opportunity and then putting some time and effort into it to get it going is more like buying an annuity than investing in risky stocks or even a small business.	<p>After investing in an annuity, one can – without effort – receive regular payments for a stated period of time, even for life in the case of lifetime annuities. But building and maintaining an MLM downline can be anything but trouble-free, except perhaps for the very few persons in the chain of recruitment.</p> <p>I have spoken with TOPPs who are constantly having to recruit to replace those dropping out, even traveling weekly to “opportunity” gathering in remote parts of the globe. They also spend enormous sums of money to display (or put on the appearance of) great wealth, living in large estates, driving luxury cars, being flown in private jets, etc.</p>
<p>According to statistics, about 90% of people retire at age 65 without significant savings, and half of them without any savings at all. This can be prevented by investing in a good MLM.</p> <p><i>(JT: I’ve seen statistics like these included in numerous presentations selling potential recruits on joining a particular MLM. The message follows with a pitch to “catch the wave” of a particular MLM that is growing rapidly, with the assumption that if you go with this MLM, you can be in a better position to retire comfortably.)</i></p>	Any suggestion that MLM can boost one’s retirement is misleading if it is not accompanied with the warning that their odds of losing money over making a profit are at least 99 to 1, and their likelihood of profiting is less than one in a hundred, or 1%. Their likelihood of earning the substantial residual income that the promoters are suggesting is possible is so infinitesimally small as to be essentially zero – less than one in 25,000. (See Chapter 7.)
Come and “play the game” of network marketing with us. With a small investment and a little hard work at the outset, you never know what great things will come to you down the road. A few lucky breaks, such as recruiting a “heavy hitter,” you could be traveling the world or playing golf while the money keeps flowing in.	Our research shows that the game of network marketing, or MLM, is one with incredibly low odds of winning. In fact, MLM makes gambling look like a safe bet in comparison. The odds of winning from a single throw of the dice in a game of craps or betting on one number at the roulette wheel at Caesar’s Palace in Las Vegas are many times the odds of profiting in most MLMs.
The stock market is shaky. MLM offers more security and stability. .	Money invested in MLM is not any safer than a carefully planned long-term investment portfolio. As established in Chapter 6, 99% of those who invest in an MLM lose money.
A DSA spokesperson has stated: “Anyone who gets involved with a legitimate direct selling company should not risk financial loss by doing	While the buyback provision is laudable, it is seldom exercised because participants have been encouraged to open and use their products, making

<p>so. The Direct Selling Association's Code of Ethics, for example, is designed to protect direct sellers and their customers. Inventory buybacks and other provisions allow sellers recourse if there's an issue with the company - no one should lose money in direct selling . . ."²⁹¹</p>	<p>the buyback option null and void. The DSA states that no one should lose money in direct selling - which we would assume means MLM – since there is no reason for anyone to lose much money in legitimate direct selling. (When I sold encyclopedias, I did not have to buy a set for myself.) But the facts are that at least 99% of participants DO lose money, based on careful analysis of average earnings statements of companies that produce them. (See Chapter 7.)</p>
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Misrepresentations regarding legality, regulation, & legitimacy of MLM:

MLM misrepresentations	The truth
<p>(on the assumption by FTC and other regulators that if an MLM were a pyramid scheme, it would soon saturate its market and collapse, as with classic, no-product pyramid schemes) Saturation just does not occur with MLM. Many MLMs have been around for over 40 years, and the market is far from saturated, with less than 1% of all sales nationally coming from the MLM industry.</p>	<p>The issue is not TOTAL saturation, but MARKET SATURATION. In a city of 100,000 people, the notion of 100,000 distributors to serve them is absurd. Perhaps the MARKET could be saturated with at most 5 or 10 distributors. Each added distributor would reduce the opportunity for existing distributors, and resistance would build up for those who have been approached several times. In fact, market saturation occurs rather quickly,</p>
<p>The market collapse predicted for MLMs never happens. Many MLMs have been around for over 40 years and are still going strong.</p>	<p>In MLM, market collapse is manifested in CONTINUOUS COLLAPSE, meaning that the market is constantly collapsing, requiring constant recruitment to replace those continually dropping out - with recruits willing to make "pay to play" purchases in hopes of cashing in. MLM leaders have learned other strategies for circumventing market collapse.²⁹² They find new markets in which to recruit, or recycle through old markets with new generations of prospects, or with new products. Without these efforts, an MLM could collapse fairly quickly.</p>
<p>The DSA Code of Ethics states: "Pyramid schemes are prohibited under the Code, ; thus companies operating pyramids are not permitted to be members of the DSA."²⁹³</p>	<p>Recruitment-driven MLMs²⁹⁴ make up a substantial portion of DSA membership. Extensive research shows that of all classes of pyramid schemes, what I call product-based pyramid schemes, or recruitment-driven MLMs, are the most extreme and harmful of all classes of pyramid schemes – by any measure – loss rates, aggregate losses, number of victims, etc. So this statement in the DSA Code of Ethics is merely a red herring; i.e., a hollow, hypocritical, and misleading statement.</p>
<p>You don't need to worry about possible illegal actions because law enforcement officials from the FTC and all the states recognize MLM as a legitimate form of direct selling.</p>	<p>This is blatantly false, as there are laws and/or rules in place that could be a serious problem for virtually all MLMs if they were enforced. Examples from my recollection include laws against (1) endless chain selling schemes (California and Wisconsin), (2) schemes in which rewards are primarily from recruitment (which could include "pay to play"</p>

²⁹¹ "Top 10 Myths & Facts about Direct Selling," posted on Directselling411

²⁹² For a detailed discussion of these strategies, see "The 8 Rs of MLM Durability" in Chapter 3 of this book.

²⁹³ DSA comments to the FTC on its proposed Business Opportunity Rule, 2006

²⁹⁴ See Chapter 2

	<p>purchases) rather than sales of products to end users, (3) collecting commissions of (downline) sales for which the (upline) person made no contribution (Wyoming and Massachusetts), etc. And hundreds of MLMs are violating Section 5 of the FTC Code, which was written to protect against unfair and deceptive acts or practices.</p> <p>If FTC official were to read the preceding chapters and this one with an open mind, I believe it would be impossible for any of them to identify any business practice that is more unfair and more deceptive – and more viral and predatory – than MLM.</p>
<p>In seeking redress for victims of the Nu Skin program by our Utah State Division of Consumer Protection, I worked with over 20 ex-distributors for almost a year to get them to file a joint complaint. Even though aggregate losses totaled over \$250,000, they were fearful of the consequences of giving out their names in the complaint. When they finally were persuaded to join in this complaint, the agency wrote one letter on behalf of one of them and recovered about \$350 – out of \$250,000!</p> <p>The DSA has reported to the FTC: <i>“Very few complaints are filed against direct selling companies. DSA conducted a comprehensive review of complaints against all 193 active DSA member companies, as reported by local Better Business Bureaus. The data showed that on average there was only one complaint for every \$55 million in retail sales or one complaint for every 23,765 individual direct sellers per year. Of those complaints, 97 percent were resolved. The data further indicated that there were on average only 17 unresolved complaints per year. That calculates to one unresolved complaint for every \$1.76 billion in retail sales or one unresolved complaint for every 764,705 individual direct sellers. By any measure, this is an extraordinarily low level of consumer.”</i>²⁹⁵</p>	<p>What is not acknowledged here is that participants in all endless chain recruitment programs, like MLMs, rarely file complaints with law enforcement or with the BBB. This is because in an endless chain of recruitment, every major victim is also a perpetrator; i.e., they have had to recruit others to try to recover their investments in MLM products and services. Some of their recruits would be close friends and family, so they fear consequences from or to those close to them if they complain. There is also a strong element of self-incrimination, plus a sense of failure for not having properly “worked the system” as they were taught. This silence of victims is one of the most insidious features of MLM, providing built-in protection against government scrutiny for MLMs.</p> <p>It should also be noted that these DSA statistics were for all of its member companies. That means that data for MLM companies was mixed with data for legitimate direct selling companies, thereby skewing the results to make MLM look better than if the review of complaints focused on only MLMs.</p>
<p>The DSA Code of Ethics states: “Pyramid schemes are prohibited under the Code, ; thus companies operating pyramids are not permitted to be members of the DSA.”²⁹⁶</p>	<p>Recruitment-driven MLMs make up a substantial portion of DSA membership. Extensive research shows that product-based pyramid schemes, or recruitment-driven MLMs, are the most extreme and harmful of all classes of pyramid schemes – by any measure – loss rates, aggregate losses, number of victims, etc. So this statement in the DSA Code of Ethics is a hollow, hypocritical, and misleading statement.</p>
<p>“If not legal, our [MLM] program would have been shut down long ago.” “MLMs have survived many legal challenges. The fact that they are still around tells you they are legitimate.”</p>	<p>Consumer protection officials are typically reactive, not proactive. Since victims of endless chain schemes rarely file complaints, law enforcement seldom acts against even the worst MLM schemes. Victims don’t complain because they blame themselves, and they fear self-incrimination or consequences from or to their upline or downline – often close friends and</p>

²⁹⁵ DSA comments to the FTC on its proposed Business Opportunity Rule, 2006

²⁹⁶ DSA comments to the FTC on its proposed Business Opportunity Rule, 2006

	<p>family. As Robert FitzPatrick observed: <i>MLM is not defined and regulated in the way, for instance, franchising is. MLMs can be established without federal or state approval. There is no federal law specifically against pyramid schemes. Many state anti-pyramid statutes are vague or weak. State or federal regulation of MLM, when it does occur, usually involves, first, proving that the company is a pyramid scheme. This process can take years, and by then the damage to consumers is done. Indeed, even when MLM pyramids are shut down, often the promoters immediately set up new companies under new names and resume scamming the public.</i>²⁹⁷</p>
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Misrepresentations regarding MLM products & services – product claims, prices, purchase quotas, stockpiling, investments in products and “tools for success,” etc.:

MLM misrepresentations	The truth
<p>Unlike the franchising opportunity, in which large amounts of money are at stake, <i>direct selling requires little or no up-front payment</i>. Individual direct sellers are able to return inventory and sales aids, training aids and the like; additionally, start-up costs are also refundable for a period of time upon cancellation by the salesperson.</p>	<p>The low signup fee is merely a ruse to deceive regulators who might be looking for large up-front fees that would trigger enforcement of “business opportunity” disclosure requirements in some states. Instead, MLM recruits are duped into investing piece meal through MLM compensation plans which include quota, or “pay to play” requirements in order to qualify for commissions or advancement in the scheme. These are usually purchased on a monthly subscription bases, often totaling hundreds, and sometimes thousands of dollars a year. The cancellation or buyback provision is seldom exercised because products must be returned in marketable (unopened) condition. Since new recruits are encouraged to open and use their products, rather than stockpiling them, few products can be returned.</p>
<p>Products can be resold at retail prices for a handsome profit</p>	<p>MLM products must be priced high enough to support a bloated network of distributors, so prices are seldom if ever competitive with alternative retail outlets. (See Chapter 4.) MLM products are sold primarily to recruits to “do the business,” rather than to persons outside the network of participants. People who shop around and are not buying products for the “opportunity” are not likely to become customers.</p>
<p>The demand for these MLM products is growing at a rapid rate. “They literally sell themselves.”</p>	<p>The sale of products is distributor-driven, not market driven. In spite of all the “outstanding products” hoopla, what is sold is the “opportunity,” not the products. New recruits soon learn that it is easier to buy than to sell – in order to meet their quota.</p>
<p>Participation in an illegal pyramid scheme requires a large, up-front investment, which is not required for participation in MLM.</p>	<p>New recruits must purchase products to “play the game,” i.e., to qualify for commissions and/ or advancement in the scheme. Also, no matter how high the quality of the products, investment in products for which you do not have orders in hand becomes a cleverly disguised means of laundering investments in a product-based pyramid scheme.</p>

²⁹⁷ “Ten Myths of ‘Income Opportunity’ in Multi-level Marketing,” by Robert FitzPatrick. Op. cit.

<p>Our high quality products are less expensive than elsewhere when sold through MLM because they cut out the middleman.</p>	<p>MLM creates thousands of middlemen, with few real customers outside the network of “distributors” (or “consultants,” “demonstrators,” etc.) Due to a bloated hierarchy of participants, MLM products are very expensive and cannot compete with comparable products from alternate sources. And anyone who believes that MLM products are less expensive than comparable products elsewhere has not shopped around much.</p>
<p>You will be offering to persons you care about the very best products available for promoting their health and well-being.</p>	<p>While some excellent products are available through MLMs, seldom are their claims backed up by valid research. In fact, the promotion of various nutritional supplements and miracle juice drinks is analogous to the “snake oil peddlers” of a century ago.</p>
<p>Our products are highly unique. It is virtually impossible to find anything comparable elsewhere.</p>	<p>MLM products are typically “pills, potions and lotions.” The secret formulas are a cover for the fact that they are priced too high to compete in standard markets. Products selected to be sold are unique so shoppers may find it difficult to compare prices with comparable shelf products.</p>
<p>Our products are consumable, which helps to guarantee repeat purchases by your customers.</p>	<p>MLM products are consumable, so participants can be lured into signing up for products on a monthly basis to meet their “pay to play” quota. Of course, this helps to assure a consistent revenue base for the company.</p>
<p>MLM products may cost more for reasons of superior quality or service. The decision to sell a product through direct selling is often based on very specific factors. For example, products that require demonstration to convey the finer points of their operation are ideal for direct selling because a knowledgeable salesperson can personally conduct that demonstration for every customer.</p> <p>In a traditional retail setting, consumers might not understand the product’s unique qualities based on appearance or packaging. It’s true that some direct selling products are priced at the upper end of the retail market’s acceptance level, but there is higher acceptance based on the value-added incentive of the demonstration and personal service. Lexus brand cars are also at the upper end of the retail market acceptance level, but superior performance and service after the sale make that higher price reasonable. Each customer needs to weigh the price, quality and desirability of a given product and make a purchasing decision accordingly.</p>	<p>MLM products are pricey to satisfy not only costs of production and infrastructure, but also huge individual commissions for TOPPs, aggregate commissions for thousands of downline participants, and often substantial skimming by founders,</p> <p>And here again, no distinction is made between MLM and legitimate direct selling. In some cases, this position could make sense for the latter category. But just because a new strain of apples has blue stripes does not justify charging four or five times as much. MLMs promoters typically use the blue stripes type of rationale to justify products that could not compete with retail shelf products.</p>
<p>Like a franchise, with MLM you are in business for yourself, but not by yourself. And you have a proven program to assure your success if you follow our program</p>	<p>Franchises offer territorial protection, while with MLM you are recruiting your own competition. And if anything is proven about MLM, you are doomed to financial loss if you follow the lead of your upline – who want you to buy products and recruit others in an endless chain of recruitment. You are being sold a ticket on a flight that has already left the ground.</p>
<p>New recruits are protected from abuse because if they decide to leave the business, they can repurchase marketable inventory</p>	<p>New recruits are encouraged to immediately open and start using the products, not to stockpile them for the future. So if they decide they will not or cannot do “the</p>

<p>and sales aids purchased in the past 12 months for at least 90% of the purchase price.</p>	<p>business,” their products are not in marketable condition and will not be bought back. Also, our experience has been that few MLM dropouts understand that they have been scammed in time to exercise their buyback option. For one major MLM, the percentage of products returned was less than 4%, even though approx. 99.94% of participants lost money in the scheme.</p>
<p>A person can begin participation in legitimate direct selling opportunities with minimal start-up costs and little or no inventory investment. Even modest entry fees may be refundable if the new direct seller decides not to pursue the opportunity. Conversely, pyramid selling schemes often require high entry fees and/or substantial "investment" in inventory, and neither are refundable. This is because pyramid operators make their money from new recruits.²⁹⁸</p>	<p>The writer of this must not have studied many MLM compensation plans. The minimal signup fee is merely a ruse to mislead investigators. Nearly every MLM has some kind of arrangement for signing up for a monthly subscription of their “pills, potions, and lotions” – or whatever they use as products and services to maintain their revenue stream. Sure, new recruits can satisfy the minimum by selling to others, but it soon becomes apparent that it’s easier to buy than to sell – especially for products that are priced too high to compete with products on the shelves of retail stores.</p>
<p>Like a franchise, with MLM you are in business for yourself, but not by yourself. And you have a proven program to assure your success if you follow our program</p>	<p>Franchises offer territorial protection, while with MLM you are recruiting your own competition. And if anything is proven about MLM, you are doomed to financial loss if you follow the lead of your upline – who want you to buy products and recruit others in an endless chain of recruitment. You are being sold a ticket on a flight that has already left the ground.</p>
<p>MLMs are like franchises in that you have a proven system of success to follow – but without a huge initial franchise fee.</p>	<p>MLMs are not like franchises because you are not given a proven system of success to follow. Instead, you are given a system proven to lead to financial loss for almost everyone except the first ones in. And as mentioned above, typically MLMs bleed new recruits slowly of their funds by inducing them to buy products on a subscription basis, to pay for ongoing training, and otherwise draining them of their resources until they run out of money or give up.</p>
<p>Our “tools for success” are unbeatable. Sign up for our seminars and conferences, and buy our books and tapes to assure your success in this business.</p>	<p>In at least one major MLM, the “tools business” is a pyramid within a pyramid. Hardly anyone makes money selling products, so a lucrative source of income for those at the top is the sale of “success tools” to supposedly assure the success of their downline – who are in fact only further victimized when they buy these motivational items, only to increase their losses.</p>
<p>We have Dr. so-and-so as our vice-president of product development, and he has a whole team of qualified scientists and technicians working with him to assure that our products are the very best and safest on the market.</p>	<p>It should come as no surprise to anyone that scientists like to eat and enjoy the good things in life like everyone else. If they are offered enough money, top flight scientists, engineers, technicians, etc. can be found to add credibility to an MLM’s product line – no matter how good or questionable they may be.</p>
<p>We have strict rules in place against purchasing and stockpiling large quantities of products just to qualify for commissions or advancement up the various levels in the compensation plan. In other words, you are not allowed to “buy your way up” to higher levels in the program.</p>	<p>While such rules in an MLM’s Policies and Procedures manual may be laudable, they are often in direct conflict with their compensation plans, which reward ascending levels of purchases and recruitment. As explained in Chapter 2, psychologists have proven that rewards drive behavior. Forced to choose between seeking rewards for buying more and more products (since it’s much easier to buy than to sell overpriced products) and complying with a rule that is seldom enforced, participants often choose the former.</p>

²⁹⁸ News & Views, American Chamber of Commerce in Croatia, *Direct Sales in Croatia Interview: U. S. Ambassador Robert A. Bradtke (2009, Issue 3 - http://www.amcham.hr/_downloads/newsviews/nv_0209.pdf)*

<p>We require that our distributors have proof of monthly sales to at least ten customers who are not enrolled as distributors in the plan. This assures that distributors comply with our “retail rules” which in turn assure that we are in compliance with FTC guidelines.</p>	<p>Such rules have never essentially been ignored by MLMs, including Amway (Quixtar), the company that escaped pyramid allegations on the grounds that it had and enforced its “retail rules.” They have never been consistently enforced, either by Amway or by the FTC.</p>
<p>These products* can give your greater vitality, can protect you from disease, and can keep you young longer.</p> <p>*Typically “pills, potions, and lotions”</p>	<p>According to Dr. Stephen Barrett of Quackwatch and MLMwatch.org: <i>Every company I have looked at has done at least one of the following.</i></p> <ul style="list-style-type: none"> • <i>Made misleading statements that could frighten people into taking dietary supplements they do not need.</i> • <i>Made misleading statements of product superiority that could induce people to buy products that retail stores sell more cheaply.</i> • <i>Made unsubstantiated claims that their products would prevent or remedy health problems</i> • <i>Uses research findings to promote products without noting that the findings are not sufficient to substantiate using the products.</i> • <i>Uses deception by omission by making statements about the biochemical properties of various substances without placing them in proper perspective. An example would be stating that a certain nutrient is important because it does this or that in the body but omitting that people who eat sensibly have no valid reason to take a supplement.</i> • <i>Exaggerated the probability of making significant income.</i>²⁹⁹

Misrepresentations regarding MLM as a “business opportunity” and the importance of timing to take full advantage of it:

MLM misrepresentations	The truth
<p>Take advantage of “momentum” and “windows of opportunity.”</p>	<p>This kind of appeal has been used for over thirty years. In any endless chain scheme, the momentum cannot continue indefinitely, leaving those who come in later in a losing position, which is approximately 99% of recruits.</p>
<p>An MLM is not presented to prospects as a direct selling or as a pyramid/chain selling program, but as a “business opportunity.”</p>	<p>Promoters are careful to refer to an MLM as “direct selling” when communicating to regulators; they do not want to trigger state regulations regarding business opportunities. However, they often label it as a “business opportunity” with “passive income potential” to prospects because many people really do not want to sell. But MLM is no more a business opportunity than gambling. In fact, the odds of profiting are far greater for most games of chance in Las Vegas than in MLM.</p>

²⁹⁹ “The Mirage of Multi-level Marketing,” by Stephen Barrett, MD, published on MLM Watch at mlmwatch.org

<p>MLM is a business offering better opportunities for making large sums of money – more than all other conventional sales and business opportunities.</p>	<p>For almost everyone who buys into an MLM program, it turns out to be a losing financial proposition. This is not an opinion, but a historical fact. For example, in the largest of all MLMs, Amway, only 1/2 of one percent of “active” distributors make it to the basic level of “direct” distributor, and the average income of Amway distributors (not including dropouts) is about \$40 a month. That is gross income before taxes and expenses. When “pay to play” purchases and operating expenses are subtracted, it is obvious that nearly all suffer a loss. Even making it to “direct distributor” in Amway, is not a ticket to profitability. When the Wisconsin Attorney General filed charges against Amway in the 80s, tax returns were gathered from all distributors in the state. It was found that “direct” distributors (approx. the top 1% of distributors) in Wisconsin suffered an average net loss of \$918! And in all of the hundreds of MLMs I have studied, the founders and a few at the top of their pyramids of participants are enriched at the expense of a multitude of downline participants, approximately 99% of whom lose money.</p>
<p>Join our program in its pre-launch kickoff phase (or entry into a new market or product division, etc.) and establish your position now. Get in on the ground floor now. You can thereby take advantage of this virgin market and experience explosive growth.</p>	<p>It has become customary for new MLM startups to announce a pre-launch kickoff, stressing the importance of getting in early to get your place established before others. The implications are that those who get in early have a huge advantage over those who come in later. Of course, they are right. In any endless chain recruitment program, whether it be a chain letter, naked pyramid scheme, or MLM (a.k.a. product-based pyramid scheme), the pay plans favor early entrants.</p> <p>This “establish your position now” invitation is about as blatant an admission that the MLM is a pyramid scheme as you can find. It is an acknowledgement that market saturation happens quickly and that early entrants have a decided advantage over those who come in later. MLMs with their endless chain of recruitment assume both infinite and virgin markets - neither of which exists. They are therefore inherently flawed, deceptive, and profitable only for founders and a few early entrants or those placed at or near the top of the pyramid in the compensation plan.</p> <p>When the founders of any MLM announce a pre-launch or early signup opportunity, they are out to get your money. You are almost certain to lose money after subtracting all expenses, including products you must buy to qualify for commissions and rank advancement.</p>

<p>MLM is destined to be a major player in the distribution of goods and services in the future. Eventually most products will be sold by MLM, a relatively new form of marketing. Many retail stores, shopping malls, catalogues and most forms of advertising will be rendered obsolete by MLM. Why advertise, when word-of-mouth advertising works so much better?</p>	<p>This is an old argument for getting on board with “network marketing.” The fact that less than 1% of all sales nationally are made through MLM, after over 30 years of promising to be a major player, should tell you something.</p> <p>Robert FitzPatrick offers this insightful comment: <i>“MLM . . . has been around since the late 1960s. Yet, today it still represents less than one percent of US retail sales. In year 2000, total US retail sales were \$3.232 trillion, according to the Dept. of Commerce. In that time, MLM's total sales were about \$10 billion. That is about 1/3rd of one percent to annual retail sales, and most of this sales volume is accounted for by the purchases of hopeful new distributors who are actually paying the price of admission to a business they will soon abandon. Not only are MLM sales insignificant in the marketplace, but MLM fails as a sales model also on the other key factor – maintaining customers. Most MLM customers quit buying the goods as soon as they quit seeking the “business opportunity.” There is no brand loyalty [after quitting].</i></p> <p><i>These basic facts show that, as a marketing model, MLM is not replacing existing forms of marketing. It does not legitimately compete with other marketing approaches at all. Rather, MLM represents a new investment scheme that uses the language of marketing and sales of products. Its real products are distributorships which are sold with misrepresentation and exaggerated promises of income. People are buying products in order to secure positions on the sales pyramid. The possibility is always held out that you may become rich if not from your own efforts then from some unknown person who might join your ‘downline,’ the ‘big fish’ as they are called.”³⁰⁰</i></p>
<p>The economy is not looking good for businesses and for those struggling to find work – or just to survive. But MLMs are growing and profiting. Liquidate what you have and invest in MLM, so that you can regain control of your finances, along with others who have found this savior of their financial well-being.</p>	<p>Don’t be fooled. Opportunity scams thrive during times of fear and uncertainty. This is because many people are desperate and will grasp at anything that offers hope, no matter how phony. As Chapter 7 clearly shows, you will not improve your situation by participating in MLM, but are much more likely to fall further behind, especially if you borrow on your credit cards to invest in the products and services necessary to “do the business.”</p>
<p>To require “direct sellers” (MLM participants) to disclose average income, a list of references, criminal background of founders, etc. would be an “intolerable burden” for persons who are working from home – with limited resources, trying to make ends meet, etc.</p>	<p>Providing prospects with a one-page disclosure document prepared by the company is nothing compared to the Franchise Disclosure Document that the FTC requires franchisors to give to prospective franchisees before they can sell a franchise. This deceptive argument was actually accepted by FTC officials in its final Business Opportunity Rule.</p>

³⁰⁰ “The Myth of ‘Income Opportunity’ in Multi-level Marketing,” by Robert FitzPatrick. Op. cit.

Misrepresentations regarding emphasis on recruitment over selling to non-participants – and on the recruitment process itself:

MLM misrepresentations	The truth
We are not in the business of recruitment. We in the MLM field don't earn a dime unless we sell products. Our signup fees are nominal (usually less than \$50), with almost no profit made from selling a simple startup kit. Of course, many who sign up love the products and go on to build a business of their own.	The DSA is on record as stating: "One thing all firms regardless of structure or compensation plan have in common is the continuing need to recruit new salespeople to their organizations. Recruiting is the lifeblood of the industry. ." ³⁰¹
Build your business by duplication. Buy five of these "business in a box" packages now, sell them to five people, and ask each to do the same, etc. Be a "product of the products" by signing up for monthly shipment of these items. Soon you will be reaping huge commission checks.	This is how recruitment-driven MLMs earn fortunes for their top recruiters. Commissions from initial and ongoing purchases by new "distributors" (in hopes of profiting) is the life blood of their business. The promised rewards never come, except to those who recruit their way to the top of a pyramid of participants. Take away the "opportunity" inducements for participant purchases, and these companies would fall like a house of cards.
Fear of loss (of potential income by not recruiting aggressively) is a great motivator.	If MLM participants understood what was happening to them, they would fear accumulating further losses by continuing to invest in the MLM. The truly lucky ones are those who refused to buy what their recruiters pressured them to buy – or got out as soon as they suspected the "business" was not a legitimate business.
You will be helping your friends and family, as well as work and church associates, by offering them the opportunity to join your team (i.e., recruiting them into your downline)	For potential personal gain, you are exploiting those you care about the most. In other words you are squandering your social capital. You may even antagonize and drive away those nearest and dearest to you. A business that incentivizes you to deceive and exploit friends and family – and anyone else for that matter – for personal gain could be considered immoral or unethical.
.. . Recruiting is not a requirement for individual success in direct selling, and compensation must always be based on the sale of products and services – whether your own sales or the sales made by your recruits. Consider the following: Thirty-four percent of direct sellers do not earn money from the sales of others, but just from their own personal sales. ³⁰² And what about those customers? It is true that most direct sellers are also consumers of the products and services they sell – for many they got involved after having already used the products, and some get involved just to buy those products at a discount. ³⁰³	Every one of the hundreds of MLM compensation plans I've studied (with the possible exception of some party plans) clearly rewards recruiting far more than retailing so much so that anyone who understands the escalating incentives to build a larger and larger downline would not waste time trying to sell products to non-participants. And I would bet that the "34% of direct sellers [who] do not earn money from the sales of others" includes some non-MLM direct sellers. This is a common deception used by the DSA – to lump MLM with legitimate direct sellers for statistical purposes to make them look better than they are. As far as recruits' getting involved just to buy at a discount, our pricing studies show that even at wholesale, MLM products are not competitively priced to compete with shelf items.

³⁰¹ DSA Comments to the FTC on its proposed Business Opportunity Rule, 2006

³⁰² 1999 National Salesforce Survey, MORPACE International, Inc. (Quoted in Direct Selling 411

³⁰³ Source: 2004 General Public Attitudes Toward Direct Selling, Burke, Inc.

<p>All you have to do to be really successful in this (MLM) business is to recruit a few good ‘business builders’ who are motivated to build a business, and they will build your downline – along with a handsome income – for you. Given the right business builders in your downline, you’ll never have to work again.</p>	<p>The search for “business builders” is really a search for aggressive recruiters in a recruitment-driven product-based pyramid scheme. Given a good understanding of the difference between a product-based pyramid scheme and a legitimate direct selling program, this is tantamount to an admission that one is conducting a product-based pyramid scheme. (See chapters 2 and 5.)</p>
<p>Dr. So-and-so is using the products on his patients who are experiencing great results. Many of them have gone on to build their own business with his help. He certainly wouldn’t lie to us.</p>	<p>Unfortunately, some health professionals are using their position to sell MLM health products to their patients and to recruit and train them in helping to build a “team of health-conscious” participants. These professionals are crossing some ethical boundaries which can lead to some highly unprofessional behavior, as well as to substantial losses. One young doctor lost over \$250,000, and she was instrumental in causing losses suffered by patients and numerous colleagues.</p>
<p>Do your due diligence before you make a decision on joining our program. Here are some materials that will help you make the right decision. Also, you will want to come to this meeting to hear Mr. Gotrocks because he had the same concerns you did before he started and now he’s a Diamond, drives a Mercedes, etc.</p>	<p>By “due diligence,” the recruiter means that you should read the MLM’s promotional materials and listen to the speeches of one of the TOPPs at an emotionally charged opportunity rally of true believers. But whatever you do, don’t do a Google search for MLM scams or negative information on this particular company.</p>
<p>Don’t give up your day job just yet. Just spend a few hours a week building your business, and you will soon be able to kiss that cursed job goodbye.</p>	<p>Here is an appeal to security needs. The thought of building a side business that will replace a job you may hate or that pays poorly or that requires a long daily commute, etc. can be very appealing. But keeping the job to pay bills while pursuing the MLM dream makes some sense. However, sooner or later, the new recruit becomes sucked into a continual round of incentivized purchases of products, paid company events, “tools for success,” etc. Savings may be liquidated or credit card balances heightened before the person can’t continue or finally decides to quit. Of course, the promised ability to quit their job as their financial situation improves never happens.</p>
<p>You may know someone who had a bad experience in MLM, or had a bad experience yourself. But THIS one is different. No other MLM has products that can compete with these, and people are improving their lives by using it. The compensation plan is more generous and fair than the others. Those who get on board with this program now are going to make a killing.</p>	<p>This acknowledgement that other MLMs have not worked can sometimes disarm the resistance of prospects who don’t have a favorable impression of MLM. However, though each MLM may have some unique features, few people have the sophistication to identify the features in the compensation plan that assure the money goes mostly to TOPPs and that the company coffers are enriched at the expense of a continual supply of new recruits who buy products to attempt to move forward, only to quit and be replaced by others who are similarly misled.</p>
<p><i>Traditional network marketing is now obsolete and we will show you the only profitable way a network marketing business can and should be built.</i> <i>Forget everything you have ever been told about MLM. Throw out your “phone verified” leads, cheesy corporate marketing manuals, expensive advertising co-ops, pay per click leads, “fully automated systems”, genealogy lists, motivational CDs, all of it.</i> <i>This won’t make me popular with the big MLM corporate executives who have no idea what the average distributor goes through in trying to build their</i></p>	<p>I am not going to comment on all the hype and deceptions contained in this invitation, but it is a classic example of the many invitations on the web to join or buy into a program that will correct all the problems with MLM. The most important concept that’s missing in this criticism of the industry and the author’s solution to it is that MLM is an INHERENTLY FLAWED ENDLESS CHAIN RECRUITMENT SYSTEM, and no lead system, miracle products, or improved compensation plan will correct it (although</p>

<p>business.</p> <p><i>I don't care. Millions of people join a home business and have no idea that they're being lied to.</i></p> <p><i>I'm going to give you 100% FREE information on how to build a massive MLM business that will rock your world.</i></p> <p><i>You will be so completely blown away by what you learn, I believe it will be a life changing moment. Why? Because you will be able to immediately implement what I tell you, without spending any money, and within 1 hour from now, you will generate results you never thought were even possible.</i></p> <p><i>It doesn't require any skill, talent, money, or motivation. Try what I say, for free. And you will realize that you just found a way to build a massive, lucrative online business.</i></p> <p><i>Every single failure in MLM is caused by one problem and one problem only. And all of the lame training, audios, videos, marketing manuals, industry gurus, and rah rah seminars are attempts to get you to overcome this one problem.</i></p> <p><i>Obviously and unfortunately, it doesn't work for 99% of the people.</i></p> <p><i>I am not going to show you how to overcome this problem like everyone else. For the first time ever in this industry, we have eliminated the problem.</i></p> <p><i>We have eliminated the one problem that causes every single failure in this business. And we are the ONLY company that has ever done this. Building a business for yourself and everyone in your entire organization has now become easy.</i></p> <p><i>You will be able to immediately implement this new approach, for free. This information is so powerful, within one hour, you will start generating massive results that will dwarf every business accomplishment you have ever made in the past and will dwarf even what you thought was possible.</i></p> <p><i>Finally, your wildest dreams of what is possible are about to become true. Just fill out the form below.³⁰⁴</i></p>	<p>it may be possible to ameliorate some of its effects. For example, not paying commissions on downline sales, but only on sales to non-participants, would give it less of a pyramidal recruitment emphasis.)</p>
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Misrepresentations regarding MLM compensation plans and promised or actual income from MLM participation:

MLM misrepresentations	The truth
MLM is like insurance, investing, inventing, acting, and writing in that hard work at the outset yields residual income for the rest of your life. This is done by "leveraging" the efforts of your downline – so you can retire early, travel, etc.	The odds of success in MLM are more like gambling than legitimate residual income. It appeals to the "something for nothing" mentality. A kind of MLM addiction has been observed in some "true believers." The large residual incomes reported are as much the result of time of entry and willingness to deceive prospective recruits as of payoff for hard work. To succeed in MLM, one must leverage one's deceptive recruiting through others who can be persuaded to do the same.
Standard jobs are not rewarded fairly. In MLM, you can set your own standard for earnings.	Fair? Most MLM compensation plans are weighted heavily towards those who got in early or scrambled to get to the top of a pyramid of participants. MLM is the epitome of an unfair and deceptive practice.

³⁰⁴ "MLM Lies Exposed," at - mlmliesexposed.com/

<p>Average earnings statements on official reports make MLMs appear highly profitable for participants. For example, one MLM company report of “actual income” of distributors may state that “.16% of active distributors have achieved the level of Blue Diamond,” whose average earnings exceed \$500,000 a year. This is made to appear to be respectable odds of success.</p>	<p>This is a mathematical trick MLM promoters play on unsophisticated recruits. MLM reports of average income of participants are full of such deceptions. When statistics are presented without deception, the “opportunity” is not so attractive. The “.16%” is 0.16% – or 0.0016 (dropping the % symbol). This is equivalent to odds of one in 625. And for statistical integrity, ALL who signed up as distributors should be factored in, but MLMs eliminate dropouts in their statistics – a huge deception. With less than 10% remaining after five years (the minimum time those at the top in the pyramid have been in the scheme), the number should be reduced by at least 90%. This leaves odds of 0.00016 of reaching the top level where the money is made, or odds of 1 in 6,250! This looks far worse than <u>“.16%”</u>³⁰⁵</p>
<p>“Anyone can do this” (i.e., earn a very large residual income like these top participants we are showing off that come to opportunity meetings in their Hummers and luxury cars.)</p>	<p>Holding up top earners as examples of what others can do is deceptive. It is unfair to sell tickets on a flight after the airplane has already left the ground.</p>
<p>Company payout to participants is reported as “earnings” to them.</p>	<p>The fact is that every MLM requires “pay-to-play” or a quota of minimum purchases in order to qualify for commissions and/or advancement in the scheme. In addition, in order to climb the ladder in the hierarchy of distributors to a level where actual profits are realized, one must recruit aggressively.</p> <p>In a one-year test of the cost of conducting a successful recruitment campaign, I found the operating expenses to be significant (over \$25,000 in today’s dollars) – just like for any recruitment-oriented business. The combination of “pay-to-play” and operating expenses raises the breakeven bar such that it is extremely rare for any MLM recruit to actually earn a profit after subtracting such expenses. Read Chapter 7.</p>
<p>Legitimate direct selling companies are very careful to represent earning potential accurately. The DSA Code of Ethics requires companies and their sales force members to provide potential independent sellers with accurate information about the company’s pay structure, products and sales methods.³⁰⁶</p>	<p>Out of hundreds of MLMs I have analyzed, I have never seen earning potential or average earnings represented honestly. All published company reports of average earnings of MLM participants leave out attrition, or those who dropped out, as well as money paid in to the company for incentivized products and services, not to mention minimal operating expenses common to all recruitment-focused MLMs.</p>
<p>Here is our “Executive Summary” of information on this unprecedented decision. Note what you can make by following this “proven success program.”</p>	<p>Projections of income based on calculated extension of formulas embedded in the compensation plan are seldom balanced with a discussion of the abysmal odds of getting to the levels where such high levels of commissions are possible. If less than 1 in 25,000 achieve that goal, and those are mostly persons who got in at the beginning of the recruitment chain, is it fair to present it as a real possibility? Again, new recruits are being sold tickets to flights that have already left the ground.</p>

³⁰⁵ See the book “How to Lie with Statistics,” by Darrell Huff. (New York: W.W. Norton & Company, 1954)

³⁰⁶ Direct Selling 911 web site

<p>People choose to get involved in direct selling for a variety of reasons. Some hope to make it a full-time career, but most sign up to either earn a little extra money or to receive a discount on their own purchases.³⁰⁷</p>	<p>The last two reasons given are manifestly false. Of the hundreds of compensation plans I have personally analyzed, none have offered sufficient payout to cover incentivized purchases, not even including minimum operating expenses.</p> <p>It would be extremely rare for any MLM participant without a huge downline (which requires enormous time and resources) to report a profit on their income taxes – especially if they counted products they purchased that they would not have purchased except to meet quota requirements for commissions or advancement.</p> <p>It would also be a very gullible person to pay the inflated prices for overhyped products, such as health products (“pills, potions, and lotions”), Internet services, or travel services.</p>
<p>When considering the dropout rate, one also has to consider direct sellers who get involved for several months each year to earn extra money for family vacations, holiday gifts or other seasonal purchases. These sellers don’t “drop out” because they weren’t successful, they drop out because they achieved their goal and don’t choose to sell all year. For many, they’ll join again the next year and drop out just the same.</p>	<p>Since MLM compensation plans primarily reward downline recruitment, and one cannot maintain resultant “residual income” on a seasonal basis, this is an empty promise – about as empty as they come.³⁰⁸</p>
<p>In most MLM reports of average income of participants, gross commissions are reported as though it is net income. Never are the incentivized purchases and other products from the company subtracted when calculating average income. The spokesmen and bean counters in the MLM company claim they cannot determine what participants have spent on operating expenses.</p>	<p>In many cases, even participants at fairly high levels in the pay plan are losing money – or at least not reporting an income on their taxes. (See report on preparers of Utah tax returns in Chapter 6.) In any case, a simple formula of money in versus money out (money paid to participants subtracted from money paid into the company by participants) would reveal an alarmingly high loss rate – made even worse when all expenses are subtracted.</p>
<p>Legitimate direct selling opportunities offer the flexibility to set your own goals and achieve them on your own terms.³⁰⁹</p>	<p>MLM participants (unlike legitimate direct sellers) can set their own goals, but not on their own terms. They must conform to a rigid compensation plan and often a very restrictive “policy and procedures” document.</p>
<p>“More than half of direct sellers report that their net income from direct selling, after taxes and expenses, is positive.”³¹⁰</p>	<p>Based on tax studies and analysis of all of the MLMs for which I have been able to obtain data on average earnings, this DSA statement is blatantly false. I can only assume that the research that was sponsored by the DSA³¹¹ was mixing non-MLM data with MLM data – common technique used by the DSA to make the numbers look acceptable.</p>
<p>Over 13.6 million individuals sold for direct selling companies as independent contractors with estimated retail sales of \$29 billion in 2004.³¹²</p>	<p>Very misleading. My calculator tells me that this would mean participants average retail sales was \$2,132.35 each for the year. Considering the fact that MLM product prices are not competitive (See Chapter 4) and that compensation plans are so top heavy that there is almost no incentive to sell to non-participants, they must be including sales to downline participants as retail sales.</p>

³⁰⁷ Direct Selling 911 web site

³⁰⁸ See Chapter 6

³⁰⁹ Direct Selling 911 web site

³¹⁰ Direct Selling 911 web site

³¹¹ 2002 National Salesforce Survey, Research International, Inc.)

³¹² Direct Selling 911 web site (DSA 2005 Growth and Outlook Survey)

<p>The “passive income” of successful MLM business builders is like that of a very successful author or inventor, yielding royalties or “residual income” forever without having to put forth any additional effort.</p>	<p>The royalties coming from intellectual properties such as inventions or books is totally passive, once the work is done, except for a few speaking tours and interviews, etc. But with MLM, the work is anything but passive. One’s downline must be carefully tended and encouraged to buy products and recruit others to do the same – often with aggressive and expensive recruitment campaigns to replace those who are dropping out at a rapid pace.</p>
<p>The income stream you establish from building your (downline) business can be willed or passed on to your heirs, leaving them with a substantial fortune, or at least a residual income that will greatly improve their lives.</p>	<p>This is a pipe dream for all but a handful of TOPPs (top-of-the-pyramid promoters) who are in the driver’s seat of a large MLM. But even then, without constant tending and recruitment, the downline can unravel rather quickly as 99% of participants eventually drop out. Unless your heirs are as aggressive as you at recruitment and “playing the game,” they may wind up having to work for a living. This is not the worst thing that could happen to them.</p>
<p>Our MLM has an unprecedented compensation plan that is far more fair and liberal in its payout than those of other MLMs.</p>	<p>Out of hundreds of MLM compensation plans I have analyzed, all have the same five commonalities that cause extremely high loss rates and that clearly separate them from legitimate selling or small business opportunities. Such claims are pure hype for an independent analyst experienced in scrutinizing product-based pyramid schemes.³¹³</p>
<p>Here is our “Executive Summary” of information on this unprecedented decision. Note what you can make by following this “proven success program.”</p>	<p>Projections of income based on calculated extension of formulas embedded in the compensation plan are seldom balanced with a discussion of the abysmal odds of getting to the levels where such high levels of commissions are possible. If less than 1 in 25,000 achieve that goal, and those are mostly persons who got in at the beginning of the recruitment chain, is it fair to present it as a real possibility? Again, new recruits are being sold tickets to flights that have already left the ground.</p>
<p>In a survey of respondents to the FTC’s proposed Business Opportunity Rule, we asked seasoned MLM participants if they were making any money. Most responded “yes.” Then we asked if they had reported a profit on their income taxes. Again, a “yes” answer. They also claimed to be using their MLM business as a tax write-off.</p>	<p>When we asked these same people “Which is greater – the money you are receiving from the company in commissions and bonuses, or the money you are paying to the company for products and services. They nearly all either said they don’t know or “That is information we can’t disclose.”</p>
<p>MLM spokesmen often speak on investor conference calls, as reflected in their financial statements, that they are entering “emerging markets” and/or introducing new products with an exciting new “product launch” - giving the impression of an innovative and growing direct selling company.</p>	<p>As explained in earlier chapters, MLM companies must avoid inevitable market saturation and collapse by re-pyramiding into new markets and/or with new product divisions. This is because they are all built on unlimited recruitment of endless chains of participants, who are the primary customers. No MLM market can sustain itself without extending its recruitment efforts to other markets.</p>

³¹³ See Chapter 2

Misrepresentations regarding success and failure, or retention and attrition (dropout) rates among MLM participants:

MLM misrepresentations	The truth
<p>Turnover, as in any business, is a reality that assures an ample supply of available prospects.</p>	<p>Again, with few real customers, MLM products are sold by recruiting a revolving door of new “distributors” who buy products to “do the business.” And since people perceive the opportunity as dwindling with each new “distributor,” market saturation requires promoters to recruit elsewhere.</p> <p>So MLMs quickly evolve into Ponzi schemes, requiring the opening of new markets in foreign countries and/or new product divisions to repay earlier investors, as has happened with Amway (now Quixtar) and Nu Skin (which became IDN, then Big Planet and Pharmanex). It’s not turnover as in a normal business, but continuous churning of new recruits to replace dropouts.</p>
<p>If you fail at this program, it is because you failed to properly “work the system.”</p>	<p>The system itself dooms nearly all participants to failure. MLM is built on an endless chain of recruitment of participants as primary customers. It assumes both infinite markets and virgin markets, neither of which exists. It is therefore inherently flawed, fraudulent, and profitable only for founders and those at or near the top of their respective pyramids of participants. Even with their best efforts, the vast majority will always lose money.³¹⁴</p>
<p>“In any business, one must invest time and money to be successful.” Like anything else, you can expect to get out of it what you put into it.</p>	<p>Independent research, supported by worldwide feedback, suggests that the more a person invests in an MLM in time, effort, and money, the more he/she loses – which is true of any scam. Committed MLM participants may continue investing thousands, and even tens of thousands of dollars, over many years before running out of money or giving up.</p> <p>Conversely, in legitimate companies, sales persons are not expected to stock up on inventory or subscribe to monthly purchases. But in MLM, incentivized purchases (required to participate in commissions and/or advancement) are merely disguised or laundered investments in a pyramid scheme.</p>
<p>“It takes time to build any business.” “This is not a get-rich-quick scheme, but a ‘get-rich-slow’ program.” “While the potential rewards are great, don’t expect instant success,” etc.</p>	<p>MLM promoters sell recruits on their programs as a business opportunity that takes time to build, but to get around state regulations on the sale of business opportunities, they present it to authorities as a “direct selling” opportunity (see above). However, In legitimate direct sales programs, sales persons earn commissions right away and don’t have to wait months or years for commissions to exceed expenses</p>

³¹⁴ See Chapter 7.

<p><i>This myth [that approximately 99.9% of direct sellers lose money] is also quite interesting because it essentially asserts that 15.2 million people in the US and 60 million people around the world continue as direct sellers despite losing money. Are we to believe the 5% of the US population would continue in a business where they are losing money? Simply put, most people do not lose money in direct selling. Neither the facts nor common sense supports that theory.</i>³¹⁵</p>	<p>Again, the DSA mixes data from MLM participation with legitimate direct selling. And we who advocate for consumers have observed a strong tendency for people who have “drunk the Kool-aid” of MLM to keep trying to make their MLM business work for them or will jump from one MLM to another in hopes of finding the right MLM for them - one that pays fairly and generously for their Herculean efforts to build a downline. I have communicated with victims of MLMs that have strung them along with empty promises for ten or twenty years, only to fall further and further behind financially.</p>
<p>A DSA spokespersons declared: “No one should feel like a failure if it [MLM participation] doesn’t work out for them.”³¹⁶</p>	<p>When a person has knocked themselves out and lost his or her life savings (or maxed out their credit cards) as a result of having been taught that if they “work the system” correctly, their success is guaranteed, it seems rather hollow to suggest that they should not feel like a failure. If not them, then who is to blame? Could it be - - - the SYSTEM???</p> ³¹⁷
<p>Turnover, as in any business, is a reality that assures an ample supply of available prospects.</p>	<p>Again, with few real customers, MLM products are sold by recruiting a revolving door of new “distributors” who buy products to “do the business.” And since people perceive the opportunity as dwindling with each new “distributor,” market saturation requires promoters to recruit elsewhere.</p> <p>So MLMs quickly evolve into Ponzi schemes, requiring the opening of new markets in foreign countries and/or new product divisions to repay earlier investors, as has happened with Amway (now Quixtar) and Nu Skin (which became IDN, then Big Planet and Pharmanex). It’s not turnover as in a normal business, but continuous churning of new recruits to replace dropouts.</p>
<p>If you don’t succeed, it is because you don’t really BELIEVE in our system and what it can do for you. You attitude is all important - you attract what you really believe in. Think success, and you will be successful.</p>	<p>This idea that our success is determined by our attitude or belief system is a nice platitude and does have some applications, but only when doing something that has validity. This reminds me of the film “Believe,” which is a mockumentary about Amway-style MLM programs. Those at the bottom of the pyramid are “Believers,” and those at the top are “Supreme Believers.”</p>
<p><i>Reports of high MLM dropout rates are exaggerated. Nearly four in five (78%) direct sellers who are in direct selling for less than a year report that they are very or extremely likely to continue as a direct seller in the future. In addition, in a survey of former direct sellers, only 34% of them had a tenure in direct selling of less than one year at the time they dropped out from direct selling.</i>³¹⁸</p>	<p>It appears the DSA is using a prestigious survey research firm to get the results they want by furnishing data that lumps MLM participation with legitimate direct selling.</p>

³¹⁵ Quoted in DS411

³¹⁶ “Top 10 Myths & Facts about Direct Selling” posted on the directselling411 web site.

³¹⁷ See Chapter 2

³¹⁸ 1997 Survey of Attitudes Toward Direct Selling, Wirthlin Worldwide. Quoted on Direct Selling 411 web site.

<p>“MLM has a 97% fail rate.” “Only 5% of people make any money in MLM.” “Only 10% of those who do network marketing achieve their goals.”</p>	<p>These kinds of statistics are thrown out all over the Internet and cited at MLM opportunity meetings” Almost none of them have any serious research to back up their figures. The reason this is important issue is that the inverse of loss rate is success rate. Actually, the loss rate is far worse than even MLM insiders suspect or admit to. Those of us independent researchers who have obtained actual average earnings reports and other data from the MLM companies agree that the loss rate falls in the range of from 99% to 99.99%, depending on the company.</p>
<p>The high turnover in MLM can be compared to high turnover among retail sales persons.</p>	<p>Robert FitzPatrick of Pyramid Scheme Alert recently wrote: <i>For attrition rates, you may find DSA's latest statement of interest. They state that the average turnover rate in MLM is over 50%, but then go on to compare that number with turnover rates in the traditional "retail" sales industry.</i> <i>This, as we would expect, is spurious. Retail sales in stores is seasonal and, by design, part time. And, as you work, you actually get paid so there is no relation to the attrition rate in real retail sales and financial loss. And you are not required or even induced to buy the goods in the store as part of your pay plan. Finally, MLMs should not be compared to retail sales at all, since few MLMers ever retail anything anyway.</i> <i>Since MLM is not sales work, but pyramid recruiting, it has no counterpart in the real world of work or employment.</i>³¹⁹</p>
<p>More than half of direct sellers report that their net income from direct selling, after taxes and expenses, is positive. In addition, a positive net income is reported by nearly half of new direct sellers — those representing their current company for less than a year — and by nearly half of direct sellers who say that they are not very likely or not at all likely to continue in direct selling in the future. In addition, research shows the following:</p> <ul style="list-style-type: none"> • four in five (82%) direct sellers have been with their current direct selling company for one year or more, and 47% for five years or more. • 89% of direct sellers rate their personal experience in direct selling as excellent, very good, or good. • 84% of direct sellers say that direct selling meets or exceeds their expectations as a good way to supplement their income or as a way to make a little extra money for themselves. • 91% of direct sellers say that direct selling meets or exceeds their expectations as a business where the harder they work the more money they can make.^{320 321} 	<p>These statistics are skewed in MLMs favor by mixing legitimate direct selling with MLM and using selection criteria for responses that fail to bring out negative responses, such as we consumer advocates receive frequently from victims worldwide. We know that approximately 99.9% (calculated from our latest data) of direct sellers lose money. In fact, if the outsized income of TOPPs (top-of-the-pyramid promoters) is eliminated from the calculations of average incomes, the loss rate is closer to 99.9%, which means that the chances of new recruits profiting is approximately ZERO. So such glowing statistics of widespread participant satisfaction should make a sophisticated analyst want to see the details of the study to see how the data sample was manipulated. (See Chapters 6 and 7.)</p>

³¹⁹ Letter to Jon Taylor dated October 21, 2010

³²⁰ 2002 National Salesforce Survey, Research International, Inc

³²¹ Quoted in DS411

Misrepresentations about the personal benefits of MLM – time freedom, improved lifestyle, supportive associates, opportunity to help others, etc.:

MLM misrepresentations	The truth
MLM allows you to use your natural talents in ways that cannot be found in any other business activity.	Your talents can be better utilized building and promoting any honest business.
In MLM, you can be the master of your destiny.	You will be a slave to the phone, to meeting the qualifications for commissions and bonuses, and to continual pressure to recruit new participants to replace dropouts. You are also caught in a money trap of hyper-consumption.
In MLM, you can't make money without helping others succeed.	In truth, you make money by deceiving others, by recruiting and selling them on investing money in a program that will cause them almost certain financial loss.
MLM offers not just a nice income, but a truly fulfilling life, with the means to enjoy the good life. (The happiness of participants living a life of luxury and ease is portrayed in sales materials used in recruitment – and in luxury cars driven by leaders.)	“Sages of the ages,” as well as oracles from most of the world’s great religions denounce the acquisition of monetary wealth as a source of lasting happiness. Those who become the most involved in MLM frequently lose their sense of what constitutes true wealth – friends, family, service to God and one’s fellowman, the search for truth and wisdom, a life well lived, etc.
The time freedom you can get from MLM can be found nowhere else. You can have more time to enjoy friends and family and other personal pursuits, etc.	With MLM, one can actually LOSE one’s time freedom. I like the way Robert FitzPatrick put it: <i>Decades of experience involving millions of people have proven that making money in MLM requires extraordinary time commitment as well as considerable personal willness, persistence and deception. Beyond the sheer hard work and special aptitude required, the business model inherently consumes more areas of one’s life and greater segments of time. In MLM, everyone is a prospect. Every waking moment is a potential time for marketing. There are no off-limit places, people or times for selling. Consequently, there is no free space or free time once a person enrolls in MLM system. Under the guise of creating money independently and in your free time, the system gains control and dominance over people’s entire lives and requires rigid conformity to the program. This accounts for why so many people who become deeply involved end up needing and relying upon MLM desperately. They alienate or abandon other sustaining relationships.</i>
You will belong to a great support team. In MLM, you have a whole network of people willing to help you succeed and be your friends.	Some MLMs operate like a cult with an “us vs. them” mentality. Watch how quickly the team ostracizes you when you quit or discover contrary information about the legitimacy of the program.
When you are earning all that money (in MLM), just think of all the people you will be able to assist in some way.	Think instead of all the people you can help by staying away from MLM and not recruiting others. They will not lose money in what is essentially an endless chain scam. They will do better with almost any honest work.

NOTE: the next five misrepresentations are debunked by Robert FitzPatrick:³²²	
MLM is the best option for owning your own business and attaining real economic independence.	<i>MLM is not self-employment. 'Owning' an MLM distributorship is an illusion. Some MLM companies forbid distributors from carrying additional lines. Most MLM contracts make termination of the distributorship easy and immediate for the company. Short of termination, downlines can be taken away with a variety of means. Participation requires rigid adherence to the 'duplication' model, not independence and individuality. MLM distributors are not entrepreneurs but joiners in a complex hierarchical system over which they have little control.</i>
MLM is a new way of life that offers happiness and fulfillment. It is a means to attain all the good things in life.	<i>The most prominent motivating appeal of the MLM industry as shown in industry literature and presented at recruitment meetings is the crassest form of materialism. Fortune 100 companies would blush at the excess of promises of wealth and luxury put forth by MLM solicitors. These promises are presented as the ticket to personal fulfillment. MLM's overreaching appeal to wealth and luxury conflicts with most people's true desire for meaningful and fulfilling work in something in which they have special talent or interest. In short, the culture of this business side tracks many people from their personal values and desires to express their unique talents and aspirations.</i>
Success in MLM is easy. Friends and relatives are the natural prospects. Those who love and support you will become your lifetime customers.	<i>The commercialization of family and friendship relations or the use of 'warm leads', which is required in the MLM marketing program, is a destructive element in the community and very unhealthy for individuals involved. Capitalizing upon family ties and loyalties of friendships in order to build a business can destroy ones social foundation. It places stress on relationships that may never return to their original bases of love, loyalty and support. Beyond its destructive social aspects, experience shows that few people enjoy or appreciate being solicited by friends and relatives to buy products.</i>
MLM is a spiritual movement.	<i>The use of spiritual concepts like prosperity consciousness and creative visualization to promote MLM enrollment, the use of words like 'communion' to describe a sales organization, and claims that MLM is a fulfillment of Christian principles or Scriptural prophecies are great distortions of these spiritual practices. Those who focus their hopes and dreams upon wealth as the answer to their prayers lose sight of genuine spirituality as taught by all the great religions and faiths of humankind. The misuse of these spiritual principles should be a signal that the investment opportunity is deceptive. When a product is wrapped in the flag or in religion, buyer beware! The 'community' and 'support' offered by MLM organizations to new recruits are based entirely upon their purchases. If the purchases and enrollment decline, so does the 'communion.'</i>

³²² "Ten Myths of 'Income Opportunity' in Multi-level Marketing," by Robert FitzPatrick. Op. cit.

<p>MLM is a positive, supportive new business that affirms the human spirit and personal freedom.</p>	<p><i>MLM marketing materials reveal that much of the message is fear-driven and based upon outright deception about income potential. Solicitations frequently include dire predictions about the impending collapse of other forms of distribution, the disintegration or insensitivity of corporate America, and the lack of opportunity in other professions or services. Conventional professions, trades and business are routinely demeaned and ridiculed for not offering 'unlimited income.' Employment is cast as wage enslavement for 'losers.' MLM is presented as the last best hope for many people. This approach, in addition to being deceptive, frequently has a discouraging effect on people who otherwise would pursue their own unique visions of success and happiness. A sound business opportunity does not have to base its worth on negative predictions and warnings.</i></p>
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Misrepresentations relating to credibility of the MLM, its leaders, and important persons whose names are somehow associated with it:

MLM misrepresentations	The truth
<p>Former presidents and other very reputable people have endorsed our MLM or spoken at our events.</p>	<p>This credibility argument is used with many scams, including the Bernie Madoff Ponzi scheme. As for speaking fees, it should be no surprise that the time and names of notables can often be bought.</p>
<p>The founders and leaders of this MLM are highly experienced and reputable people who would not want to cheat anyone. They are certainly not criminals.</p>	<p>Communications with top officials of MLMs convince me they don't wake up each morning wondering how many people they can defraud of their money that day. MLM leaders at even the highest levels of the company resolve "cognitive dissonance" between what they say or believe and the harm done by their program by highly developed self-deception and denial. They also typically interact with the TOPPs (top-of-the-pyramid-promoters), or kingpins, in their organizations and not with the victims at the bottom of their respective pyramids.</p>
<p>Warren Buffet and Donald Trump, who are famous for their riches and extremely successful careers, think MLM is a great way for the average person to accumulate wealth.</p>	<p>These men have ownership in some MLM companies, but do not participate in the endless chain of recruitment. They are simply cashing in on an MLM as one of many investments they profit from. They did not originate the schemes.</p>
<p>Our MLM company invests in very worthy (and visible) humanitarian causes. ". . . direct selling companies gave an estimated \$90 million to charitable causes in 2003. When asked if they contribute any money, goods or services to social programs, 89 percent of the direct seller respondents said they contributed to human services programs and charities."³²³</p>	<p>The mafia supported local charities. And because a bank robber donates some of his take to charity, does that excuse the robbery?</p>

³²³ Estimated Social and Economic and Social Contributions of the U.S. Direct Selling Industry, Ernst & Young, Feb. 15, 2006. Quoted by DSA in its comments to the FTC, objecting to its Proposed Business Opportunity Rule (July 17, 2006)

<p>The founders and leaders of our MLM are highly experienced and reputable people who would not want to cheat anyone. They are certainly not criminals.</p>	<p>Communications with top officials of MLMs convince me they don't wake up each morning wondering how many people they can defraud of their money that day. MLM leaders resolve "cognitive dissonance" between what they say or believe and the harm done by their program by highly developed self-deception and denial. They also typically interact with the TOPPs (top-of-the-pyramid-promoters), or kingpins, in their organizations and not with the victims at the bottom of their respective pyramids.</p>
<p>NOTE: The next four misrepresentations were debunked by John Fogg³²⁴</p>	
<p><i>The Wall Street Journal</i> had at one time said that by the year 2000, 60 to 70 percent of all goods and services would be sold through MLM.</p>	<p>The U.S. sells about \$6 trillion plus worth of goods and services per year - give or take ten or twenty billion. By the most aggressive accounts, network marketing (which for the sake of quoting really BIG numbers must include the Direct Selling industry) accounts for \$50 billion in annual sales. More conservative estimates put the figure at a maximum of \$15 to \$20 billion worldwide.</p>
<p>Some 20 percent of all the millionaires in America were created through network marketing.</p>	<p><i>Twenty percent of all the millionaires in America were not created through network marketing. By most accounts, as many as 90 percent of them were created through real estate, 90 plus 20 equals 110, and that kind of math would get an F in any school.</i></p>
<p>Network marketing is taught at Harvard and Stanford business schools and in numerous other leading colleges and universities throughout the country.</p>	<p>Not true. As Harvard 'B' School professor Thomas Bonora said in an article in <i>Marketing News</i>: <i>We do not teach such methods [MLM] at the Harvard Business School; they are not part of the curriculum; to my knowledge, they are not taught at this or any other reputable business school in the country . . . Multi-Level Marketing schemes, like chain letters and other devices, sometimes are at the borderline of what is legal -- and over the borderline of what is ethical . . . He concluded by saying that examples of legit MLMs are few and far between.</i> <i>Stanford officials have refused to react to this statement, apparently not considering such a claim as worthy of comment.</i></p>
<p>Some 20 percent of all the millionaires in America were created through network marketing.</p>	<p><i>Twenty percent of all the millionaires in America were not created through network marketing. By most accounts, as many as 90 percent of them were created through real estate, 90 plus 20 equals 110, and that kind of math would get an F in any school.</i></p>
<p>John Naisbitt, in his best-selling book, <i>Megatrends</i>, said network marketing is the wave of the future.</p>	<p><i>John Naisbitt never mentioned network marketing in <i>Megatrends</i>, <i>Megatrends for Women</i>, or anywhere else for that matter. You can't even find a mention in back issues of his far more liberal "Trend Letter."</i></p>
<p>"Proprietary density" (unique verbiage) to obfuscate explanation of pay plan leaves recruits confused and deceived; e.g., "unlimited income."</p>	<p><i>Explanation of compensation plans for legitimate direct selling programs are comparatively simple and straightforward.</i></p>
<p>NOTE: The foregoing are merely samples of the misrepresentations that are used to mislead prospects into joining an MLM. I am continually learning of new MLMs and additional misrepresentations used to promote or justify them.</p>	

³²⁴ "Four Lies about MLM," by John Fogg. posted on MLMwatch.org In 2002

Cartoon by Cal Grondahl. From the book THE NETWORK MARKETING GAME. ©1997 by Jon M. Taylor.



"Be my downline? What happened to valentine?"

Chapter 9: VILLAINS AND VICTIMS – Who or what is responsible for MLM abuse? Who are victimized by MLM? What is the impact of MLM on individuals and families? On the business community? On society at large?

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Introduction and summary

Most people who join an MLM buy some products, test the waters by approaching a few friends and/or relatives, and then quit without much fanfare after spending no more than few hundred dollars. But there is a significant portion of participants who lose thousands, even tens of thousands of dollars, after making Herculean but vain efforts to succeed in what is actually a flawed business model. Had they understood the deceptions and fallacies underlying all MLMs, it is likely they never would have joined and allowed themselves to be victimized with such predictable results.

In this chapter we will explore who is to blame for this class of consumer abuse, what types of people are affected, and in what ways individuals, families, business, and society in general are impacted by MLM.

MLM's villains



As established in prior chapters, the loss rate for MLMs is high enough and widespread enough throughout the industry that independent analysts would not consider MLMs to be legitimate business opportunities at all. But if people are harmed by MLM participation, who is responsible? Is the blame to be found in those who dream up the schemes, in those who promote the schemes, in lax law enforcement, in gullible victims, or some other group of people? Or is the blame to be found in a fundamentally flawed business model – and inadequate laws to protect consumers? Below are the types of players that I believe deserve some of the blame for MLM abuses and for allowing such flawed systems to go forward at all.

“Anything goes” entrepreneurs seeking to make a killing. There is a certain class of entrepreneurs who believe that anything goes, as long as it's not illegal – or at least not enforced. They are opposed to strict government regulation and believe it is the consumer's duty to remember and observe the “buyers' beware” dictum. In other words, if someone gets hurt in their MLM program, it's not their fault, but should be placed squarely on the victim's shoulders for not being wise in his spending and investment choices. I have heard conservative, pro-business politicians call this the “stupidity tax,” i.e., “they get what they deserve.” Some even see consumer protection efforts by government agencies as an encroachment on our free market system. They are for free markets and less regulation.

MLM company leaders who don't understand – or don't want to understand – the harm. Some MLM leaders (founders, executives, and TOPPs (top-of-the-pyramid promoters) truly do not understand the inherent flaws in MLM as

endless chain recruitment schemes. They interact mostly with high level people in the MLM organization, and therefore don't get much feedback from recruits who lose money and drop out. Since they live and work in an echo chamber of enthusiastic promoters, they ignore or remain in denial of the harm even when they see signs of serious problems, such as high attrition or high loss rates.

In 2001, in the presence of two witnesses, I met with Corey Lindley, who was then CFO for Nu Skin Enterprises, Inc., about the deceptive reporting in their "Actual Average Incomes" of distributors report. Mr. Lindley responded cynically, "People don't pay any attention to those numbers."

Of course, why would Nu Skin officials want to tell the whole truth if they can obfuscate the numbers to make them appear innocuous? If true statistics were provided to prospects in a form that they could understand, no rational person would join. (See Chapter 7 where it is clearly shown that less than one in a thousand realizes a significant profit after expenses.)

White collar criminals who find MLM an easy way to scam people. While this is not necessarily the norm for those leading this activity, we do occasionally hear of convicted or suspected criminals who start or promote MLMs. The rapid and huge gains that can be made can be very enticing to someone who is willing to set principles of fairness and honesty aside in order to cash in at others' expense. An Internet search for MLM leaders with criminal – or at least questionable – backgrounds can yield many examples.

MLM company communicators, industry spokespersons, DSA lobbyists, and attorneys hired by MLMs.

Those whose job it is to explain away the many problems that surface in this corrupt industry create and share arguments against whistle-blowers who challenge the system and plaintiff attorneys and their experts who present evidence of fraud.

These paid pro-MLM forces, especially the DSA (Direct Selling Association), are



well-funded and powerful. They may be acting purely out of pecuniary or self-serving interests and divorce themselves from concern for the well-being of the public. I saw this demonstrated in several legal cases against MLMs in which the experts hired by the defense repeated the same deceptions used by MLM spokespersons for decades. (See Chapter 8 for over 111 typical examples of misrepresentations used by MLM defenders.)

Legislators responding to MLM special interests – and consumer protection officials influenced by them.

Consumer protection has suffered as legislators have caved to the demands of MLMs willing to support their election campaigns with money and promises of support from a large block of voters.

I witnessed this first-hand when the DSA and some Utah MLM companies drafted and lobbied the Utah State Legislature for a bill exempting MLMs from prosecution as pyramid schemes – so long as they offered "consumable products." When I spoke at the hearings, I found the attitude towards me to be quite hostile, as the room was full of DSA and MLM spokespersons and minions.

One state senator, apparently influenced by implied support from a large block of "90,000 direct sellers in the state" (according to deceptive DSA testimony in 2005) and donations towards his next election campaign, lectured all present on how in any business there are those who succeed and those who fail. He said that if a person invested in a program and didn't work hard enough or made foolish decisions, it was not the company's fault. His message, in essence, was "You can't legislate morality." His highly conservative associates all nodded their heads in agreement.

Even Utah's Attorney General, Mark Shurtleff, testified in favor of a 2006 pro-MLM bill, saying it targeted "only the really bad pyramid schemes – the ones that are not selling any legitimate products." He was clearly misinformed on the subject – and not interested in getting informed. I later learned that the primary contributors to his campaign were MLMs. He also spoke at a USANA convention, a video of which was shown on

YouTube in which he said, “If I were not Attorney General, I would be a USANA distributor” – which brought wild applause!

Complaint-based law enforcement does not work with endless chains. Since victims of endless chain schemes rarely file complaints, less than proactive regulators fail to see MLM as a problem. In the consumer protection function in law enforcement, generally the squeaky wheel gets the grease. No complaints – no action. It takes a truly caring, daring, and dedicated public official to stand up to the powerful lobby and defense forces of the MLM industry. In other words, this type of white collar crime is not one for which complaints are an effective trigger for action.

Why do MLM victims remain silent?

Victims rarely file complaints for a variety of reasons, including the following that we have observed in working with MLM victims:

- *They blame themselves.* They’ve been taught that anyone who “works the system” will succeed and that if a new participant fails it is their fault, rather than the fault of the system. Such deceptions are common.
- Since they are part of an endless chain of recruitment, they *fear consequences for filing a complaint from or to those they recruited or those who recruited them*, who may be close friends or relatives still in the program.
- *They may fear self-incrimination*, since in MLM every major victim has likely been a perpetrator, recruiting unwitting persons in order to cover their escalating expenses.

In the aforementioned legislative hearings, officials from the Utah Department of Commerce and Division of Consumer Protection testified that they had received only a couple of dozen complaints from victims of MLM companies. I knew from my research that Nu Skin victims alone numbered in the hundreds of thousands – mostly out-of-state. But as explained earlier, it is extremely rare for an MLM victim to file a formal complaint with authorities.

In its 2006 proposal for a new Business Opportunity Rule, the FTC noted³²⁵

³²⁵ Federal Register / Vol. 71, No. 70 / Wednesday, April 12, 2006 / Proposed Rules

The Commission staff’s analysis of consumer fraud complaint data also demonstrates the prevalence of deceptive pyramid marketing schemes. For the period January 1997 through December 2005, Commission staff found that consumers lodged 17,858 complaints against pyramid schemes, reporting alleged aggregate injury level of over \$46 million (\$46,824,347). Indeed, complaints against pyramid marketing companies consistently ranked among the top 20 injury categories reported in consumer fraud complaints to the Commission.

As serious a problem as “pyramid marketing schemes” may seem from these FTC complaint statistics, they grossly underestimate the problem. Since 99%³²⁶ of the over 15 million MLM participants³²⁷ every year lose money³²⁸ – all of whom joined the MLM based on a whole litany of misrepresentations³²⁹ – the actual number of MLM victims every year easily exceeds ten million (including some long-term victims), and tens of millions more if you count overseas victims of U.S.-based MLMs.



Aggregate losses could amount to well over \$10 billion per year in this country alone³³⁰. In fact, when these numbers are properly understood, losses from MLM fraud easily exceed all other classes of “work from home” or “business opportunity” fraud put together. (For background on this these statistics, see Chapters 2, 7, and 8.)



In fact, if you extrapolate from the above statistics, the aggregate losses suffered by victims of MLMs since the 1979 Amway decision could easily be hundreds of billions of dollars – suffered by hundreds of millions of victims worldwide. Losses suffered by victims of the entire MLM industry would be many

³²⁶ Chapter 7

³²⁷ DSA 2009 sales figures, dated 7-27-2010 – showing 16.1 million “direct sales representatives” – which DSA admits are mostly MLM participants

³²⁸ Chapter 7

³²⁹ Chapter 8

³³⁰ DSA 2009 sales figures, dated 7-27-2010 – showing \$28.33 billion is U.S. sales by “direct sales representatives” – which DSA admits are mostly MLM participants. Our research shows this represents losses for at least 99% of participants.

times the huge aggregate losses suffered by victims in the Enron or Bernie Madoff scandals!

Again, complaint-based law enforcement or consumer protection simply does not work in combating pyramid marketing schemes, or MLMs. What is needed is consumer protective legislation and rules – and law enforcement officials with both the skill and the will be proactive in dealing with “entrepreneurial chains.” They need to understand the fundamental flaws in MLM and be willing to stand up to powerful legal teams that defend them.

Occasionally – but only rarely – a dedicated public servant goes beyond acting on the volume of complaints and looks at the issue qualitatively and in depth. I have been privileged to share research and experiences with two such persons.

One is Bruce Craig, former Assistant to the Attorney General of Wisconsin. Following his experiences with Amway and other MLMs in Wisconsin, he petitioned the FTC to be more aggressive in enforcing existing laws against pyramid schemes, including MLMs. He is the official that reported that the average income as reported on their taxes for the top 1% of Amway Dealers in Wisconsin was about minus \$900.³³¹

Another was Kristine Lanning, who worked on consumer protection under the Attorney General for North Carolina and worked to get officials in other states to be more proactive in curtailing MLM abuse. Ms. Lanning explained to me why consumer protection officials are so hesitant to go after MLMs. She said it would take twenty times the resources to prosecute an MLM as it would to go after the typical consumer fraud case that comes before them.

The ultimate villain – a flawed unlimited recruitment system! recognize that most MLM participants, including even many TOPPs, do not see the flaws in their system and certainly don’t see themselves as con artists. It is not the people or the products that are at the root of the problems with MLM. I am convinced that it is the endless chain recruitment system (and their top-weighted, upside-down pay plans) that is to blame – and the legislative bodies and

regulatory agencies who have allowed MLM to continue virtually unchecked. (The FTC only prosecuted about 14 MLM cases in ten years – out of hundreds of MLMs likely to have been violating Section 5.³³²)

I will not repeat here all the arguments and evidence behind the conclusion that MLM as an endless chain recruitment system is inherently flawed, uneconomic, and deceptive –



benefitting a few at the expense of whole multitudes of victims. Properly understood, MLM should be illegal per se – as are “pay to play” chain letters and no-product pyramid schemes.³³³

For a satirical look at the importance of compensation plans, or underlying flaws in MLM, read the “Parable of the Missing Children” in Appendix 9A. And review the letters from Bruce Craig, formerly Assistant AG in Wisconsin at Appen-dixes 2E and 2F.

The villain we don’t want to see – all of us! As the famous Pogo cartoon caption said, “We have seen the enemy – and he is us.” Ultimately, all of us must assume some responsibility for allowing such an unfair and deceptive business practice as MLM to spread like a fast-growing cancer without doing everything we can to stop it.

Clearly, the FTC made a huge mistake in not ruling MLMs as inherently unfair and deceptive, and therefore illegal (in violation of Section 5 of the FTC Code), as they do with classic no-product pyramid schemes.. The 1979 Amway decision established a problematical precedent, but we may have to live with it – since the “DSA/MLM cartel” (my term) is too powerful to be stopped altogether. However, we don’t have to allow the DSA/MLM lobby to have all their wishes for pro-MLM rulings granted. In our democratic system, we can vote for officials who will take measures to protect consumers from unfair and deceptive practices, such as MLM.

³³¹ See Capter 1

³³² See Chapters 2, 7, 8, and 10

³³³ See Chapters 2, 7, 8, and 10.

Adequate disclosure would go a long way towards protecting consumers. If prospects knew that their chances of earning a significant profit after expenses were at best about one in a thousand, or that the odds of earning the huge incomes displayed at MLM opportunity meetings and in their promotional literature were one in 25,000, or one in 50,000, etc., they may hesitate to sign up. Regulators need to provide a fence to prevent casualties (through adequate warnings and disclosure requirements), rather than a hearse to pick up the bodies.

Other suggestions that could work to prevent the worst abuses of MLM, thereby creating a “good MLM”, are at the end of Chapter 2. However, I don’t expect any of these to be taken seriously by MLM entrepreneurs, as they could not then achieve sudden and massive wealth.

MLM’s victims

There are many kinds of people who fall prey to the false promises and questionable appeals of MLM recruiters. Some that I have observed through the years include:

Friends and relatives of participants.

Many simply fall for the person-to-person appeals used so effectively in endless chain recruitment programs. And some join just to please a friend or loved one and come to see after meeting with skilled recruiters some possibility that they may personally gain as well. However, in nearly every case, the result is disappointment and loss – sometimes significant losses as result of a recruiter exploiting this relationship. Trust is violated and relationships are strained.

The unemployed or underemployed.

Many are struggling and eager to improve their situation – often willing to grasp at any straw that looks promising. They are sitting ducks for the oft-repeated slogans of MLM recruiters that portray MLM as a solution to their financial woes. This to me is one of the most reprehensible strategies of MLM recruiters. Those who join nearly always get further in debt or lose what precious resources they had left – only to enrich TOPPs (top-of-the-pyramid promoters).

Ambitious but unwise entrepreneurs.

Some find the MLM appeals of “residual income,” “time freedom,” “multiple streams of income,” etc. irresistible. They are always looking for ways to make a buck, especially the possibility of “absentee income.” They also fail to see the fundamental fallacies underlying all “entrepreneurial chains.”

The unsophisticated and uneducated.

Persons unschooled or weak in their understanding of basic mathematics or economics may they fail to see the inherent flaws in endless chain recruitment systems. These folks may not be of low intelligence, just lacking in mathematical savvy.

The knowledgeable but unwary.

Others are just caught unaware, as the dialogue of deception is so pervasive and skillful that some even well-educated people are duped into believing MLM is legitimate.

I have to admit that I was one of those. With an MBA background which included two years in statistics, economics, accounting, and finance and with research skills from my doctoral studies, and though I was originally very skeptical, I eventually fell for the deceitful rhetoric of my recruiters and upline. My “due diligence” in contacting federal and state sources and the Better Business Bureau was not rewarded with valid information. (See Chapter 1 for my full story.)

Common interests. Some find themselves drawn into MLM because of some interest shared by an MLM recruiter. It may be an important relationship with the recruiter or an interest in earning large sums of money on an absentee basis so they can pursue other interests. More common are those who have a passion for alternative medicine, for “pills, potions, and lotions,” with magical properties that promoters claim will cure or prevent all sorts of maladies, enhance one’s energy and mood, and even prolong one’s life.

Affinity groups. MLM recruiters have enjoyed unusual success with tightly-knit groups that we sometimes call “affinity groups.” Once a member of an organization that



has cultivated very close relationships becomes hooked on MLM, they may be successful in recruiting others and they still others in a subgroup of MLM adherents that eventually involves the whole organization.. An “us vs. them” mentality can set in, much like a cult. This is particularly noticeable with some churches, such as the Amish, Latter-day Saints (Mormons), and some evangelical entrepreneurs who tie MLM to being better able to perform Christian charitable work. One MLM seminar was labeled “Christian Millionaire Mindset Conference.” We have also received reports of small churches that are virtually ruined by a pastor’s involvement in some MLM recruit-ment tied in with a church’s fundraising efforts.

Persons with a “lottery mentality.

Even when the extremely low odds of winning are posted, millions of people participate in state and private lotteries every year. So full disclosure of the abysmal odds of profiting may not prevent some vulnerable consumers from participating in an MLM, believing that it is possible they could be that “one in a thousand” who receives the promised rewards.

MLM junkies. These are persons who have become addicted to the passive income appeal of MLM and have failed time after time in each of several MLMs, but keep trying new ones in hopes that “this may be the one.” They are like the person in and out of a long string of romantic relationships looking for the ideal mate.

Many friends and family members of such MLM junkies have written me, pleading for ways to deprogram those for whom they care deeply, but who turn a deaf ear to reason. Regrettably, I have to repeat the old adage that “a person convinced against his will is of the same opinion still.” They may have to crash and burn before they come to their senses.

Some never will accept the truth about what their MLM involvement has done to them. One woman reported that during her youth, her father was always spending the family’s resources chasing the dream of becoming a Diamond in Amway. He had given up his college education to pursue his “dream” and accepted government welfare to

help support his family. She avoided having friends over because they would see that she and her siblings slept on mattresses on the floor. This had been going on for 20 years!

The small business community. Any unfair and deceptive business model saps resources that could have been better spent on legitimate businesses. Loans are made to MLM companies that could have been made to honest businesses – though bankers and SBA officials have said they will not loan to individuals (new recruits) seeking funds to start their MLM “business.”

Products are produced for consumption by MLM participants that draw sales away from legitimate businesses. People attempting to do legitimate direct selling may find it difficult to compete with MLMs that deceptively use the implied “business opportunity” to sell products. Unfair competition is harmful to legitimate business generally.

Humanitarian causes. We know of MLMs providing nutritious dry-pack meals to poor people in Africa. New MLM recruits are told that a portion of their product purchases goes to feeding starving populations through these special meals. What they are not told is that the food is supplied with a huge profit margin to the company.

We have learned of MLM recruitment campaigns in which scouts identify AIDS victims in Africa. New recruits are told that they can sponsor an AIDS victim and that a portion of their purchases will go towards helping that person. The implication is that if the recruit quits and stops meeting his or her quota of purchases, the aid to that person will stop. This exploitation of the poor I find especially repugnant.

Society at large – all of us. When MLM or any form of white collar crime spreads unchecked in a free society, we all pay a price. We wind up providing support for victims who have been impoverished, to families whose marriages are broken up, to attorneys and courts who must deal with class action lawsuits. And we lose respect for those in authority who we assume are there to protect us from scams. This includes the FTC, state attorneys general, consumer protection agencies, legislators, the Better Business

Bureau, and a complicit business press that gives glowing reports of rapidly growing new MLM companies – that are merely following a pattern of early momentum in a typical MLM.³³⁴

In fact, MLM not only has a negative impact on those at the bottom of their respective pyramids, but also on those at the top. Many reports of how MLM has negatively affected their value systems to the point of becoming dishonest, proud, and greedy. *MLM impoverishes those at the bottom and corrupts those at the top.*

Victims cheering the victimizer. When I tested the Nu Skin program, I remember vividly one “IDN University” meeting in a large auditorium where a “Blue Diamond” (highest rank in the pay plan) was introduced to an enthusiastic audience. He stammered as he admitted sheepishly, “I really don’t have much to say. I haven’t been working much lately, as I have plenty of money coming in to support my ranch, travel, and many hobbies.”

He left the speaker’s podium, and the person presiding announced, “There goes a man who’s made \$20 million in network marketing!” We all cheered and clapped as he strutted down the middle aisle of the auditorium in his double-breasted suit with gold buttons. What I didn’t know then but understand now, is that *we were all his victims. And we were cheering him on!*



Victims cheer their victimizer

MLMs often display characteristics of a cult.

Cult expert David Brear³³⁵ has written a very insightful article titled “The Universal Characteristics of a Cult,” which applies in

no small degree to the culture that is fostered in many MLM programs. The ten characteristics he identifies are as follows:

1. **Deception.** They never present their true colors. With its many typical misrepresentations, this is certainly characteristic of MLMs.³³⁶
2. **Self-appointed sovereign leadership.** Founders and TOPPs (top-of-the-pyramid promoters) call the shots. Some are psychologically dominant and narcissistic individuals.
3. **Manipulation.** New recruits are manipulated by their upline and by a compensation plan that incentivizes them to repeatedly buy and recruit.
4. **Radical changes of personality and behavior.** This is often seen in participants who “drink the Kool-aid” and act in strange ways not seen until they became involved in MLM.
5. **Pseudo-scientific mystification.** Quoting Brear: “The instigators of pernicious cults seek to overwhelm their adherents emotionally and intellectually by pretending that progressive initiation into their own superior . . . knowledge (product endorsements by scientists, athletes, etc.) will defeat a negative or adversarial force of impurity . . . and lead to future exclusive redemption in some form of secure Utopian existence. (“residual income,” etc.)”
6. **Monopoly of information.** They achieve this “by constantly denigrating all external sources of information whilst constantly repeating the group’s reality inverting key words and images.”
7. **False justification.** “A core group of adherents can be gradually dissociated from external reality and reformed into deployable agents.”
8. **Structural mystification.** Cult leaders secretly and cleverly organize to prevent or subvert investigation and isolate themselves from liability. They “survive all low-level challenges and spread like cancers enslaving the minds, and destroying the lives, of countless individuals in the process. At the same time, their leaders acquire absolute

³³⁴ See Chapter 3

³³⁵ Published by FECRIS (European Federation of Centres of Research and Information on Cults and Sects). Copyright 2006-09-18

³³⁶ See Chapter 8: “MLM – a Myriad of Misrepresentations”

control over capital sums which place them alongside the most notorious racketeers in history.”³³⁷

9. **Chronic psychological deterioration symptoms.** Some long-term participants even show symptoms of psychosis, such as severe depression. (Several suicides have been reported from MLM participation.) Signs of what could be termed MLM addiction have been observed in persons who keep trying the latest MLMs with no success. They may become unable or unwilling to work at a regular job again.
10. **Repression of all dissent.** Some MLM leaders have megalomaniacal personalities, with a self-righteous demeanor and a willingness to humiliate or intimidate dissenters. Also, they have sought to squelch legitimate criticism with lawsuits.

Why victims seldom complain

Several years ago, I decided to bring the losses suffered by Nu Skin victims who had contacted me to the attention of Utah's Division of Consumer Protection in hopes of helping them recover some of their losses. There were about 20 victims who had lost a total of over \$250,000 in the Nu Skin program.

I soon found extreme reluctance on the part of these victims to file a complaint against the company. Some were embarrassed at their “failure” to make it work for them, as they had been taught that there was nothing illegal or wrong with the Nu Skin program. After all, they would say, “if they were illegal, they would have been shut down long ago.”

And as explained and illustrated in Chapter 8, MLM thrives on deception. Unless a person has made a determined effort to learn the truth about the legitimacy of MLM as a business model, they can be easily deceived by the many arguments put forth by MLM promoters and defenders. Few of the victims I spoke with had any real understanding of the fundamental flaws in MLM programs such as Nu Skin.

But *I discovered an even greater factor in the reluctance of victims to complain was fear.* Since MLMs like Nu Skin depend on endless chains of recruitment, every major victim was

of necessity a perpetrator. This is because they had to recruit friends and family to have any hope of covering their monthly “pay-to-play” expenses, to say nothing of their operating expenses. They feared that if they complained, there would be consequences suffered from or to those they recruited – who could be their loved ones or best friends. They also feared self-incrimination for having been partly responsible for scamming others. These are the reasons victims of endless chain recruitment schemes almost never file complaints with law enforcement.

MLM may be the cleverest con game of all time. Many of the very people who are out promoting the scam are themselves victims, until they run out of money and drop off the vine. They shrink from filing complaints, and since in law enforcement, the squeaky wheel gets the grease, nothing gets done. No complaints, no law enforcement. No law enforcement, no complaints. It's a vicious cycle. And so the game goes on.

Don't bother calling the Better Business Bureau. Victims also rarely report their losses to the Better Business Bureau for the same reasons. Besides, we have observed “A” ratings for some of the most damaging product-based pyramid schemes, having had few or even no complaints registered with the BBB. For example, Amway gets an A+ rating, which (to those who understand their numbers and practices) says more about the BBB than it does about Amway. It should also be noted that the DSA, Amway, and other major MLMs are “corporate partners of the BBB.” So much for what was once wise advice to “check out a company with your Better Business Bureau.”

Personal and social costs of MLM

MLM's effects on individuals and families. By now it should be clear that MLM exploits the time and energy of participants, all for the benefit of founders, TOPPs, company executives, and others who dip their hands into the lucrative MLM till. While most recruits buy some products and may try unsuccessfully to sell products or recruit, some take in the deceptive appeals of MLM promoters and make a valiant effort to succeed. But because of the flaws in the

³³⁷ See Chapters 7-11.

system, almost all recruits after the first ones in wind up losing money and dropping out.

In the long run, impoverishment of participants is not the worst of problems with MLM. Participants squander their “social capital,” placing in jeopardy those relationships they have spent a lifetime cultivating. It is not unusual for persons who are hooked on MLM to become ostracized by other family members and social groups of which they are a part. The social networks that were built on trust and caring now find them a liability and an embarrassment.

We have received reports of numerous divorces due in no small part to MLM involvement, as one partner rejects the other partner who becomes a “dream-stealer” for not supporting him/her. And some extended families become split over MLM involvement.

Sadly, MLM leads to worse effects for some. I have learned of four murders, seven suicides, and one near suicide resulting at least partly from intense MLM involvement.

For samples of thousands of concerned letters we have received, see Appendix 9B.

Complaints filed with FTC show a surprisingly strong pattern of unfair and deceptive practices

On December 21, 2013, acting on behalf of an International Coalition Of Consumer Advocates, we requested from the FOIA (Freedom of Information Act) office of the FTC all consumer complaints received by the FTC from January 1, 2004 to date concerning business opportunities, and multi-level marketing programs (MLMs) and/or pyramid schemes. Personnel from the FOIA office explained that such records are destroyed after five years and that these complaints would have to be redacted to remove personal and other information that were not to be made public and that this would be too large a task to start with. We finally settled on all complaints having to do with business opportunities, MLMs, pyramid schemes, Ponzi schemes, and pay-to-play chain letters for the year 2013.

The complaints were filed in an extremely awkward spreadsheet format – about 100 columns wide – which allowed for

statistical analysis, but totally impractical for reading of the complaint content to discover patterns of abuse. Also, over half of the complaints filed under the heading of multi-level marketing had nothing to do with MLM, but instead were about payday loan programs, bank abuses, and even FTC failures to enforce the law. So it is not surprising that FTC staff were uninformed of the records of MLM abuse in their own collection of complaints.

This may partly explain the lack of awareness of MLM abuses on the part of staff involved in the rulemaking for the Business Opportunity Rule. The staff claimed that consumer advocates failed to provide evidence of widespread fraud in the multi-level marketing industry. Actually, the FTC had plenty of evidence of unfair and deceptive practices in the complaints, once irrelevant material was removed from the collection and complaints were formatted for easy reading. This was accomplished by a team of volunteers who spent weeks processing the complaints. (For excerpts from a sample of complaints filed with the FTC in 2013, see Appendix 9C.)

From 930 complaints filed with the FTC against MLMs in 2013 (there may have been more that were misclassified), and then processed to make qualitative analysis possible, we can with confidence conclude:

1. These complaints demonstrate that unfair and deceptive practices in the MLM industry are far worse than FTC staff have previously perceived.

2. Key word analysis demonstrated widespread perceptions by complainants of MLM as an unfair and deceptive practice, not just in a few companies, but across a wide spectrum of the MLM industry. This should not surprise anyone familiar with the inherent flaws of MLM as a business model.

3. MLMs are far more prevalent and are perceived as more unfair and deceptive than are no-product pyramid schemes or Ponzi schemes.

4. There is little correlation between number of complaints and number of victims of MLM. Only a tiny percentage of victims file a complaint, so those included in this report represent a very large population of victims. And we believe that those brave enough to file a complaint deserve serious attention.

Obviously, some MLMs are worse than others, and some of the older MLMs are more adept at masking the flaws in their systems.

5. MLM defenders and lobbyists have made a concerted effort to re-brand multi-level marketing as “direct selling.” Regulators, educators, consumers, and the media have failed to distinguish between legitimate direct selling and MLMs with their inherently flawed characteristics, including endless chains of recruitment, rank advancement through recruitment, “pay-to-play” quotas, and top-weighted pay plans. These characteristics are incorporated into a more consumer-friendly definition of multi-level marketing quoted in this report³³⁸, which also reflects the experiences of complainants.

6. Although MLM is inherently unfair and deceptive as a business model, the industry has gained too much influence to be completely shut down. There are too many MLMs violating Section 5 (engaging in unfair and deceptive acts or practices) for the FTC to prosecute all but the worst of them on a case-by-case basis. It is more realistic to provide some consumer protection by removing the MLM exemption from the Business Opportunity Rule. At least MLM promoters would be required to disclose average incomes, to accept a 7-day waiting period before accepting any money, and to be restricted from making unrealistic claims of income potential. Also, on its web site, the FTC could warn against participation in any MLM without a thorough investigation during the 7-day waiting period.

MLM is the perfect con game. The very people who are being victimized are often its promoters – until they run out of money and quit. They seldom complain to regulators, having been taught that any failure is their fault. They may also fear self-incrimination for their own recruiting efforts – or retaliation from or to their upline or downline, which may include close friends and relatives.

³³⁸ See Introduction and Chapter 2

Conclusions

We see many villains and many victims in MLM. People who have read my reports, as well as reports of other consumer advocates and researchers in this field, are surprised at how much worse MLM is than they had previously supposed. It certainly qualifies as an unfair and deceptive practice, which the FTC is pledged to protect against.

From our communications with thousands of MLM participants and their families, as well as with MLM and law enforcement officials, it is clear to me that few understand the harm that results from MLM participation. Finding one or more villains in this field is virtually impossible. *It is the system underlying all MLMs that is the chief villain – unlimited recruitment of a whole network of endless chains of participants as primary customers. It is essentially a money transfer scheme, transferring funds from a revolving door of recruits (who must make purchases to participate fully) to a few key people in the organization – founders, managers, and TOPPS..*

The victims of MLM are many and varied, including family, affinity groups, and those struggling to get ahead. Most participants are minimally affected because they buy a few products and drop out, but those who believe the hype and invest a lot, lose a lot.

Cultism abounds in MLM. Some participants even display patterns of addiction and are never the same. As MLM spreads virally, struggling consumers who fall for MLM suffer, legitimate businesses suffer, the integrity of law enforcement suffers, and society at large suffers.

We have also observed that MLM not only impoverishes those at the bottom of the pyramid, but it also corrupts those at the top.

According to a statement by former FTC Chairman James C. Miller, III, “Section 5 of the FTC Act declares unfair or deceptive acts or practices unlawful.”³³⁹ I would add – *If there was ever an unfair and deceptive act or practice, MLM is it!*

³³⁹ *FTC Policy Statement on Deception* by James C. Miller, III, FTC Chairman, dated October 14, 1983. Appended to *Cliffdale Associates, Inc.*, 103 F.T.C. 110, 174 (1984).

Appendix 9A

THE PARABLE OF THE MISSING CHILDREN

By Jon M. Taylor, MBA, Ph.D., President, Consumer Awareness Institute

The administrators of a boarding school decided to start a petting zoo to give the children direct experience with nature. They gathered a few animals in a trial run with the first group of youngsters. Everything went fine, until several of the children showed scratches on their arms. Upon investigating, they discovered that the culprit was a spotted cat.



After careful deliberation, it was decided not to allow any spotted animals in the petting zoo. Other animals were brought in—frisky dogs, big beautiful cats with stripes or furry manes, darting lizards, and wonderful crocodiles with snouts as long as the children, birds that chirped and giant birds with hooked beaks, garden snakes and reptiles that were as big around as a watermelon and as long as a cottage, and white bears with giant paws for walking on the snow. The children would be safe because none of the animals had spots on them. This wonderful collection of animals was sure to amuse these children and to be a big hit with their parents when they returned in the spring to pick them up.



The administrators felt comfortable leaving groups of children in the petting zoo for long periods of time because they had taken great care to exclude all spotted animals. However, when they returned to pick them up, the children were missing. What could have happened? They knew the animals were not to blame because they had double-checked to make absolutely certain that none of them had spots. What was the problem? No one knew. And no one did anything – because none of the children complained.



Interpretation of the parable of the missing children

The administrators are legislators and those in law enforcement charged with protecting consumers from unfair and predatory business practices. The children are the victims of product-based pyramid schemes. The tell-tale spots of the supposed villains are the products and people connected with the MLM's and the "rules" for legal compliance by participants. MLM promoters have duped almost everyone into evaluating their programs by their "great products" (usually pills, potions and lotions), by company "rules" requiring a minimum percentage of their purchases be sold to non-participants ("the Amway rules"), by "buy back" policies, by the sterling credentials of their leaders, by their generous contributions to worthy causes, etc. These are like selecting the animals for the petting zoo and judging how safe they are by whether or not they have spots. One should look instead at the compensation plan, especially top-weighted programs that reward the building of a downline of participants as primary buyers far more than the sale of products to non-participants. The villain – the chaining of participating buyers in the "plan" – is analogous to the animals that ate the children.

Conclusions from the parable of the missing children

The real villains (the ones eating the children in the parable) are *schemes which reward endless chain recruitment of buyers*, that inherently constitute an unfair trade practice. Their compensation plans require people to buy products in order to “play the game.” These investments are characteristically in the form of monthly purchases on a subscription basis – paid by automatic bank draft.

Though they can merely buy and sell products without recruiting, this is just a ruse, which becomes apparent in studying the compensation plan to see where the emphasis is – sales or recruiting. Recruits advance up the ladder of rewards in commissions, bonuses, and discounts by aggressive recruitment of new buying participants into endless chains of recruiters recruiting recruiters, each of whom are likewise buying still more products – with exorbitant rewards going to those at the top of the pyramidal hierarchy of “distributors,” “associates,” etc. – all of whom got there by aggressive recruiting or by being one of the first distributors into a given market.

If you are being recruited into an MLM, I would advise you to find out from the person recruiting you if you can likewise recruit others into “the plan,” and then if they can in turn recruit others, ad infinitum. Also, ask if you will be expected to make initial or ongoing purchases without actual customer orders in hand. If so, you are looking at an endless chain recruitment scheme, or product-based pyramid scheme. Selling flowers on a street corner would be a more profitable option than MLM for all but a tiny few at the top.

And remember, the best opportunities are not those seeking you out. The best income opportunities are those you diligently search out and discover yourself, based on your own talents, means, and resourcefulness.

Almost none of the new recruits in MLM earn enough to report a profit on their taxes from selling products direct to consumers. This has been confirmed by surveys of hundreds of tax professionals, who have prepared tax returns of thousands of MLM participants. And from research on available documents, we have learned that the percentage of people who lose money from participation in almost all MLM's (approximately 99.7%) is even higher than for those who participate in classic no-product pyramid schemes (about 90%). A person can expect much better odds at most of the gaming tables in Las Vegas.

When you understand it, MLM (or “network marketing”) is the perfect con game. The very people who are its victims are also out recruiting until they run out of money and drop out. But they seldom complain to authorities, believing “failure” to be their fault – or fearing consequences from or to their upline or downline (which are often close friends or relatives). Few have the insight to see that the fault was primarily in a fundamentally *flawed system* – an unfair and deceptive trade practice.

In the regulatory field of consumer protection, the squeaky wheel gets the grease. Since few complain, little if any action is taken. So the game goes on, with no referees to cry “foul” – just a few whistleblowers like us.

MLM's have virtually taken over the DSA (Direct Selling Association), which tries to convince consumers and regulators that MLM's are direct sales companies. They work tirelessly to get legislation passed to exempt MLM's with legitimate products from prosecution as pyramid schemes. However, when dealing with MLM's, or product-based pyramid schemes, remember that a pig is still a pig, regardless of how much money, effort, and politicking go into making it appear to be a horse. The typical MLM is no more a direct sales company than a pig is a horse. The primary customers are the distributors.

Appendix 9B

Sample feedback

NOTE: For obvious reasons, the individuals who have sent us letters such as these are often reticent to identify their names or addresses. Many have suffered great losses or have family members who are still suffering but are in denial about the fraud perpetrated upon them. These particular letters were selected because they powerfully express problems with MLM participation of which many in law enforcement officials may not be aware. Victims of MLM abuse seldom file reports with law enforcement officials for reasons outlined in this chapter. However, they will write us because we do understand and can advise them on what actions they might take. Such actions will be discussed in Chapter 11.

Impact of MLM on individuals and families

“Fancy Free” escapes the madness

Everything on your website has been going through my mind in the past month. About 2 months ago, I started on my "MLM mission" in Arbonne. I was completely head over heels with the thought of "residual income" just for "sharing" with others how they could make "residual" income. Now I am just sick about the whole thing, especially because a close friend of mine signed up under me.

Every night I would cry just THINKING about having to go talk to people about the "opportunity." I was being forced by the whole MLM thinking to talk to friends I haven't been in touch with and pester them or "drip" on them as my upline told me.

I was continually told by my upline that I was feeling down because I was getting out of my "comfort" zone or because it was building my character. . . I was more stressed out than I have been in my whole life!!

I had so much money into it that my husband didn't want me to quit. We even had to put MORE money into it at the end of the month so we didn't "lose" our qualification quota. The night I spent another \$450 on our credit card to keep our "district qualification," I broke out in hives. I have never been allergic to anything in my life, and I don't think it was a coincidence.

So, after crying every night for a month and being completely sick about life I have decided to stop the madness! Now I feel like I am FREE! It's amazing, I can talk to people without feeling the weight of "did you talk to them about ARBONNE??" on my shoulder. I can't tell you the relief I feel!

I regret that I got my very good friend involved and I am afraid of the rift it may have put in an otherwise great friendship. I am not sure how I ever got talked into this or how anyone stays in it! I appreciate your insight and humor. .

Thanks, Fancy Free! (Erica)

So, after crying every night for a month and being completely sick about life I have decided to stop the madness! Now I feel like I am FREE! It's amazing, I can talk to people without feeling the weight of "did you talk to them about ARBONNE??" on my shoulder. I can't tell you the relief I feel!
– Fancy Free

Family torn apart by various MLMs over the years

Thank you so much for providing the truth regarding MLMs. **Pyramid schemes have torn my family apart on many different occasions. My dad was involved in Dare to Be Great in the late 60s/early 70s. Now several of my family members are involved in LifeMax. It hurts more than you can imagine. Seeing everything get taken from us as children and now seeing the potential for it to happen again to my younger sister who has a 10 month old baby.**

Perhaps what's worse is knowing so many people who are hurting in this bad economy are desperate and are turning to this. And how the scammers use God and "the chance to help starving people around the world"! It's AWFUL!!!

Just a quick question, I noticed now when I Google " LifeMax and pyramid schemes" that I can no longer find articles about people who've been burned (I know they're out there). Seems that Lifemax has purchased all the key words and used Search Engine Maximization to continue to sell their "lifestyle" and silence the truth. They're deceiving people even more than ever with articles that are disguised as legitimate reviews. So, sadly, people will have a hard time getting the facts. Is there any solution or recourse?

I'm lucky to have found your web site. I will keep it in my files for backup when I need it.
– Paige B.

Daughter of Amway dealer who lost much of her childhood is still haunted by Amway.

My parents were involved with Amway – the leading MLM – for 20 years. The costs to my family for their participation have been devastating. I and my six other siblings were robbed of my parents' time, attention, and relationships because they spent most of their waking hours dreaming about their Amway business, going to rallies, seminars and functions that continued to fuel this fire but which

eventually cost them their self-respect, their children's and many friends' trust, and tens of thousands of dollars.

It also cost my father his college education because as he was beginning plans for attending school, he decided to join the Amway system because it promised to be a short cut to financial freedom. Now, after 20+ years of financial, relationship, physical and emotional loss, he struggles to find work that can support his family and pay off his gargantuan debt.

I grew up with the secret that my parents were in Amway – I couldn't tell friends what my father did for a living. I only said he had his own business.

I couldn't bring friends to my house because I was embarrassed that they may find out I didn't have any bedroom furniture or that my siblings slept on mattresses on the floor. Not only have we as children had to pay for our own college educations and weddings, but we had to pay for our own school clothes, school supplies and other basics growing up; except for the time they received welfare.

Even now I am not comfortable leaving my own daughter in her grandparents' home because of its depressing state of disrepair. You may be thinking, well maybe my father was just lazy. But I am here to testify that my father and my mother worked the Amway business [with total dedication].

When we went without the basics year after year we believed as children that if we were patient a little longer while my parents were gone showing the plan or attending meetings, they would one day "go Diamond" and it would all be worth it. We were going to be rich someday and then we would get our parents back; then we would have clothes and furniture and security. But the promise couldn't be kept because the compensation plan for MLMs don't make good on their word that it is an opportunity of a lifetime.

If working hard and sacrificing your every waking moment for the dream was what it took, my parents should be at the top. They wouldn't quit, no matter how

much they and we suffered, they believed it was just around the corner so they kept working the business for 20+ years. The suffering created from belief in the lie and scheme of MLM will continue to haunt my family.

– Daughter of Amway victim

Woman wastes half her life and thousands of dollars on the false promises of 60 MLMs³⁴⁰

I stumbled upon your article on a complaint board about Arbonne and some others recently and someone mentioned that we should all read your article.³⁴¹ So, I downloaded your audio and listened and everything was all too familiar with my own experience in direct selling and party plans I have been involved in. You will be getting the Readers Digest version because my story would be way too lengthy here.

I have been with so many companies over my lifetime, thinking the next best thing was just around the corner. I signed up with my first party plan direct sales co. When I turned 18. It was Mary Kay. I loved the products and the neighbor who recruited me was just like family. She became very successful and to this very day some long years later she is still selling as a director with the company. I always wanted to be like her and be successful and follow in her footsteps. I went to college and sold part time. I went to all the meetings and even their seminar in Dallas some years later. I was in and out over a period of about 20 years. I never showed a profit that I can remember. Long story short, I had sent a large inventory back to the company as I was losing money and did not want my credit to go bad. I could never sell Mary Kay again. It was a very sad experience. I have not heard from my director in years.

I kept going back to direct sales because I have always wanted my own business where I could work from home. They make it sound so easy. They

would say, "Work part time hours, flexibility, vacations, trips, prizes, jewelry, a free car! " Wow, I wanted in! I went from one company to another. I would say at least 60 or so over the years. I am now 40 and I feel I have wasted half my life on the promises made to me by others. My accountant had advised me that rarely does he ever file taxes for direct sellers who actually ever show a profit from them.³⁴² It is rare I guess. I kept thinking if I just tried harder, if I just did it different this time, if I just had the right product to sell, I would make it. I have spent thousands of dollars over a long period of time thinking things would turn around for me. It becomes almost like an addiction to find the next best thing. Now, I am both physically and mentally exhausted. I read where someone said, "The definition of insanity is doing the same thing over and over expecting different results." Things that make you go, hmmm.....

I now have to move on and it is already feeling like I am out of my comfort zone because direct sales are all I have known most of my life. Heck, my mom even sold Avon when I was little. I wanted to be just like her too! By the way, she quit, never made any money from it though. She said she didn't have enough time to sell it with us three kids and all. The supply costs were eating up her profits, especially the gas money running around making deliveries.

I hope to be able to still have my own home based business someday. A legitimate one. One that makes me feel good about myself. **I don't want to feel like a failure the rest of my life, because direct sales failed me, and not the other way around! Wow, 99 percent of people fail! So, now I have validation that I have been part of that 99 percentile all along.** And now I KNOW the truth from reading your article. . . Karla

³⁴⁰ Letter to Robert FitzPatrick of Pyramid Scheme Alert January 9, 2014

³⁴¹ ["What About This One?"](http://pyramidscemealert.org/What-About-This-One/) –pyramidscemealert.org

³⁴² See ["Who profits from MLM? Tax preparers have the answer."](#)

I went from one company to another. I would say at least 60 or so over the years. I am now 40 and I feel I have wasted half my life on the promises made to me by others. . . direct sales failed me, and not the other way around!
– Karla

Get a real job at McD's and make honest money.

MLMs? Stay away from them and those that promote them. The pressure to join is intense and subtle. The guilt that can be applied is terrible.

My wife and I were in 7 different systems – Nu Skin, Amway, through to ACN and Usana. Each held the carrot of success and leisure before our eyes, and we could taste our prize. The tricks to get us hooked were ingenious, the pressure to conform was enormous and at times brought my wife to tears because we just couldn't afford to attend a certain "Function." This of course showed that we were NOT committed to our success and would hold up our advancement in the organization.

We made just enough money to entice us to try a little harder, spend a little bit more money on a NEW and BETTER lead generating system. Any profit you might make for that month would be swallowed by the next system that was sure to make finding your next downline a snap. Did we make any profit after all those years of chasing our dream? NO! Did we spend our grandchildren's inheritance? No, but if we had continued, who knows?

The functions, weekly meetings, the phone calls from and to your all-knowing upline, the books, the seminars and the constant search for the 'BEST' lead generating system with their set-up fees and monthly lead expenses and your monthly commitment of product purchases finally broke our back and our spirit, and we quit.

Where are all those upline "friends and supporters"? Nowhere in sight.

Anyone looking to make money in MLM had better start by selling third rate used cars and get skin as thick as a rhino. Better yet get a real second job at a Mc D's and make some honest money.

– George

Girlfriend threatens relationship and dumps almost \$50,000 into two MLMs.

I am a Chiropractor in PA. My girlfriend is pulled into MLM / Pyramid schemes "businesses. She was deeply involved in Market America.

Brainwashed into spending her own money (Credit Cards!), purchasing products and working toward false "LEVELS" of achievement. Now reaching "Executive Coordinator" and was almost pulled into the DEEP recruiting part of the business.

She spent over \$30,000 purchasing products, going to seminars and buying marketing strategies to "success". They had her brainwashed telling her she must put family, friends, relationships, work, everything second for the next few years to accomplish her "Financial Freedom". She almost left me.

She finally left MA and saw that they were all cons and stopped spending full force, only because someone from another MLM, "UNIVERA" told her that their program was much better and easier to make money. She admits she understands that it is the same "PYRAMID" scam as MARKET AMERICA, but tries to reassure me that she knows they are sharks, but she can work it "smart" and not get scammed.

She believes the products are actually HELPING people, and justifies that is why UNIVERA is "ETHICAL". I managed to get her out of credit card debt (almost \$50,000) and refinance that debt into her house payment and close all of the credit cards to stop the temptation of dumping money (22% interest) into this new MLM.

It is destroying our relationship. How can you get someone to completely stop

involvement in these organizations? When it comes from myself or family, she defends the programs and pushes away. Could you please send emails to her, or to me warning of MLM/Pyramid scams? How they are illegal and unethical, no matter how "good" the product is for people. Thank you,
 – Jonathan

MBA grad sucked into 3rd MLM in seven years, sinks into depression

My son lives in California, has an MBA and has been involved in network marketing for about seven years. At one point he had a six-figure income and thought the sky was the limit (Cyberwize). When his upline decided to change network marketing companies due to a disagreement and pending lawsuit, my son followed with financially unfortunate results.

Now he and the same upline are in a third company. My wife and I have been pretty much supporting him for the past nine months. He keeps thinking that he will experience a 'break-through' and be on top again, but he seems very depressed some of the time. We are very worried about him.

Do you know of anyone who might help him to see the reality of the MLM lie? I have tried to reason with him, asking him to discuss his situation with a job counselor on several occasions and offering to pay for the counseling. No luck. **It seems to me that MLM is very much like a religious cult and that victims like my son will require deprogramming by a professional.** I'm sure he won't listen to me and has a pretty closed mind at this point.

– Anonymous victim with MBA

Mom turns irrational regarding MLM

For just some quick introductory back story of my relationship to MLM, my mother began playing the game with Excel telecommunications when I was about 12 years old. It was more than bizarre. She put 500 dollars on a credit card to buy miniature phone magnets, while I had to be on the free lunch program at school.

But at age 12, it's hard to tell your mom that she's being scammed. And of course I wasn't as equipped to do the research as I am today. Then flash-forward about 10 years, where she divorces and moves in with her mom. For a while she works normal jobs, and seems more happy than I've ever seen her. We all laugh to ourselves in relief that she has dropped the cultish Excel, but don't bring it up, assuming that she herself is embarrassed about her participation.

Then one day she drops all that, and relapses into Xango. When we finally confronted her about MLM, she had already spent all of the money she had gained in the divorce, lost a house, and went into what we are estimating is around \$150,000 in debt.

I know you're not going to believe this, but in almost every other facet of her life she is an especially rational person, but this one sector has her so brainwashed we don't know what to do.

Being as how you are one of the primary - or at least most visible - specialists on decoded MLM rhetoric and practice, I KNOW that you must get these emails often, so let me also say upfront that I'm not writing to beg you to fly here and deprogram my mom, though we (my brother and I) are desperately attempting to do so.

In all my years of education, I never researched something as intensely - and neurotically - as this company and its mode of operation, mostly because no grade has ever been as important as the mental health and well-being of my mother.

In a frantic couple of months, I had compiled my research (beginning with Excel and ending with Xango) into a Power Point presentation that became our two-day long intervention. It was presented in a way such that I thought this was information she was unaware of, and tread delicately, as I felt like I was about to destroy something she loved.

It seemed to break her emotionally, and when it seemed she was going to quit, she left on vacation, and came back, defiant like I had never seen her before, insistent that we are never allowed to bring up this topic again, and that she would continue to run rampantly

into debt along with this magic juice Xango. We are the dream stealers. . .

My brother and I have had the unique experience of borrowing my mother's DVD's and training materials provided by this company, and we noticed some peculiar things, one of which is the introductory DVD they give you when you sign up. On the DVD menu, there are 4 videos to choose from. When you play all, it plays the first 3, each of which are maybe 5 minutes long. The first two are essentially the regular MLM hype with limos and yachts, and then the 3rd one basically a commercial for training material for you to buy. **And then oddly enough...it just turns off. That's right, the DVD TURNS OFF.**

But wait, wasn't there a 4th video? So you go back, turn it on, and scroll down to the 4th video and press play, and it's about an hour-long video giving you the legal side of what can and can't be done in MLM, what health claims can and can't be made etc. - basically the part of the video their lawyer made them put in.

We made my mom watch it, because she admitted she never had, and it absolutely decimates the way this business is conducted. I mean, there is NO WAY any of these reps have actually watched or abide by this section of the video - not that that's new to you... but it made me wonder if that becomes a legal issue, deliberately hiding that sort of thing. . . If any of this is help then I am glad to offer it, and if there is any complimentary information to what you have learned, I would love to know about it. Either way my sincerest appreciation for your dedication and your time,
– Richard

Woman seeks MLM income to work from home but winds up having to work harder than ever to repay debt.

I joined Herbalife as a supervisor on June 8th 2005. I joined through the marketing company Online Business Systems.

I became a supervisor because my coaches said that it was a proven marketing plan and that if I had a desire and worked

hard then I would be able to replace my income within 6 months. My goal wasn't to become extremely wealthy. It was just to make enough so that I could stay home with my children. That amount was around \$1700 per month that I would need in order to complete my goal. I am a hard worker and I do have a strong desire to succeed and even though my husband had some very strong reservations against this plan, I was going to prove my ability to make it work.

I worked my regular 40 hour weeks and then put in countless hours recruiting and selling product for my Herbalife business. The first month that I was in business, which was July of 2005, I produced \$10,000 in business for Herbalife. This achievement propelled me to the level of World Team. I received a check for \$450. I thought that I was doing very well and that what they had told me was true: Desire and Hard Work = Freedom, Time, and Money. However, this excitement died very quickly.

When I began this business my "coaches" told me that if I was going to do this at all I needed to invest some money so that I would have the ability to make it work. I was promised that if I followed the steps that they gave me and with their help and expertise I would make my money back in the first month. I invested approximately \$4,500 on a credit card. I spent the next 8 months the exact same way as the 1st month but without the results. I was only fattening Herbalife's coffers while putting myself and my family at extreme financial risk.

Everything I was told about this "business" has been a lie. None of Herbalife's representatives told me that according to their "Statement of Average Gross Compensation of U.S. Supervisors in 2004" only 1.5% of "Active Leaders" earned enough to meet the "pay to play" requirements of \$2,000/month in Herbalife sales/purchases in order to qualify for commissions and advancement in the program – and that more likely less than 1/10 of 1% of ALL distributors (including dropouts) ever earn enough to report a profit on their income taxes after subtracting the most minimal expenses needed to be

“successful.” Had I known this crucial information, I would never have invested a penny in their program. To even present this as a legitimate income opportunity is a huge misrepresentation.

This MLM scheme is fraudulent and should not be marketed as a money making opportunity. I did follow all of the steps and I did work very hard which is a proven and solid fact. These were the conditions which I was told would produce a profit. I followed the plan and it didn't work. Everyone who gets into this business is lied to and in turn required to lie to others to achieve even a little.

– Nicole L., Utah

Photographer misled by MLM recruiter & loses over \$15,000 (Excerpts from a copy of the letter that was addressed to the president of the company):

I have been married for fifteen years and we have four children – ages two, six, seven and ten. I home school them. I am also a photographer. I began my home studio in late September of 2006, so I am still in my very fragile first year of business. My husband also is self-employed with his own ceramic tile and hardwood flooring business, which provides our family with just enough to manage a growing family of six.

In late January of this year, a Photomax Distributor contacted me. She had purchased my name in a leads package. She went through the scripted call with me, and I listened to the recorded voice on demand call made by Laura. I was interested in Photomax as an addition to my new photography studio. It seemed possible to me that I could use the lab and sign people up as customers. I thought that I could earn a decent commission from all my new customers to help fund my new studio, as well as help with family needs.

According to Laura's voice recording I could get started in this business for next to nothing while using what she called "OPM" or "other peoples' money" because "nearly every business gets started this way" and that "it only cost most people about \$25 in interest to get

started" with the \$1350 Fast Track package. This is the package which is meant for the "real go-getters" who "want to quickly begin earning the bigger money faster."

According to Laura, going with that package would position me to, "begin earning several thousand a month quickly, earn higher commissions and be entered in a monthly bonus pool, which is like a profit sharing plan, with checks ranging anywhere from \$1200 to over \$20,000 a month - on top of your regular commissions."

I was led to believe that I could use the opportunity to help support my family. I was told I only need to bring two things into the business. These were "commitment" and "coachability," which meant I needed to do everything my upline told me to do.

I was immediately sent out training information and training call schedules and told I should attend a minimum of two training calls a week and at least one prospecting call to be successful. I was also instructed to make a list of goals and set my time commitments.

All of this I did. I also was told to provide a list of at least 30 people to contact; I then listened in on three-way calls while my "success coach" called them for me. I was given a list of Lead resources and I listened to every recorded training available on the "Millionaire Max" web site. I was completely coachable. . . .

It is now August and almost a full six months later, **after hundreds of hours of work making thousands of calls and contacts, I have been able to sign up only one recruit who quit the first month, and I have received approximately \$400 in commissions. Thanks to this Nu Skin scam, I now have a debt of "OPM" (your OPM) totaling \$15,456.97!**

[OPM is "other people's money".]

That is not at all what the "Power of Four" model showed! That is NOT what I signed up for. I have a young family that this company has preyed on by using unethical methods. Your company has distributors playing on peoples' emotions and is causing great harm to families around the world.

What you have with Nu Skin are a few people at the top making millions of dollars at the expense of middle and lower income people who are defrauded of their funds through one deception after another. There is a form of emotional abuse of distributors going on that is not only causing emotional pain, and family turmoil, but is causing financial ruin to many. What you have no matter how your attorneys word it is a pyramid scheme!

Now I have to wonder as well about the supposed successful uplines like mine. Are they actually even able to retire? If they are making such great residual income and are now millionaires, then why do they continue to recruit? It is surely not out of the goodness of their hearts, as they would have their downline believe. . . I did not plan to fail and I will not fail! I will not let your monster company ruin my family relationships or businesses by adding this unnecessary debt to my family. . . *This type of scam needs to be exposed more fully to protect the public. . .*

Seriously,
Scammed by PhotoMax (Div. of Nu Skin)

Son gives up college for MLM

OMG, Dr. Taylor, *your research is incredible and a direct hit.* I'm trying but this cult is getting stronger as our economic down turn continues to plague us. However we survived harder times. . . It is sad in this case because this family will pull their son from his sophomore year at University of San Francisco to work full time in this cult. I escorted my family members to this conference and felt like it was a version of the Jonestown revival act episode II.

You are our hero!

Kind regards from California,
Karen

These MLM companies are preying on people's misery and perpetuate a cycle of despair and cruelty. They accomplish nothing for the good of society and not only that, they warp how people treat each other. Friends become clients, families become numbers. It's sad to me. – Nick

Homeless person left to walk 20 miles because he didn't join

Hello sir, I am sort of an information addict. One of those people that get lost for hours on Wikipedia sometimes because I enjoy reading and learning.

I had become homeless due to a massive heroin addiction and was panhandling on the streets. A young family came over to me and said they could help me kick my habit and put my life back on track and then offered me \$20 to go with them. I needed the money so I accepted. They took me to a sales meeting with all these well-dressed people and the words "marketing" or "direct sales" were not used before the presentation.

However as soon as the presentation started I saw immediately what this was. I asked to talk to the people who brought me there in the lobby. When we got out I **asked him how I was supposed to invest \$200 in a start-up kit when he had picked me up on a street corner? He said that this was a good way to get myself back on track.**

When I told him what I needed was rehab and then job security he switched around and then did something that proves just how soul-less some of these true believers can be. He told his wife to go back inside and then whispered to me "think of all the drugs you could buy earning thousands a month". I was nothing but a dollar sign to him and I said I may be a drug addict but I have a soul, I couldn't live deceiving other poor, lost people like myself for a living. When he saw he wasn't going to get to me he

demanded his \$20 back and told me to leave. I ended up walking 20 miles back to the city.

I have almost a year clean time now and a wonderful job making food at a hospital. I may not be making millions but I'm still alive and feel like my job means something. Every day I make food for people with terminal illnesses and have grown to become good friends with my co-workers and customers.

These MLM companies are preying on people's misery and perpetuate a cycle of despair and cruelty. They accomplish nothing for the good of society and not only that, they warp how people treat each other. Friends become clients, families become numbers. It's sad to me. . . Thanks for letting me share.

– Nick

A woman's family has for decades been torn apart by MLMs:

Thank you so much for providing the truth regarding MLMs. **Pyramid schemes have torn my family apart on many different occasions. My dad was involved in Dare to Be Great in the late 60s/early 70s.**

Now several of my family members are involved in Lifemax. It hurts more than you can imagine. Seeing everything get taken from us as children and now seeing the potential for it to happen again to my younger sister who has a 10 month old baby.

Perhaps what's worse is knowing so many people who are hurting in this bad economy are desperate and are turning to this. And how the scammers use God and "the chance to help starving people around the world"! It's AWFUL!!!

– Paige B.

Worldwide feedback convinces us that great harm is being done to vulnerable populations who can least afford to be impoverished by these fraudulent MLM schemes. – JMT

Perhaps what's worse is knowing so many people who are hurting in this bad economy are desperate and are turning to this. And how the scammers use God and "the chance to help starving people around the world"! It's AWFUL!!! – Paige B.

Feedback from around the world

Egyptian at German University sees MLM as epidemic disease that threatens his third world country

I am Egyptian living in Cairo and working, as appears in my signature, in the German University in Cairo.

The spreading of the network of that MLM spider at my university terrifies me. Actually, this industry CHANGES people. My friends have changed! They act weirdly and treat me as a "customer". In addition, some of my colleagues, who are supposed to be researchers, left research and are now active for MLM!

Now, to be honest, I am being their opponent. **I am trying hard to stop that epidemic disease that threatens our community; especially that I am in a third-world country where people tend to be lazy and unproductive.**

– Mohammad A., Egypt

Swiss financial advisor warns friends and family in Spain against MLM

[MLM-thetruth.com] has been extremely helpful as I am Spanish and live in Switzerland and was never aware that such schemes were actually legal. I have been approached by an ex-colleague in Spain to join the so called FANTASTIC opportunity offered by Agel because they are opening up their Swiss branch and at the same time my brother in Spain got contacted through colleagues. It took me 5 minutes to look at their website, see their recruitment video to understand it is all a scam.

I am a financial investment advisor working in the financial industry now for over 7 years with a long experience in marketing-sales jobs (I worked 5 years at Goldman Sachs) so it wasn't difficult for me to see that it is a scam.

That said, **I am shocked the regulators in the US are so bland on these types of schemes** and I believe I had never heard of any of them in Europe until now. All your research has been extremely insightful and hopefully helpful (time will tell). I have on as well.
– Rosa forwarded it on to my whole family and network of friends in Spain and asked them to forward it. – M., Switzerland

I am shocked the regulators in the US are so bland on these types of schemes.
– M. from Switzerland

Woman in London finds Nu Skin recruitment methods deceptive:

Nu Skin is currently putting ads onto London Craigslist, an online job forum in London, England. I sent an application and was invited to a 50-minute or so telephone call with a lady in France called Clemence, another lady from Strasbourg and a man called John who claimed to have been with Nu Skin since 15 years.

I had originally thought that they were looking for a distributor to get them into big department stores.

I checked the Nu Skin website and saw that the prices are very high. I could not understand how it would be possible to sell the products with a profit. I was amazed to hear from John that he had recruited thousands and thousands of people.

They put real pressure on me during the call and wanted me to sign up as a distributor either for 85 Euros (one-time fee) or 45 Euros (monthly recurring business). It made me suspicious that they insisted on this as the ad said no capital outlay. I was also not interested in trying their product as I use my standard products which are cheaper.

Then I came across your article, thank you

very much for your website. Before I came to your website, I was on another MLM website <http://mlmtuition.com/kwcp/success/3837/200570>, the MLM mastermind system.

I was suspicious when John told me that people in Hungary are making \$20,000 a month with their products. **What is worrying is, that they are placing their ads on job sites in European countries now.** Thanks again for your web site.
– Renata L.

Woman wishes she could put an end to MLM deception in South Africa:

I have been reading some interesting information on MLM. I cannot believe, looking back at it now that I fell so hard for MLM (Nu Skin) to be specific.

I wish I could expose what is happening here in South Africa as to put an end to the deception but I guess that would be a waste of time since people still believe what they want to believe - and they would much rather believe that MLM is a legitimate opportunity

Anyway, it made me feel better to read your stuff

Kind regards – Lerina

I'm indignant to see it (MLM) has become a global phenomenon to the detriment of all.

Thank you so much for hosting this website. The truth about these scams needs to be presented as an antidote for the lies of illusive riches which only appeal to ones baser nature. I feel these scams harm financially, relationally and morally to individuals and society as a whole. It seems the cancer is growing and spreading to the developing world which can ill afford to slow their economic progress. – Concerned

Insights of professionals

From a licensed private investigator:

You guys rock!!

I can't tell you how useful your site is. Thank you so much for proving that ethics, moral standards and common sense are not lost. I have a friend who gets involved with the newest MLM every time a recruiter asks him to come to a meeting. It has become such an issue that it has affected our friendship. I will refer to your website often to counter the nonsense and unethical behavior that traps people like my friend. I commend and thank you for your efforts in helping people who truly are victims of this economic cancer.

I am a local licensed private investigator that would love to help you in any way I can and if I have the time. (My time would be free of charge) Please let me know if there is anything I can do to help *further your cause*. ***I will do anything to help the public see these for what they are, because in one way or another they affect all of us.***

—Jake A.

When I wrote Jake to thank him. I explained that my advocacy is all voluntary and that it is heartening to receive such a letter to counter all the deceptions I hear and hate mail that comes my way. He responded as follows:

"You're a good man and the only reason anyone could possibly use to justify sending you hate mail is ignorance. I think a lot of people are playing for the wrong team and just don't know it yet."

I will do anything to help the public see these for what they are, because in one way or another they affect all of us.

— ***Jake A., private investigator***

Doctor warned against MLM product. And it's OK to work at a job for money:

Hi, I was doing research about MLMs and found your site, it was very helpful. The new item is "MaxGXL" offering kind of a wonder drug, well supplement. My wife has medical history and thinking this might help her I did research and took the product to her doctor before she even tried it. **The doctor said it can cause her kidney damage and maybe failure, so I am not doing this.**

I was asked to join and I told them if this helped my wife I could sell the product but I was told to take the product myself and wait on her, then join and get people under me – that's all I needed to do.

I was thinking this could actually help people and to be honest never really heard of MLM but yes I have heard of the pyramid schemes. Anyways thank you for making things understandable for people that don't know too much about these programs. [Instead of MLM,] hard work and lots of patience is usually what earns the good old American dollar.

Thank you

— Ron D.

Attorney mom finds web site helpful in debunking deceptions

I found your website (mlm-thetruth.com) and all of its information extremely compelling and useful, thank you for it. Here is my dilemma, I hope that you can take a moment to respond.

I am an inactive attorney in California, currently staying at home to raise my 15 month old son (I also have a first grader). I received a call from a friend (also an attorney) telling me about this great "business opportunity" and after speaking with her I agreed to attend a PBR (personal business reception) about this wonderful new deal.

It sounded good of course, but light bulbs went off in my head for various reasons so I stalled my friend (I'll call her "Donna") and told her that I would think about it and get back to her.

Needless to say I did some further research, found your website (and others)

and realized what a huge scam ACN (and others like it) really is. Here's my issue: I really like Donna, she is about 10 years younger than me and I knew her when she was still a law student. She is now a public defender (as I was when I first graduated from law school) and is pushing ACN. She learned of the business from her boyfriend (now her fiancé) and even got her mother involved in the "business". She's very into it because she wants to have a family one day and stay home to raise her children but her law school debt is over \$100,00.00, etc., and this looks like the perfect vehicle. You get the picture.

I think what pulls the wool over people's eyes with ACN is that they are not selling products (the lotions and potions you describe) but claim to be offering for sale something people use every day, the service on their phones (mobile and landlines) and of course the right to become a representative to sell the service to others. So it seems distinct from an Amway or an Herbalife because people do pay for mobile (and cable and internet) every month, so why not sign them up with ACN and watch the dollars just roll in?

Donna just called me the other day, and asked if I would at least sign up for a service if I did not want to become an "ACN representative". I intend to put in writing exactly why I am not interested but would like to know how can I best refute the claims that ACN specifically makes.

I know that I should just tell her no in conversation and move on but as a fellow lawyer and because she is someone I really care about, I feel compelled to make a strong case to help her understand what a mistake she is making. **I shudder at all the social capital she is expending, never mind all the money she's already invested in seminars and trips to conferences** (I attended one in Modesto CA and was surprised at how many people were involved!). Of course I will tell her about your website, the Merchants of Deception book and the fact that ACN was barred from "selling" electricity in California in the mid 90s but anything else that you may have on ACN would be greatly appreciated.

Jon, Donna and I are both Latino and we speak Spanish and she keeps talking about how ACN is going to open up in Mexico etc. and I just cringe when I think of all the people who could get taken in by this and by someone speaking to others in their native tongue. It just seems so wrong to scam someone and the fact that we are lawyers which gives us added credibility sends chills up my spine. What really kills me is Donna really BELIEVES. She would never bring her mother (a real estate agent whose business is right where you expect it to be in this economy) or speak with me about this otherwise. She is sincere. We both have always cared about those less fortunate, hence our professional choices.
– Vylma O.

Tax accountant never sees clients profit from MLM

I was first exposed to Amway, by a young recruiter, in the summer of 1977, months after I graduated from the local private university. I turned down the opportunity, then, but the MLM business model has, since then, intrigued me. . . but not in a good way!

For 31 years, now, I have prepared tax returns for clients, some of whom, try to recruit me into their "great once-in-a-lifetime" business opportunity. At first, my reaction was to be gentle and friendly. Now, when one of my clients tells me he is doing so well, I am bold to say, "C'mon, John . . . I am the one who does your tax returns, every year!" I have never seen a client profit from one of those "low ticket," product-based, recruiting MLMs!

Now, being a resident of California was one thing. Everything changed, in 2006, when I got married, and in January 2007, I relocated to Utah, the MLM capital of the world! It is unbelievable how many "MLM-Hoppers" there are, out here!

So, though it may be me against the MLM establishment, I published an advisory article

online. And, even then, in the last year, two MLM recruiters, who had read my website, tried to recruit me! (Of course, their MLM is different! Yeah, right.)

I will do anything to help the public see these for what they are, because in one way or another they affect all of us.

– Phil F., CPA (Note: For data from other tax people, see *Survey of Tax Preparers*.)

For 31 years, now, I have prepared tax returns for clients, some of whom, try to recruit me into their "great once-in-a-lifetime" business opportunity. . . I have never seen a client profit from one of those "low ticket," product-based, recruiting MLMs!
– Phil F., CPA

Analyst uses web site to debunk the deceptions in one MLM and in MLM as a business model.

I found your paper on the internet – the five red flags to identifying product based pyramid schemes. Very informative. I have some friends who are caught up in the Arbonne scheme.

It definitely meets the five red flags and as you said the compensation structure is the key. It has the emphasis on recruiting, you have to pay to play in personal retail volume, there are 6 levels of payout, and the "promotions" are based on recruiting rather than by appointment.

The products can supposedly be sold at retail for a higher consultant commission but this is unrealistic because everyone signs up as a non-active consultant for \$29 and can order over the internet at "wholesale". If you want to be "active" you have to do \$100 per month retail volume (\$65 with consultant's discount) and at the bottom commission rung of 4% you have to sell to quite a number of customers to

recoup your required minimums – so then the emphasis becomes on recruiting.

To jump to the 8% commission level a \$1,000 in personal retail investment is involved to qualify within a certain time frame – so they have the opportunity to stick you for this more than once because you buy kits to get started. They pay on 6 levels – they have a width/depth structure.

I forwarded my friends your paper and tried to get them to understand that what they are involved in is unethical at a minimum...but they just sent me back the published hype – all the typical things you referred to in your paper. I think one of these people got in early enough in the scheme that she may be making some money. **These [MLM] companies seem to prey on housewives who don't understand the basics of market supply and demand. They are so naïve that they cannot see the forest for the trees.**

Thank you,
Susan S, MBA

Susan wrote later:

Yes, it was an interesting learning experience for me. I had never been approached by something like this. I also didn't remember covering these schemes in any of my course work in my undergrad or MBA marketing classes.

It was the compensation structure that got me suspicious – when I realized that these minimum purchases were involved I started doing a little breakeven analysis and realized how much I'd have to sell at these low commission rates to just make back the money they have you spend as monthly minimums. It really does not become clear until you start to calculate how many people you have to sell to just to break even! Then it became clear to me that you had to recruit people to make any money. I thought this was very fishy – and so I jumped on the internet and found your article...and then it all really clicked in my brain.

– Susan S., MBA

Insights from MLM insiders

MLM job applicant asked if he preferred being a pimp - or a prostitute!

I worked for Nu Skin enterprises, at the company headquarters for over 10 years. I worked in many departments and had many roles including; commission systems, marketing, competitive research, returns, customer service, account executive, and manager and SAP implementation team. I LOVED working for Nu Skin, it was a wonderful work environment!

One day back in 1999 they "downsized." I was hit-up by every MLM around and never joined any, then one day I was reading in the Epistle of James . . . just kidding. Actually I followed some of my supposed friends to other MLM's, one of which was XANGO.

I asked for a job but they wouldn't hire me and instead suggested I become a distributor, I said "no" I prefer not to work on the sales side for many of the same reasons you share on your website.

I was speaking to Dr. Pendleton at the time and he said, "What's wrong with being a distributor?" I said it wasn't my thing and he made a statement that really turned me off about ALL MLMs. He said, **"Oh, you are OK with being a PIMP, but you don't want to be a PROSTITUTE huh?"**

I always looked at what I did at Nu Skin as honorable work and employment, but after a twisted statement like that, I find any MLM distasteful and I would like to help in any way I can to "Get the Word Out!" I am fighting an uphill battle since some of the TOP distributors from Nu Skin and Noni are actually close relatives. What direction would you suggest I take with other family members to not get sucked in? It's funny, after ten years in ALL aspects of MLM, I would almost consider myself an Expert, but when family (in-laws) see the big houses, nice cars and freedom to go and do as they please. . . all my expertise goes out the window. What to do, what to do?

By the way, the DSA has direct sales statistics with graphs and everything but one statistic that I no longer see on their site

was what percentage of revenue goes to the company and what percentage goes to actual distributors to pay commissions??? If I recall correctly from seeing it over 5 years ago, over 75% goes to the company and the rest in paying distributors. **After dividing the \$17 billion between the 3-400 MLM's, then dividing those numbers by the millions of distributors and taking all of that from only 25% of the \$17 billion, I find it hard to believe ANYONE wouldn't head to Idaho and put all that time and money into Lottery tickets???**

—Aaron T.

"Oh, you are OK with being a PIMP, but you don't want to be a PROSTITUTE huh?"

— Aaron T.

From a former employee who worked in call centers of two MLM companies:

Thanks for your awesome website! I finally quit working at these MLM call centers. I am done forever supporting these terrible businesses. I worked at Nu Skin and MonaVie. They both treated me well. **But really, it felt like working for the mafia deep down inside and I kept rationalizing it because the pay was good (as a college student).**

It is sad when I think about all the people that worked in these call centers that touted it as such a great business. The managers all thought it was the greatest thing and I always wondered how they could be so blind to how many people were falling prey to the "business." I didn't complain outwardly at work, but I was not a loyal employee on the inside. I despised these companies.

The things you have written on your website I have seen every day. Especially the part about self-deception. I really do feel that all of the distributors involved either are corrupt and knew it or just somehow convinced themselves of the legitimacy. Taking a step back it is so

easy to see the ethical problems with Nu Skin and MonaVie.

MonaVie is extremely despicable in my eyes. The juice is absolutely ridiculous. It tastes great but the only claim they can really make is "antioxidant protection." The juice has obscenely high antioxidant protection; more than is needed even.

I have seen so many people on fixed income that are wasting their money on cases of juice. They really will sacrifice other important things because they believe "maybe next month I can earn something" and so they keep buying in. I even saw a few people using their unemployment money on it! There are so many times where I wanted to tell the person on the phone: "You aren't going to make it, please get out!"

The other thing that really gets me is how they cover behind their humanitarian work. Don't get me wrong, I know it is a good thing to help anybody out, and they are doing some good. But around MonaVie headquarters, there were pictures of poor Brazilian kids plastered everywhere, and it was just so fake.

Your website helped me a lot in moving forward according to how I felt on the inside, so I wanted to thank you.

– J. D.

Former MLM insider uses web site as ammunition against "MLM cancer":

I just wanted to let you know how much I appreciate your cut-to-the-chase information about MLM and everything related to it. It has been a continual resource as I am approached often about the next great business opportunity that will make me a millionaire. **I am a web developer and have worked on the inside of a MLM and saw firsthand the continual plot to capitalize on the failure of others. This site has given me ample ammunition against the spread of MLM cancer.**

– Mick D.

Insider reveals obscene wealth of founders:

A family source (an ex-husband) of one of Nu Skin's founders reported in a confidential interview that one of the founders includes among her holdings at least ten homes:

"I am just guessing, but I have a fairly good idea. The one in Sandy, Utah, worth about 6-7 million [*dollars*], one in Deer Valley; about 4-5 million. One on Maui or on Oahu: about 3-4 million. On Kauai she has an amazing house worth at least 8 million. We bought also that together like the one in the Trump Intern. Tower, worth now about: 4.5 million. One huge penthouse in the Time Warner Building, also on Columbus Circle, worth about 36 million. A lot of land in Deer Valley worth at least 5 million. Land in the Oakley is worth anywhere between 10 and 30 million, depending how you handle it. A condo in Park City of about 1 or 2 million, the Oakley Cabin; at least 15 million. A ranch in Oregon: 3-4 million, a farm in Spanish Fork, Utah: 3-4 million. Land in California, my guess is as good anyone's. She owns a lot of stuff I have never seen. My friends have seen the paperwork and it is quite impressive. She also bought and sold a \$17. million condo on 515 Fifth Ave. while I was with her. Do you get the drift?"

A magazine article reported she also owned a Gulfstream II private jet.

Her brother, Blake Roney, is reported to be worth at least \$800 million. Other key figures have accumulated tens of millions each.

Of course, these leaders have initiated and donated to humanitarian causes, and they use this to justify their exploitive scheme. And believe it or not, many in the public and the media buy into this thinking. "They can't be bad people, if they do such good things." To use an appropriate metaphor – If you rob a bank and then give 15% to charity, the bank robbery is OK, right? Sure.

And as for the 3+ million distributors (since the company's founding) who have paid to get into this opportunity of a lifetime? According to my calculations, based on Nu Skin's own reports, approximately 99.9% of the company's recruits lose money, after subtracting required purchases and the bare minimum of operating expenses. Less than one in 400 distributors ever turns a profit. Perhaps less than one in 20,000 earns the

“substantial residual income,” also referred to as “permanent income” – that is promised to new recruits who are deceived into investing in this money trap.

BTW, this is not just Nu Skin. I have studied hundreds of MLMs and found a similar pattern with every one for which I could obtain data. You would be doing friends and family a great favor by using the “Answer cards” on my site to warn them against ALL MLM/chain selling programs. (It refers them to my site for more info).

Mlm-thetruth.com reveals deceptions typical of MLM

5 Red Flags best detection method for MLM fraud:

In 40 yrs. of studying MLM fraud I have not found a better detection method than the 5 red flags found at – mlm-thetruth.com

– Frank Thomas

Man thanks mlm-thetruth for keeping money in his bank account

First off, let me say that your site is an absolute wealth of knowledge on MLMs, and is what started to make me question a recent proposal that sounds a little too good to be true. [After reading some of your reports], I went back and listened to the compensation plan again on UCI's webinar. **They specifically state that selling the energy alone is a waste of time, that you need a "team" to get the most out of the program. I am officially disinterested now. Thank you very much for your vast, knowledgeable website, and the money you kept in my bank account, both long term and short term. I will definitely take a long look at your 1,357 ways to make more money [than MLM] list.**

– Dan M.

Unmasking MLM deceptions via mlm-thetruth.com

Thank you so much for all your hard work in "Un-masking" the truth about these scams!!!

I almost got involved with Fortune High Tech Marketing because of a friend. Wow!!! You hit it right on the head. Your "Typical Misrepresentations Used In MLM Recruitment" put it to rest for me. THEY ALL FOLLOW THE SAME UN-GODLY LIES. Just to make money off the reps. It's a numbers game. The more people under you, the more people get ripped off to pay you!

I wish the Federal Government would put a stop to these people! Or at least the "Federal Trade Commission".

– John T. (not Jon Taylor)

MBA grad sucked into 3rd MLM in seven years, sinks into depression

My son lives in California, has an MBA and has been involved in network marketing for about seven years. At one point he had a six-figure income and thought the sky was the limit (Cyberwize). When his upline decided to change network marketing companies due to a disagreement and pending lawsuit, my son followed with financially unfortunate results.

Now he and the same upline are in a third company. My wife and I have been pretty much supporting him for the past nine months. He keeps thinking that he will experience a 'break-through' and be on top again, but he seems very depressed some of the time. We are very worried about him.

Do you know of anyone who might help him to see the reality of the MLM lie? I have tried to reason with him, asking him to discuss his situation with a job counselor on several occasions and offering to pay for the counseling. No luck. **It seems to me that MLM is very much like a religious cult and that victims like my son will require deprogramming by a professional.** I'm sure he won't listen to me and has a pretty closed mind at this point.

– Concerned parent

Woman bombarded by friends wanting to practice presentations on her.

Thank you for this site. I like how organized it is and not full of ads and other bogus marketing. I have seen enough of that.

I hope this site can help my friends. I have been bombarded with Primerica and Agel bull crap, and I have been sending this link to my friends who are trying to "practice their presentations" on me. God Bless, Stephanie B.

Prospect at MLM meeting did not feel good vibe about the MLM hype:

Dr. Taylor,

You offer outstanding insight on MLM's. I recently had been invited to attend a meeting on Fortune Hi Tech Marketing. I went and listened. I didn't feel a good vibe about what they were telling me, so I did some research and found your website. I found it very informative and interesting. I made the conclusion not to join FHTM. . . It appears that the "pay for play" aspect is very much involved in this MLM. – Tim W.

MLM obfuscation compared to IBM:

In the brief time that I have been "communicating" with a bevy of "Coaches" at Nu Skin, making the obligatory cold calls, listening to the various audio programs that are supposed to "inspire" me to "Blue Diamond" status, I can only say that if my very brief experience could be made into a movie, it would be titled, "Willey Wonka and the Kool-Aid Factory".

Rarely are the products ever mentioned and as far as the Coaches providing me with any type of Standard Operating Procedure (manual or online version), the total lack of this kind of important resource reminds me of what once was said about how IBM or Big Blue used to indoctrinate and "groom" their executives like they were mushrooms, or in plain English, "KEEP THEM IN THE DARK AND FEED THEM BULLSHIT". I hope that your website [is seen by many MLM prospects] and thanks for your work on behalf of all of "US".
– Lee H.

Time to start a real business:

Thank you for your website. It opened my eyes to a lot of things! I am very young lady but had about 30 jobs in my life and scammers just love to take my money...

It's time to start my own business (not MLM). Thank you for ideas! ("1,357 Ways to Make More Money than in MLM")

Red Flags go up when a skin care line is promoted with typical MLM hype:

I personally would like to thank you for shedding light on MLM schemes. I read through your entire article, as I was suspicious of the "business opportunity" I had just become aware of through my friend, who invited me to a meeting earlier in the week, and today to an event with a motivational speaker.

I decided to investigate this company she's been telling me about, as I've always been interested in health and beauty for women and saw this as an opportunity to perhaps generate some extra income.

My BS radar is pretty high and a couple of things said today and earlier in the week bothered me - when the speaker mentioned he "was doing it all for the glory of the Lord." Please, this is the Bible belt but that doesn't legitimize any business venture for me. Instead it raises a question of hypocrisy and doubt in my mind. I don't like when people use the "Lord" as some kind of tool to convince me of their sincerity. Frankly, it convinces me otherwise.

Also, when much of what is discussed is "how much you can make" - that bothers me too. Also, saying that "You owe it to your children" - using an emotional tug - that didn't sit well with me, either.

The product was barely discussed – the potential to change women's lives by using it – and if this product was created by women and is all about women, why were so few women actually speaking? And the ones that did speak of, I wasn't very impressed with, as I've been in sales myself for a while and am a

pretty impressive speaker myself, so it takes a lot to get my notice. With all that said, I decided to come home and do a bit more research on the topic and I was glad to find your website. Now I want to discourage everyone I met - to not get involved with this venture!

– Diana C.

MLM scams harm individuals and society financially, relationally, and morally

Recently a close friend of mine got involved with ACN with her grown son and husband. She has turned into a brainwashed zombie and because I'm less than enthusiastic about it (I haven't said anything disparaging, though) our relationship is slowly waning. She's bought into it hook, line and sinker. It seems that at this point she would just rebuff my critical analysis. It has spurred me to do a lot of research, however, and I'm indignant to see it has become a global phenomenon to the detriment of all.

Thank you so much for hosting this website. **The truth about these scams needs to be presented as an antidote for the lies of illusive riches which only appeal to ones baser nature. I feel these scams harm financially, relationally and morally to individuals and society as a whole. It seems the cancer is growing and spreading to developing world which can ill afford to slow their economic progress.**

Thank you

– Concerned

As MLM grows, struggling consumers who fall for MLM suffer, families suffer, legitimate businesses suffer, law enforcement suffers, and society at large suffers.

– JMT

Critics of mlm-thetruth.com

Not everyone is pleased with my research and web site, as the following attests:

Dude you are a complete hipocrit. Get a life. 99.9% jajajajaja. Way to over react. On top of that, u have created 40, of these so called scams, nice job you ass
- Unnamed

[Unnamed is likely referring to Jon Taylor's having been involved in 40 business startups before getting into MLM. However, all were legitimate, and none were MLM.]

RE: Get a job, Taylor

You are so out of wack with your so called "experts" and research that you should be held liable for the crap information you peddle. You are so mis-informed about what you spread over the Internet! God, you need to get a life.

Business Millions

Blah blah blah...Jon, you and I both know that the only people who don't make any money in Network Marketing are the ones who don't do anything! The failure rate is no different for Real Estate agents, life insurance sales, any profession that you are an "independent contractor". It's simple, we were never programmed to work for ourselves, people just don't want it bad enough. . .

Network marketing is easy, the more you show the more you make...period. Product does not have feet, you need to share product, share the opportunity and not care who say's yes or no. It's not about the answer, it's about the process!

Man I wish somebody would lay the blame where it needs to be!

John

I THINK YOU ARE A LAZY MYOPIC LOSER! PEOPLE DO NOT MAKE MONEY FROM MULTI-LEVEL-MARKETING IF THEY FAIL TO BUILD A FORMIDABLE ORGANIZATION JUST AS YOU WILL NOT MAKE MONEY FROM A PRINTING FRANCHISE IF YOU FAIL TO ACQUIRE CUSTOMERS.

IF ANY MLM BUSINESS PROMISES YOU A GET-RICH QUICK FORMULA IT IS A SCAM, BUT MLM ORGANIZATIONS LIKE AMWAY, ACN, AVON ETC DEMAND HARDWORK AND PERSISTENCE FROM THEIR REPS IF SUCCESS IS TO BE ACHIEVED. IF A REP FAILS TO DO THE RIGHT THING, HE/SHE WILL NOT GET RICH JUST BECAUSE HE HAS ENROLLED IN A MULTI-LEVEL-MARKETING ORGANIZATION.

ACN AS A MATTER OF FACT IS THE BEST BUSINESS MODEL IN EXISTENCE AT THIS POINT IN TIME, IT DOES NOT MATTER IF LOSERS LIKE YOU SEE IT OR NOT.

I HAVE FRIENDS WHO HAVE BUILT UP ENVIABLE FINANCIAL FREEDOM FOR THEIR FAMILY THROUGH ACN, SO IT IS SAD THAT YOU GO ON CRITICIZING WHAT YOU HAVE NOT EXPERIENCED SIMPLY BECAUSE YOU HAVE TALKED TO PEOPLE WHO ENROLLED IN ACN WITH WRONG PERCEPTIONS AND FAILED TO FOLLOW THE RECIPE AND THEREFORE FAILED TO ACHIEVE ANY RESULTS. WHY DON'T YOU TALK TO THOSE WHO HAVE CHANGED THEIR FINANCIAL FUTURE THROUGH MLM BUSINESS MODELS AS WELL? I BET YOU THERE THOUSANDS OF THEM AROUND THE WORLD. I LIVE AND INTERACT WITH SOME OF THEM.

IT IS AMAZING HOW LOSERS LIKE TO CONGREGATE TOGETHER AND SEEK ATTENTION FROM PEOPLE IN ORDER TO HIDE THEIR INEFFECTIVENESS AND LACK OF PERSISTENCE.

MY CHALLENGE TO YOU IS TO ENROLL AS AN ACN REP, FOLLOW ALL THE RECIPE THE COMPANY HAS PUT IN PLACE, AND ENDEAVOR TO BE COACHABLE, IF YOU DO ALL THESE THINGS AND ARE ABLE TO BUILD UP A LARGE ORGANIZATION OF REPS AND CUSTOMERS BETWEEN 2 - 5 YEARS, AND YOU FAIL TO BECOME FINANCIALLY FREE, THEN GO AHEAD AND CONDEMN THE COMPANY; NOBODY WILL BLAME YOU.

OTHER THAN THIS, JUST SHUT UP AND GET A LIFE!
JERRY O.

Great job of destroying the dreams of thousands of people.. Yes there are problems with some MLM companies however the numbers you quote just don't add up..billions of dollars in sales by direct marketers sort of tells the tale.. In addition, why don't you attack Wal-Mart..they have hundreds of stores that hardly pay a decent living and make millions of dollars off of people..there is a Sears outlet store in about every small community..of course all those independent gas station operators that thought they were going to make it big and went broke tryin to.. You have some type of income that depends on the efforts of others unless you farm and then someone has to get paid for the seed they sold you.. The point is..most MLM companies simply offer an opportunity to be more in control of your financial future via a REAL business..some make it..some do not..most come into the business thinking that they are going to get rich in a few months and fail..either because they did not work the business or they did not work and probably fail at most of what they have tried in the past.. What you do is throw water on the hope of some people because they think you are a doctor and know what you are talking about.. I DON'T!!
Robert B.

You have too much time on your hands. I found most of your information to be inaccurate. You need to talk to Donald Trump or Robert Kyiosaki or anyone who actually has had business success. You clearly have no idea what you are talking about. I would invite you to take a true look at a more upscale, growing and successful company and see if all those points apply-- you'll find that they don't.
Donna W.

I am just amazed that such an article would attempt to be out there after many years of MLM winning the battle initially fought by the granddaddy of MLM, Amway over 60 years ago. Maybe someone should explore what this industry has done for hundreds of thousands of people worldwide and thus making families more focused and together. There is nothing illegal or a scheme with MLM. Read the next billion dollar trend to see the trends and get your records straight and begin educating people the right way.
Rosa S.

RE: Loved your site!
You know, you seem to be a pretty smart guy...but don't you have better things to do with your time?
Do you know why most network marketing company's fail people? It's because people don't work...they are lazy!!!
Paul

One of the unfortunate things that your site doesn't take into account is that there are few if any small businesses that make any kind of profit within the first 5 years. The only real opportunity for regular people to start their own business is in network marketing. A legitimate networking company will allow someone to start a business for less than a hundred dollars, when a typical small business takes more than a hundred thousand. And yes, most of

not all of the money made should go back into the business in order to continue making money, but this is true of all small businesses for the first several years.
Marissa D.

[NOTE: Marissa should read some of the statistics from the Small Business Administration and other agencies that help with small business startups. Based on reliable statistics, all four of the above four sentences are false.]

RE: Your website is bul-sh...!!

This website should called mlm-thelie. There may be some truths in there but the idea of the website is completely wrong. I would suggest you to evaluate more network marketing companies. And I mean "network marketing companies". Don't put network marketing and mlm together. That is just bull.
Now put that in your testimonial page!
Hung T.

Can you help me?

hello, uhm, how sure are you that what you presented is true? i know people that are rich from mlm, how can you say such things? do you know why most people fail? because they didn't do this right. why are you so negative? because you couldn't do what some people can do? not everyone can succeed, but there are +2000 blue diamonds. please explain to me why... i just don't get it...
Sydney T.

RE: MLM IS THE BEST BUSINESS!

I am writing to you because I am going to prove you WRONG! You obviously are to incompetent to understand what a MLM is. I became a wellness consultant for Nikken back in the beginning of June and this was a life changing decision I have ever made! I received a \$2,100 commission check the

next month my commission check was \$3,200!! I am continually earning a large income and it was because I joined the most amazing MLMs ever!! The people who just start out in a MLM can be very successful!! If this was a pyramid scheme I would not be making this much money!!! MLMs are the most rewarding business opportunity!!!! I will speak this truth to the very end of my life!!!

David R.

Nikken Wellness Consultant

My response to "Nikken Wellness Consultant":

David –

If a business is legitimate, one will be able to report profits on their income taxes. Please write me back in a year and tell me what you reported as net profits from your MLM.

– JMT

NOTE: David did not write back, and did not respond to a follow-up inquiry two years later.

Your an idiot! You are ignorant! A website dedicate to that! Get a life!

Kelly L.

Appendix 9C

Excerpts from a sample of complaints against MLMs filed with the FTC in 2013

Many of the complainants who filed complaints pleaded for help from the FTC. These excerpts from a small sample from across the MLM industry show that this is a serious systemic problem to be addressed. For a more thorough collection of complaints filed against MLMs, read the full report of complaints as posted on the web site – www.mlm-thetruth.com. (Names of complainants and MLMs are redacted, as the purpose is not to focus on any one company but to show a general pattern of MLM abuse; so only reference numbers are included at the end of each excerpt. Spelling and grammar is not corrected.)

This is how they make money some are successfull but a vast majority are dupped Im one of the dups IM not stopping here I WILL KEEP MAKING NOISE UNTIL SOMEONE HEARS ME **this is not fair im on disability I figured this is a way to make extra cash I dont have funds to throw away PLEASE HEAR MY COMPLAINT . . . [to the FTC] PLEASE DONT LET OTHER PEOPLE GET PLAYED. PUT AN END TO THEIR SCHEMES ON THE AMERICAN PEOPLE** (#46157475)

This (MLM company _____) is a **nightmare!! It practically caused my sister to almost loose her mind. . . This thing is a CULT and it continues to get people in it, somebody has to do something about it. It is ruining so many lives. They keep believing the brainwash. They are loosing cars, houses, going homeless, yet they still believe the brainwash. . . . These people are cult leaders please stop the madness! someone has to save all these poor souls!** (#43422929)

PLEASE INVESTIGATE THIS (MLM) COMPANY. IT IS A PYRMID SCEME AND NEEDS TO BE STOPPED IT IS PREYING ON POOR PEOPLE AND IS DECIEIVING WITH THE IDEA OF YOUR OWN BUISNESS AND THERE IS NO BUISNESS ITS A MONEY LOOSING SCAM ADDING NEW MEBERSHIP IS THE ONLY REAL WAY TO MAKE MONEY, (#49250725)

I am writing to urge the Federal Trade Commission (FTC) to take a look into (____ company) _has been accused of operating an abusive pyramid scheme that targets minority groups, especially Latinos, and falsely promises large profits. . . the evidence of consumer harm is widespread in my district and across the country, I believe it is critical for the FTC to conduct a thorough investigation and protect consumers from these malicious recruitment tactics and false promises. If (MLM company _____) is acting illegally by making false income claims to vulnerable Latinos in my community, then they need to be held responsible. (#47799802)

(MLM company _____) is DEFINITELY a pyramid scheme. Ive been in it for about a year now and Im probably one of the only people who are wise enough to see that it is a pyramid scheme and can help the FTC build a strong enough case against it to take it down. In short, the primary motivation for people to join the company is the business opportunity, not the products, the products suck, and then the primary aim is to "recruit" other people into the bizop... making it a pyramid scheme. . . Its time for the FTC to finally take notice too and take it down. . . (#44199076)

Consumer is writing on behalf of his church community. They have a complaint about the (MLM company _____), who they say is a "get rich" quick pyramid scheme. . . . Consumer is requesting the FTC initiate an investigation into (MLM company _____), and their illegal business practices. (Complaint #49895035)

I became a member very recently and was not informed that I would be required to make a minium purchase every month or one will be placed for me against my will. When I called to cancel, I was told that it was too late, an order will be placed for me, and the amount deducted from my checking account. I cannot afford the purchase and will endure a finanical mess if they force this deduction. I pleaded my situation to no avail. I feel violated and now have enourmous stress. This is robbery. (#43123669)

I am writing since we are in the middle of a difficulty with this (MLM company _____) and wanted to alert about this type of dishonest practice. . . . We just want our money back and alert people who, in good faith, rely on this type of business. (#45566292)

I conclude that this company is nothing but running a scam in American soil. I did pay for all products I have ordered during my three months trial period even though the products are very expensive. But time came to get my money back like other scam under disguise of genuine business failed to keep their side of the bargain. . . . I want those authority who oversight these type of activity do an investigation about the business and types of agreement. --- (#48558336)

(MLM company _____) seems like an unfair bussiness and I simply want to make sure that the public in my community is not being scammed out of their hard earned money in a tough economy. The information I've read on the internet seems pretty compelling and I'm inclined to believe that (MLM

company _____) is a Puramid and a MLM. Hopefully, this complaint will save consumers their time and money. (#49780798)

I was invited to a meeting for (MLM company _____), Scam, Pyramid, Rip off... call it what you want they need to be stopped. They are ripping people off and the worst part is it's people who can't afford it and are embarrassed to say anything when they have been. Met some very nice people brainwashed by a snake in the grass. Shut them down please (#48949355)

After politely telling them [MLM recruiters] no they preceeded to belittle me. Tell me that attending college was a waste of time and that I was "doing nothing with your life". . . the business did not approach me about the product itself. Instead, the calls and personally meetings I had attended were about buying into the business itself. The meetings did not aim to promote me, as a consumer, to drink (MLM company _____) products but to pay for a "builders kit" to become a "brand partner" to sell the drink as well, which makes it mandatory to buy arbitrary amounts of (MLM company _____) product a month. I request that the 70-30 rule be applied in the investigation . . . and that (MLM company _____) be acknowledged as a pyramid scheme. (#50122667)

I have encountered their marketing materials on social media, and they have all the tell-tale signs of a classic pyramid scheme: outlandish income claims with little work, revenue comes from recruiting new members, they pose as a work-from-home (MLM) system but there is no apparent product beyond vague "business services."What's more, they appear to be preying specifically on low-income individuals with poor credit. Please put a stop to this scam promptly, as it is spreading quickly on social media. (#48188074)

Ive heard promoters in the company say things like " I am SO glad we got in when we did"! Thats a sure sign that something illegal is going on. **The market saturation is getting so bad they are having to extend to Europe just to find promoters.** The product is GROSSLY overpriced and the only way people can make money is to RECRUIT MORE PEOPLE. **Please look into this, thousands of people are losing money, thousands of people are putting off looking for a real job because they are lied to from this company. The promoters are teaching people that if you have a JOB - you are just. over. broke. and the only way to be truly free is to join the company. The FTC is supposed to protect consumers. Please do that for people that are falling left and right for the (MLM company____) Scam (#44849463)**

in my stupidity, I signed and payed to join the program. I tried to contact them, no answer and no money back (although it was guaranteed. I'm feeling really stupid and can't do nothing about it. **please if you can help me and others not to fall to this scam.** (#43791952)

I currently joined zhunrize inc as it grows its business and members to over than 5,000 members. **However, it seemed to me that based on its operation and compensation plans, it is identical to those with pyramid schemes business model.** Is (MLM company____) business a pyramid scheme? If so, I would be very concerned with the current members and myself. Even if there is no complain filed against it, **will the FTC/Authority-in-charge shut it down as we know that pyramid scheme model will never succeed and is illegal?** (#49468870)

This company targets many college students, and created a very believable website and scheme. There are many people involved in the state of New York and it is growing very fast. . . **This company is going too far and needs to be stopped.** (#44800314)

They're [*the MLM*] HEAVILY focused on recruiting people rather than selling the bottles of juice and they're using cult-like techniques to control their people **You guys [FTC] gotta do something.** (#49110645)

No where in the online order process did it state non refundable. It is only listed on the print out order form that you mail in. **This is absolutely misleading to the customer and this practice needs to be addressed as well as changed.** (#46673510)

I am writing to express my concern regarding (MLM company____)'s illegal pyramid scheme. As you know, pyramid schemes such as this can be very damaging to consumers. (MLM company____) members are much more likely to lose money (as much as \$10,000) than make any money from the company because its compensation program is based exclusively on the recruitment of new participants. **I respectfully urge you to promptly bring an action to end (MLM company____)** (#46104681)

Hi, My 19 year old son . . . was a good student, . . . Since becoming involved with (MLM company____), **he is no longer interested in college or music, and tells me (MLM company____) is his only career plan. . . it is as though he has been brainwashed. . . I believe marketing a pyramid scheme to naive teen agers is a very evil way to make money. . . The aspect that I find very troubling is the brain washing and the discouragement of education. . . Their videos and "motivational" techniques all point out that college is a waste of time and resources. The emphasis is on recruiting brand partners on your downline, not selling product, which sounds to me like fitting the pyramid model. But even if not illegal, this company is highly unethical and is ruining our future generation. . . I would like to ask that you investigate them and try to find a way to shut them down if at all possible** (#49951790)

Chapter 10: IS MLM LEGAL?

**When is an MLM program a bogus “business opportunity”?
Or an illegal pyramid scheme? Are all MLMs technically illegal?
What are the most significant legal precedents for MLM cases?**

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Introduction and summary

Let me begin by stating I am not an attorney and make no pretense about this being an exhaustive legal treatise on this thorny issue. I have been a consultant, teacher, salesman, entrepreneur, and consumer advocate.³⁴³ This latter focus came after witnessing what I believe to be the most unfair, deceptive, viral, and predatory business practice ever foisted on unsuspecting home-based business opportunity seekers (and victims who were not seeking anything) – most of whom had no idea how damaging MLM can be to their personal and financial well-being.

When I have consulted with attorneys and/or acted as expert witness in MLM cases, I have found it necessary to focus on legal precedents for much of my analyses. And of course, attorneys must constantly focus on the law and its interpretation, regardless of what logic and research may suggest.

Acting as a small business analyst, I try to be guided by solid logic and research and by feedback that I have received from MLM participants and their families worldwide. In this chapter, I will focus on the larger issues, and attempt to strike a balance between the legal issues and the economic and social consequences of MLM.

³⁴³ See Chapter 1 for bio and Appendix 1A for vita.

The preceding chapters serve a dual purpose: First, I have attempted to thoroughly analyze and expose the inherent flaws in multi-level marketing as a business model and as manifested in hundreds of MLM programs currently operating, and – by extension – in thousands of defunct and future MLMs. Substantial evidence for these flaws has been summarized, including new evidence presented here for the first time.

Secondly, this book demonstrates that the degree of unfairness and deceit of MLM as an industry, as well as harm to participants, strongly suggests that MLM is as bad as or worse than any classic, no-product pyramid scheme. If MLMs were classified as per se pyramid schemes, or as inherently unfair and deceptive practices, they would be illegal, according to FTC guidelines.³⁴⁴

Though it is not my primary objective in this book to prove that any given MLM is an illegal pyramid scheme,³⁴⁵ it is relevant to know whether or not an MLM displays the characteristics of a typical recruitment-driven MLM³⁴⁶, or what I would label a “product-based pyramid scheme,” because such schemes lead to horrendous loss rates among participants. Where data has become available, approximately 99.7% of MLM participants lose money,³⁴⁷ assuming at least somewhat realistic estimates of attrition, purchases, and minimum operating expenses are factored into the analysis. Re-pyramiding³⁴⁸ and related non-legal issues have also been treated in this book.

I will in this chapter attempt to summarize some of the more significant statutes, court decisions, and agency rules and communications that have been and could be used in arguing and deciding the merits of a case. It is my hope that this chapter, along with those preceding it, will

also provide information that will be useful for business scholars, media investigative reporters, consumer awareness groups, attorneys, and consumers themselves.

A brief history of Ponzi and pyramid schemes, chain letters, direct selling, and MLM

We will now consider an abbreviated history of the origin of multi-level marketing programs (MLMs). Note that I have labeled MLMs as “product-based pyramid schemes” to underscore the fact that the existence of products does not mitigate the harm caused by pyramid schemes.

Ponzi schemes. When Charles Ponzi organized the Securities Exchange Company in Boston in 1919 and issued promissory notes payable in 90 days with 50 percent interest, he kicked off a storm of investment frenzy which duped just about everyone, including politicians, law enforcement officers, and reporters. He tricked speculators by using the money of new investors to pay old investors huge ‘profits.’

Ponzi took in over \$15 million from this and other schemes before his house of cards collapsed, causing losses for thousands and leading to jail time and his eventual deportation to Italy in 1934. Incidentally, there were similar schemes prior to Ponzi (for example, John Law’s “Mississippi Bubble” scheme in France in 1719 and William Franklin Miller’s Franklin Syndicate in 1899—a.k.a. “520 percent Miller”), but the Ponzi name stuck for this type of phenomena.

Some consider Ponzi schemes as separate and distinct from pyramid schemes, but as one writer observed,³⁴⁹

Ponzi and pyramid schemes do have similarities. Both are fraudulent arrangements for the receipt and redistribution of money with early participants winning and those who enter later losing. In each case it is essential to continue the game with new infusions of money, for if the play ends and there is an

³⁴⁴ Letter from Robert Frisby of the FTC, citing section 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. 45 (a)(1). See also *Koscot Interplanetary, Inc.*, 86 F.T.C. 1106 (1975)

³⁴⁵ Again, I am a business analyst and consumer advocate, not an attorney

³⁴⁶ See Chapter 2 .

³⁴⁷ See Chapters 2- 7. Similar results were also reported in “*The Myth of ‘Income Opportunity’ in Multi-level Marketing*,” by Robert FitzPatrick, Pyramid Scheme Alert, 2008.

³⁴⁸ A more complete discussion of re-pyramiding and how major MLMs manage to avoid market collapse and endure for decades is found in Chapter 3.

³⁴⁹ Joseph Bulgatz , *Ponzi Schemes, Invaders from Mars, and More Extraordinary Popular Delusions and the Madness of Crowds* (New York: Harmony Books, 1992), p. 36.

accounting, there must be a deficit and cries of pain. But where Ponzi promised a definite return on one's investment – albeit a huge one —the possibilities in a pyramid were almost limitless as new subscribers feed those who joined before.

Furthermore, the machinery of the pyramid is always explained and is, in fact, one of its alluring features, whereas Ponzi plans invariably refer obscurely to exotic investments that are really irrelevant and usually nonexistent. In some cases the pyramid seems almost acceptable socially, as in the cases of chain letters or [chain] distributorship plans, but there has never been any question about the vice of Ponzi schemes.”

“Pay-to-play” chain letters. Later came chain letters, beginning with the “send-a-dime” letter widely appearing in Denver in 1935, which bore the heading “Prosperity Club” and the slogan “In God We Trust” This led to the \$1 chain letter in Omaha, chain letter agencies or “factories, and the “Circle of Gold” which spread from California throughout the country in the late 1970s – all of which used the postal system. Participants would send a dollar to the person at the top of a list of names that was mailed to you, add their name to the bottom of the list, and then mail copies of the letter to persons they know with instructions to do the same.

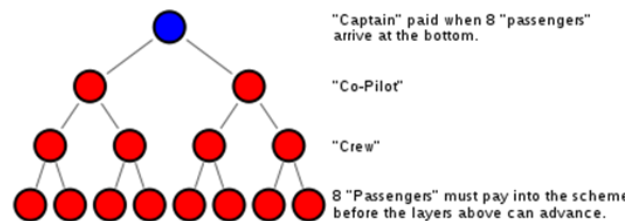
Many of these chain letters went underground because of aggressive enforcement of federal mail fraud statutes. Still other variations, such as chart and airplane games, emerged later.

Another variation appeared about the time the Internet was launched. What I call “report chains” encouraged you to buy reports listed on a list of names with addresses and then mail a report on anything of interest and add your name to the bottom before mailing it to your list of contacts. The reports were typically useless rehashes of readily available information – often money-making ideas.

“Chain selling” or “chain distribution” systems, or what later came to be called “pyramid selling” or “multi-level marketing” (MLM), were an eventual offshoot from chain letters. With chain selling, the selling of products was made through endless chains of distributors, each of whom received some

type of compensation for the sales of those recruited at lower levels, or one's “downline.”

No-product (cash-based) pyramid schemes. I use this designation to separate these schemes from product-based pyramid schemes, or MLMs. It is difficult to determine when the first no-product pyramid schemes were promoted, but by the 1980s several were operating. One example was “The Airplane Game,” in which participants were recruited into four layers, or “tiers” – one captain, two “co-pilots,” four “crew” members, and eight “passengers.” Typically, one would pay up to USD\$1500 to enter at the level of passenger, in the hopes of receiving a payout of 14 times that amount (in a 1-2-4-8 pyramid) when one 'piloted out' at the top of the scheme. The pyramidal structure is shown below:



The Airplane Game: *The "eight-ball" model contains a total of fifteen members. Note that unlike in the picture, the triangular setup in the cue game of eight-ball corresponds to an arithmetic progression $1 + 2 + 3 + 4 + 5 = 15$. The pyramid scheme in the picture in contrast is a geometric progression $1 + 2 + 4 + 8 = 15$.*

The “captain” at the top walks away with the money and then either drops out – while the others each move up a level – or he/she starts a new pyramid and repeats the process all over.

The problem is that at some point the game reaches a point of saturation in which no one wants to enter the pyramid and it collapses – or is shut down by authorities. Then all those at the bottom levels lose money, which approximates 90% of participants. (For a breakdown of the loss rates, go to Chapter 7, “Appendix 7B: Winners & losers in no-product pyramid schemes “)

It doesn't matter how many times the pyramid has been recycled into other pyramids, the scheme will eventually collapse, leaving approximately 90% in a loss position. These schemes are widely considered to be

unfair and deceptive practices. And though the FTC Act does not specifically address pyramid schemes, such schemes have been deemed unlawful under Section 5 in the Federal Trade Commission Act.³⁵⁰

Another recent genre of no-product pyramid schemes were the “gifting schemes,” such as “Women Empowering Women,” in which participants donated or “gifted” money to the operators of the scheme, who claimed it was legal since the money was paid as gifts, rather than investments. But authorities did not accept this distinction, and the gifting schemes were shut down.

“Affinity groups” were also promoted, in which close-knit groups were targeted to promote “Dinner Parties” with guests investing in a pyramid of participants similar in structure to the Airplane Game. These too were shut down by authorities.

Periodically, others followed suit. However, most pyramid promoters today see little need to initiate no-product schemes which are easily recognized as pyramid schemes. The trend today is to introduce products to give them an air of legitimacy – and to deceive regulators, the media, and the public into accepting them as legitimate.

Early direct selling programs.

Parallel to these developments were the appearance of door-to-door salesmen. These became common during the depression when some people were desperate to do anything to bring in some needed cash. Examples included those selling Bibles or miracle cures door-to-door.

Some of the more sophisticated direct selling programs that were popular in the 50s and 60s included *World Book Encyclopedia*, *Encyclopedia Britannica*, Fuller Brush, and Kirby vacuum cleaners..

To help pay my way through college, I sold *World Book Encyclopedia*. When I made a sale, the largest commissions from the company (20-30%) went to me as the person who produced the sale. My division

manager got a smaller percentage, and his manager a still smaller percentage – but of course they were drawing commissions from many salesmen. I found a similar pay structure when I sold insurance many years later. The person who made the sale got the lion’s share of the commissions.

In sharp contrast, in MLM, the commissions paid by the company to the front line person making the sale is only a small percentage of the total commissions paid by the company for that particular sale. Most of the commissions go to the upline. The only exception to this was retail markup on sales to non-participants, but this was rare. The suggested retail price was too high to be competitive with retail outlets.

In Chapters 2 and 7, I explained why one must examine carefully the compensation plans of direct selling programs in evaluating them. This, of course, would apply to any packaged home “business opportunity.”

Multi-level marketing programs (MLMs), or product-based pyramid schemes, evolved from no-product pyramid schemes.

In about 1934, a company called Nutralite was founded and by 1945 developed multi-level marketing (MLM), a means of turning consumers into distributors. They learned they could sell far more products by selling to distributors than they could by selling direct to consumers. After all, it is easier to buy than to sell, and if a person can be convinced that they will make money by buying products to qualify for commissions from sales by those they recruited, the sale is an easy one.

The nutritional products were promoted as effective in treating a variety of ailments, including even cancer, heart disease, and depression. Sales exploded. For a brief period, the FDA took notice and battled spurious product claims. And other regulatory agencies began questioning the legitimacy of MLM as a business model.

In 1960, Rich DeVos and Jan Van Andel developed an MLM they named Amway – short for American Way. Their product was a unique biodegradable soap called Frisk that would avoid FDA scrutiny. They created a compensation plan that essentially rewarded those at the top of a pyramid of distributors at

³⁵⁰ Section 5 in The Federal Trade Commission Act states that “Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.”³⁵⁰ In re Koscot Interplanetary, Inc., 86 F.T.C. 1106 (1975)

the expense of a continuing stream of recruits at the bottom, who bought the hype of promised riches if they followed their system – which included buying products on a monthly basis to qualify for commissions and for rank advancement by recruiting others into the pyramid.

Sales exploded from about \$½ million in 1960 to \$25 million in 1964. Amway also acquired Nutralite in 1972. The “recruiting machine” that Amway developed quickly attracted the interest of prospects and of regulators as well – setting the stage for a later battle with the Federal Trade Commission. Thus Amway, and the contest between those advocating for consumers, and an industry promoting a flawed business model that featured unlimited recruitment of a whole network of endless chains of consuming participants, was born.

In-home demonstration plans, or “party plans.” Party plans feature gatherings of neighbors, friends, and family members for a demonstration of lines of products typically sold by persons in their own home. Rewards, which are based on sales volume of those sponsoring the “party,” may include products, commissions, and bonuses with upline sponsors also receiving commissions and bonuses.

Whether or not a party plan can be considered a product-based pyramid scheme in disguise depends on how the participants at the upper levels are compensated. So the same analysis used in evaluating an MLM should be done with party plans.

To say that the addition of products somehow mitigates the damage done by a pyramid scheme is an uninformed view.

CONSUMER PROTECTION – AND LEGAL ISSUES – RELATED TO MLM AS A BUSINESS MODEL

As an endless chain recruitment model, MLM is inherently flawed.

In Chapter 2, I carefully defined and distinguished MLM from all legitimate forms of direct selling or business opportunities. I also explained the inherent flaw in all MLMs.

In a nutshell, MLMs are driven by a network of endless chains of recruitment by TOPPs (top-of-the-pyramid promoters). New recruits enter the bottom level of the pyramid by purchasing (and/or selling) products or services to qualify for commissions and advancement up the various ranks (levels) in the pyramid.

In MLM, the distinction between buyers and sellers is blurred. The sellers are the buyers, and the buyers are the sellers – to themselves and their families.

All of the hundreds of MLM compensation plans I have analyzed are built on the fallacious assumption of infinite markets. They are therefore inherently unfair and deceptive, – profitable primarily for those at or near the top of a pyramid of participants, who are often the first to join.

MLM compensation plans also assume virgin markets – which cannot continue indefinitely. So to avoid market collapse, since there is little if any retail customer base, they must be continually expanding (“re-pyramiding”) into new markets and/or with new products.

A continuing stream of new participants must be recruited to replace those continually dropping out – all to enrich a few TOPPs and the founders, who typically skim a percentage from every sale. The vast majority of new recruits become victims, having been promised substantial ongoing income but experiencing a net loss; i.e., having spent more than they received.³⁵¹ They also lose time and often important relationships from incessant recruitment.

³⁵¹ See Chapter 7

When the issue of saturation was raised in the 1979 FTC vs. Amway case, the Amway defense was that the total market for its distributors was nowhere near saturation. What was overlooked (or not understood) at the time was that total saturation is not a relevant issue. Why would a city of 100,000 people need 100,000 distributors? Ten or twenty may be plenty to serve the city as a market. It is *market saturation* that is relevant, not *total saturation*. Realistic *market saturation and collapse* happens quickly, as is explained in Chapter 3.

The 1979 FTC decision was based on inadequate information. In studying the Amway decision, it is apparent that little was known then about the long-term effects or the many deceptions on which MLM depends. Had the FTC prosecutors had the research reported in this book, the ruling that Amway was “not a pyramid scheme” (assuming compliance with the “retail rules”) likely would not have happened. Assuming these officials had access to the data and the associated research we have today – and the will to stand up to the Amway attorneys – *Amway would likely have been shut down, and you would not be reading this today. Hundreds of millions of consumers would have been spared hundreds of billions of dollars in losses, to say nothing of the personal costs suffered by victims.*

Judging MLM by behavior vs. structure and rewards. As I explained in Chapter 2, rewards drive behavior, and the structure of MLM compensation plans clearly reward TOPPs at the expense of those at the bottom levels. Therefore, I believe that to approach MLM as strictly a behavioral problem is counter-productive. Yet it is the behavior of participants and leaders that many of the laws and rulings address, resulting in much of the confusion in efforts (or lack thereof) to regulate MLM.

An example of behavioral yardsticks is the tendency of regulators to look at such things as the percentage of personal consumption of participants compared with sales to non-participants – or worse, products consumed vs. products stockpiled. Proving such spending patterns requires much research and discovery efforts, which can be

very expensive and time-consuming. It is also easily circumvented by evasive company “policies” and pretended enforcement actions.

Another behavioral “policy” is that related to refunds, or buybacks. While this can appear to provide consumer protection, those who deal with MLM refunds know that the fine print of how they are to be executed can assure that only a small percentage of purchases (usually less than 5%) ever result in refunds. They have been encouraged to open and use the products – to “be a product of the products.” Other conditions also discourage those applying for a refund – “clawback” provisions, compliance investigations, etc. And few MLM participants are sophisticated enough to know they’ve been deceived and determined enough to demand a refund. In Herbalife, for instance, it has been reported that refunds are approximately only 0.4% (0.004) of sales revenues.

Short attack on Herbalife by Bill Ackman.³⁵² William Ackman, the founder of hedge fund Pershing Square Capital Management, shorted Herbalife stock to the tune of \$1 billion, claiming after extensive research that Herbalife is a pyramid scheme and betting that the stock price would drop to zero. Other hedge fund managers, Dan Loeb and Carl Icahn, bet long (hundreds of millions of dollars), claiming Herbalife was a legitimate business. This unleashed a firestorm of articles, interviews, research and presentations on the pros and cons of Ackman’s claims. Investors and advisors took sides. The stock price fell when Ackman presented his short thesis in December of 2012, but then it rose for a time. It was only slightly affected when regulators began investigating the company as investors debated the pros and cons of the company.

Again, most definitions of pyramid schemes focus on problem behaviors, rather than on the underlying structure. Ackman posits six behavioral “indicia of pyramids” –

- exaggerated earnings claims
- Inflated prices and need to sell to other members

³⁵² Reported in a 340-slide Power Point presentation to a Sohn conference of investors Dec. 20, 2012. Go to factsaboutheralife.com for excellent videos, reports, and presentations.

- Emotional sales pitch - the "Dream"
- A history of lawsuits
- Targeting the financially unsophisticated
- Complex compensation plans

Note that none of these address the fundamental flaws in all MLMs, as explained in Chapter 2.. However, Ackman does a good job of describing problem behaviors in MLM.

Recently, Ackman's group produced an outstanding whiteboard video presentation which does a beautiful job of explaining to novices (and even some poorly informed "experts") some of the fundamental flaws in MLM schemes – and why they are merely disguised pyramid schemes. The video can be seen at his informative web site www.factsabouth Herbalife.com. Many of his presentations and reports can be downloaded from this website.

One of the most informative and interesting presentations occurred July 22, 2014, which revealed the investigation of Pershing Square into Herbalife Nutrition Clubs. It shows how Herbalife leaders crafted a system for literally plundering the resources of a vast population of low income Latinos. Instead of having to make a \$3,000 investment to achieve a sales leader position where profits might be possible, participants pay a small daily fee that eventually qualifies them. However, very few achieve this goal, and most of those who do qualify wind up losing money and dropping out.

Although Ackman's attacks on Herbalife focus on the one company, much of his information applies to virtually all MLMs. As explained in Chapter 2, consistent commonalities in compensation plans have been found in all of the over 600 MLMs I have analyzed.

Needed – Consumer protection against MLM fraud. The FTC and some states prosecute selective MLMs on a case-by-case basis. A far more cost-effective strategy would be to consider all endless chain recruitment schemes to be illegal per se because of the flaws in their fundamental operational structures and reward systems. But with the reality of the 1979 Amway decision, which the FTC seems unwilling to revisit even with evidence strongly suggesting reversal, at the very least the following consumer protections should be provided by the FTC, state attorneys general,

and other agencies charged with protecting against unfair and deceptive practices:

- The fundamental flaws of endless chain recruitment systems, or "entrepreneurial chains," should be recognized and pointed out to consumers, so they can be given valid guidance to avoid all such programs – which includes MLMs.
- Consumers should be provided adequate disclosure of information needed to make an informed decision. If a prospect knew that less than one in 100 persons earns a gross profit (receives more from the company than is paid to the company and upline for products and services), and that less than one in 25,000 receives the huge residual incomes reported for TOPPs, they may choose not to participate. As will be discussed later, the FTC bungled the opportunity to require such disclosure when it exempted MLMs from having to comply with its Business Opportunity Rule in 2011.

The powerful DSA/MLM lobby.

Unfortunately, neither of the above protections is being provided, and only a handful of states make an effort to challenge the MLM industry and the DSA (Direct Selling Association). The DSA is the MLM lobbying organization that – together with member MLM firms – functions as a cartel to promote the dialogue of deception that shields MLMs from legislation or rulings that could hurt the MLM industry, regardless of how helpful they may be in protecting consumers from abuse.

MLMs vs. pyramid schemes – a distinction without a difference

A rationale for the legitimacy of MLM was promoted quite successfully by the MLM industry in the 80s and later by DSA lobbyists. This was the argument that when products were sold by MLM participants, an endless chain recruitment scheme somehow became a legitimate business. The chain of recruitment and stacking of participants into levels of rank in a pyramid was acceptable because this was just another way of moving products to the ultimate consumer. A petition and letter regarding these issues was sent by Bruce Craig, former assistant to the Wisconsin Attorney General, to former FTC

Chairman Robert Pitofsky and FTC economist Peter Vander Nat. (See Appendix 2F and 2G)

The problem with this line of thinking is that products can then become merely a means of disguising or laundering investments in the pyramid scheme. However, the dynamics of the chain selling system are essentially the same. In fact, money from sales must go through a company infrastructure with only a portion (typically less than half) of payout rebated to participants – after company costs, including skimming of a significant portion of revenues by founders and company executives. And instead of 14 downline participants in a 1-2-4-8 no-product pyramid scheme³⁵³ paying 100% of investments to TOPPs (top-of-the-pyramid promoters), in MLMs most of what is left over after cost of goods sold and other expenses goes to TOPPs and founders. The rest is typically spread amongst tens or hundreds of thousands of participants. So approximately 99.9% of new recruits lose money, meaning that the number of new recruits profiting (after all expenses) is close to ZERO!³⁵⁴

The net result of all this is that provable statistics show that participants in classic, no-product pyramid schemes are ten to 100 times more likely to profit from the scheme as are participants in MLMs, or product-based pyramid schemes. So overall, participants in MLMs suffer far greater harm than those in classic no-product pyramid schemes by any measure – loss rate, aggregate losses, and number of victims. To say that the addition of products somehow mitigates the damage done by a pyramid scheme is an uninformed view.

A “good MLM” may be an oxymoron.

So from a systems standpoint, the difference between “legitimate MLMs” and illegal pyramid schemes is a distinction without a difference,³⁵⁵ except that MLMs offer products and are more damaging to the vast majority of participants. I would go so far as to say that a “good MLM” is an oxymoron. They all use the same structurally flawed system.

³⁵³ For more on comparisons between no-product and product-based pyramid schemes, see Chapters 2 and 7.

³⁵⁴ Chapter 7

³⁵⁵ This is an argument made by Bruce Craig, formerly assistant to Wisconsin AG, who was involved in the Koscot Interplanetary case.

I have frequently been asked how one would create a fair and honest MLM. In response, I have given suggestions as outlined in Chapter 2, but no one has followed my advice – which would take away the huge payout to founders and TOPPs and give the bulk of the commissions to those actually making sales to non-participants. Other features would include paying no commissions on sales to downline participants.

No one would suddenly get rich in such a program, and to make a profit the founders and TOPPs would have to work as hard as they would in any legitimate business. In fact, they would have to work harder because direct selling has been replaced by handy and competitively priced discount stores and Internet shopping.

Causative and defining characteristics of MLMs – or product-based pyramid schemes

In Chapter 2, I described in detail typical characteristics of MLM programs that are recruitment-driven, which includes all of the over 600 MLMs whose compensation plans I have analyzed. Below is a summary of the characteristics that cause the horrendous loss rates of these MLMs. These same characteristics also clearly distinguish between product-based pyramid schemes and legitimate direct selling. This is why I refer to them as *causative and defining characteristics* (CDCs), or “red flags.”

Endless chain of recruitment of participants as primary customers. The FTC’s position on pyramid schemes was originally set forth in the *In re Koscot Interplanetary, Inc.* case. On page 1181, the *Koscot* court noted:

The Commission has previously condemned so-called “entrepreneurial chains” as possessing an intolerable capacity to mislead. *Holiday Magic, Inc.*, Docket No. 8834, slip op. pp. 11-14 [84 F.T.C. 748 at pp. 1036-1039] (Oct. 15, 1974); *Ger-Ro-Mar, Inc.*, Docket No. 8872, slip op. pp. 8-12 [84 F.T.C. 95, at pp. 145-149] (July 23, 1974), rev’d in part 518 F.2d 33 (2d Cir. 1975). Such schemes are characterized by the payment by participants of money to the company in

return for which they receive (1) the right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users. In general such recruitment is facilitated by promising all participants the same "lucrative" rights to recruit.

This "intolerable capacity to mislead" is demonstrated by over 110 typical misrepresentations used in MLM recruitment campaigns, as discussed in Chapter 8.

MLM programs are recruitment-driven, and advancement is tied to recruiting a downline. On the basis of hundreds of MLM compensation plans I have analyzed, I can say with confidence that all MLMs reward recruitment far more than selling of products to non-participants.

One advances to the top ranks of the pay plan not by appointment, but by recruiting a downline. This feature was alluded to in the *Webster v. Omnitrition* case, from which I quote the following:

"The key to any anti-pyramiding rule in a program like Omnitrition's, where the basic structure serves to reward recruitment more than retailing, is that the rule must serve to tie recruitment bonuses to actual retail sales in some way."³⁵⁶

The "basic structure" likely refers to the potential for growth of an expanding downline, or pyramid, of participants in exponential fashion so that – even though the commissions from purchases by each downline participant is small, the aggregate commissions can grow to rapidly increasing amounts with each additional level of participants. This makes retailing of products to non-participants in the scheme a comparative waste of time for those seeking to maximize their gain – which it is human nature to do.

"Pay to play" purchases are used to finance pyramid schemes. On the FTC web site³⁵⁷ is a page "The Bottom Line about Multi-level Marketing Plans." Under "Evaluating a Plan," the following advice is given:

Beware of plans that ask new distributors to purchase expensive products and marketing materials. These plans may be pyramids in disguise.

Most MLMs, require purchases in order to participate in the financial rewards outlined in the compensation plan. This is one of the earmarks of a pyramid scheme, as opposed to legitimate direct selling.³⁵⁸

For comparison, when I sold *World Book Encyclopedia* to help pay my college expenses, *I was never expected to buy my own set.* But I was able to get my own set for a discount – my own commission. *And when I made a sale, most of the commissions (about 20-30%) went to me. I did not have to recruit a "downline" to make a good income.*

In an MLM, while the cost of the enrollment fee, including a sales kit, may be small and likely not a for-profit item, the cost to qualify for commissions and bonuses can be substantial. In fact, participants are soon encouraged to sign up for a monthly subscription to purchase enough products to satisfy their minimum monthly quota to qualify for commissions and/or rank advancement. This "pay to play" feature of an MLM pay plan assures that – given the low amounts of commissions and bonuses received – 99% of participants wind up losing money. It would be rare for anyone to realize a profit – after minimal operating expenses are subtracted, along with purchases from the company.³⁵⁹

A lack of retail sales is also a red flag that a pyramid exists. Many MLM/pyramid promoters will claim that their product is selling like hot cakes. However, on closer examination, the sales occur only between people inside the pyramid structure or to new recruits joining the structure, not to consumers out in the general public.
– Debra Valentine, FTC

³⁵⁶ *Webster v. Omnitrition, IIB, filed in the Appeals court for the U.S. District Court for the Northern District of California, March 4, 1996*

³⁵⁷ www.ftc.gov

³⁵⁸ *FTC v. Amway (1979 – 142-145), Webster v. Omnitrition (Discussion on "Pyramid"), and FTC v. Skybiz (29)*

³⁵⁹ See Chapter 7.

MLMs are top-weighted. MLMs typically use “upside-down” compensation plans, in which those at the top receive as much or more of the commissions per sale from the company as those at the bottom who do the selling (usually to new recruits). This contrasts sharply with legitimate direct selling, in which the person making the sale gets the lion’s share of the commissions. In the case of retailers, most of the retail margin goes to the retailer. Thus the emphasis is on retailing.

In virtually all MLMs I studied, the rewards (in commissions and bonuses) escalated almost exponentially towards the TOPPs (top-of-the-pyramid promoters). – mainly because those at the top draw commissions from the purchases of thousands of participants at the lower levels. Those at the lower levels paid out more to the company than they received back, and their purchases from the company served only to impoverish those at the bottom to the benefit of those at the top. This can be considered an extreme form of leverage.

This “top-weighted” characteristic was most noticeable for those with a large number of “pin levels” or ranks in the pay plan – another red flag. This is because the pay increases exponentially towards the top as the number of levels increases. This inequity in distribution of income across the various ranks in the pay plan was confirmed by actual payout statistics in companies that release average earnings data.³⁶⁰

Some party plans may be more retail-focused. One group of MLMs that tries to be more retail focused are “party plans.” While their products are typically priced much higher than those in supermarkets, they may focus on actual sales to non-participants, even though TOPPs get most of the commissions.

Some experts have suggested³⁶¹ that emphasis on sales of products to non-participants could be a mitigating factor in the otherwise despoiling effects of an MLM. But even with party plans, whether or not they are recruitment-driven and top weighted would depend on the details of the compensation plan, particularly as they apply to those at the highest levels.

³⁶⁰ See Chapter 7.

³⁶¹ Letter from Bruce Craig to Peter J. Vander Nat, then chief economist of the FTC, April 24, 2001.

MLM as simple fraud – or as systemic fraud

When I spoke at a seminar for officials of state and national regulatory agencies on product-based pyramid schemes³⁶², I carefully laid out MLM’s flaws and examples of loss rates of at least 99%, though its promoters were claiming MLM was the answer to their financial problems. Those who attended were shocked at the unfairness demonstrated by the statistics. I asked the group if any believed MLM qualified as a legitimate business opportunity. None of them thought it qualified.

Then I asked if it qualified as a lottery or a form of gambling because a lucky few made it to a place at or near the top of the pyramid of participants where large amounts of money was made. Again I got a “no” answer because not everyone had an equal chance. Those who entered at the beginning of the chain of recruitment had a huge advantage over those who came in later – almost all of whom lost money.

Finally, I asked, “If MLM is not a legitimate business opportunity, and if it does not qualify as a fair game of chance, what should we call it?” And almost in unison, they answered, “Fraud.”

While it may be appropriate – considering the great amount of deception used in MLM recruitment campaigns – to classify MLMs as simple common law fraud, the term “fraud” poses a problem. Most definitions of fraud include an element of intent, such as the following in my dictionary:

Fraud – intentional perversion of truth in order to seduce another to part with something of value or to surrender a legal right.³⁶³

However, I have been informed by competent legal authority that intent is not always necessary for the charge of fraud in cases of white collar crime. Be that as it may, (as I explained in Chapter 9) it is my observation that few MLM participants deliberately seek in their recruiting to defraud those who join their team. They are merely doing what they have been instructed to do to “build their business.”

³⁶² “Product-based Pyramid Schemes,” sponsored by Pyramid Scheme Alert. Washington, D.C., June 1, 2001.

³⁶³ Merriam Webster’s Collegiate Dictionary, Tenth Ed.

They are taught that they can both sell products and build a “team,” or downline. And I have found denial of deliberate intent to defraud at the highest levels, where a great deal of self-deception occurs, even though they should have the information to recognize the deceptions and unfairness of the system. In MLMs, self-deception is characteristic of both management and participants at all levels.

In MLM, the very people who are doing the deceptive recruiting are themselves victims, having to recruit large downlines to have any hope of recouping their investments, which include monthly quotas to participate fully in the pay plan.

Participants keep buying and recruiting until they run out of money and drop off the vine. They have been conned into participating in a deceptive marketing program with a pay plan that mathematically guarantees that nearly everyone will spend more than they get back. What money is paid to participants is funneled up primarily to TOPPs. It is primarily the SYSTEM that is deceptive, not the participants who are duped into carrying it out.

There is no legal term for *systemic fraud*, except that regulatory agencies such as the FTC consider some activities per se illegal, simply because they are inherently unfair and deceptive. These include classic “no-product pyramid schemes”³⁶⁴ and (we can infer) pay to play” chain letters and Ponzi schemes. Based on the evidence presented here, they should include MLMs.

As Bruce Craig, former assistant Wisconsin Attorney General observed:³⁶⁵

In the case of pyramids, the unfairness was the inherent failure in their marketing systems, as Mr. Ponzi demonstrated long ago. *The FTC actually recognized this in their Amway decision, and then frittered it away with its exculpatory [retail] 'rules.'*

This makes discussion of 'fraud', as you point out, a little more difficult. Fraud is often thought of as misrepresentation and, in the case of pyramids, the details of the plan are fully spelled out and they are, usually, implemented as stated. Most plan operators say the plan works just as they say it does. While earning misrepresentations may also be present, they aren't central to the plan – often earning experiences do not even exist when the plan is first offered. The problem, as

I have stated, is in the inherent nature of the pyramid, product based or not. *Legally, this can still be considered 'misrepresentation' because the marketing plan is held forth as a viable business concept when it is not. It is usually not required that the perpetrator knows he is misrepresenting, just that*

the offering is in fact deceptive.

Again, my position – and that of other informed consumer advocates – is that product-based pyramid schemes, or MLMs, should be regulated the same as no-product pyramid schemes, since they are as inherently unfair and deceptive as are no-product pyramid schemes.³⁶⁶ In fact, the addition of products (as disguised or laundered investments in the scheme) does nothing to lessen the harm, but in fact increases it – by any measure – loss rate, aggregate losses, or number of victims.

However, since a 1979 FTC ruling that Amway was not a pyramid scheme, consumers are left exposed to an MLM industry that constitutes an exceedingly unfair and deceptive business practice – in my opinion without a doubt the most unfair and deceptive of any packaged programs sold as “business opportunities.” At the very least, rules need to be in place to provide consumers some protection against deceptive MLM recruitment practices.

The addition of products as disguised or laundered investments in a pyramid scheme does nothing to lessen the harm, but in fact increases it – by any measure – loss rate, aggregate losses, or number of victims.

³⁶⁴ Email communication from Robert Frisby of the FTC staff dated May 22, 2001 citing section 5(a)(1) of the Federal Trade Commission Act, 15 (in re Kosco Interplanetary, Inc., 86 F.T.C. 1106 (1975))

³⁶⁵ Letter from Bruce Craig to Jon Taylor dated May 4, 2004

³⁶⁶ As demonstrated in Chapters 2-9

The inherently flawed characteristics of MLM suggest that all MLMs may be in violation of Section 5 of the FTC Act.

As has been discussed elsewhere, as a business model, MLM ignores laws of supply and demand. MLM assumes an infinite market which does not exist in the real world. It also assumes a virgin market, which does not exist for long. It is therefore inherently flawed, unfair, and deceptive. And it is clear from analyses of MLMs for which data is available that MLM promoters promise something they cannot deliver, except for a few TOPPs, or “kingpins,” at the top of a pyramid of participants, which contrasts sharply with what is promised at opportunity meetings and in company communications. MLM has been found to be an extremely unfair and deceptive practice, which places virtually all MLM companies in a position of being in violation of Section 5 of the FTC Act.

A hodge-podge of state statutes against pyramid schemes

A hodge-podge of state statutes and terminology. Those who expect to find uniform definitions and sanctions against pyramid schemes across the 50 states would be disappointed. As explained in Chapter 2, statutory definitions of what is and what is not a pyramid scheme vary, and many show lack of recognition of the fundamental flaws in all “entrepreneurial chains,” or endless chain recruitment programs. This is not surprising, as many attorneys, legislators, academicians, and so-called experts are not clear on these issues. Even the terms suggesting pyramid schemes vary, as the following list of terms used in state statutes demonstrates:

- Pyramid sales structure – Alabama
- Chain distributor scheme – Alaska, Nebraska, New Hampshire, New York, Vermont, Wisconsin,
- Pyramid promotional scheme – Arizona, Colorado, Georgia, Idaho, Indiana, Kansas, Louisiana, Maryland, Montana, Nevada, New Mexico, North Dakota, Oklahoma, South Dakota, Texas, Virginia, West Virginia
- Pyramiding device – Arkansas

- Endless chain – California, Wyoming
- Endless chain scheme – Hawaii
- Pyramiding – Connecticut
- Pyramid or chain distribution scheme – Delaware
- Pyramid sales scheme – Florida, Illinois, Mississippi, Missouri,
- Pyramid distribution plan – Kentucky, North Carolina
- Pyramid club – Maine, Oregon, South Carolina
- Pyramid or chain promotion – Michigan
- Chain referrals, pyramid sales, or multi-level sales distributorships – Minnesota
- Pyramid sales plan or program – Ohio
- Chain letter plan or pyramid club – Pennsylvania
- Pyramid distributorship
- Pyramid scheme – Utah, Washington

Definitions and terms designating pyramid schemes used in state statutes are compiled in Appendix 2H of Chapter 2. In Appendix 10B following this chapter you will find a checklist of prohibitions and restrictions related to pyramid schemes used by federal agencies and included in statutes in the 50 states. The actual statutes for the states are quoted with my commentary in Appendix 10G. Reviewing and comparing these wide variations in nomenclature, definitions, and statutes should convince anyone that there is far from unanimity across the country on what should – and what should not – be considered an illegal pyramid scheme.

Some of the more useful – and problematic statutory provisions. Eleven of the state statutes employ the endless chain terminology that implies the fundamental flaw of all no-product pyramid schemes and product-based pyramid schemes (MLMs). A few suggest or specifically state that a program that does not emphasize income primarily from sales to non-participants is a pyramid scheme. Careful study of the statutes in the various states will reveal that some are more consumer-friendly than others.³⁶⁷

Unfortunately, most of the states fail to mention the inherent flaws of the endless chains of recruitment. And many definitions allow sales to participants to qualify as legitimate sales to end use consumers. The latter have in many if not most cases been influenced by clever lobbying by the

³⁶⁷ See Appendix 10G and Appendix 2H

DSA/MLM cartel, which works to weaken anti-pyramid regulation to its advantage – but to the detriment of consumers who need protection from such schemes.

State statutes regarding “unfair and deceptive practices.” A characterization that describes pyramid schemes that is addressed by many state statutes is that of “unfair and deceptive practices” – which an informed person would assume would have to include MLM.³⁶⁸ But unanimity in defining and regulating this category of abuse at the state level is not much better than is the case for defining and regulating MLM at the national level. The wide diversity of statutes related to unfair and deceptive practices is included in state laws relating to MLM, along with author’s commentary, in Appendix 10G. (Sometimes these state statutes are referred to as “little FTC acts.”)

NOTE: It is possible that one or more statutes have changed since the printing of this book. The DSA/MLM lobby is always seeking to weaken laws that would protect consumers – and help themselves!

Rule 23: Class actions³⁶⁹ against MLMs – or “private AG actions”

Victims find class actions a viable option for redress. Given the very limited effectiveness of law enforcement at federal and state levels in recognizing and controlling MLM abuse, victims of MLMs have resorted to class actions for redress. These are sometimes referred to as “private attorney general actions” because they may accomplish what state AG’s should be accomplishing – protecting consumers from MLM abuse to some degree by collecting damages and demanding other concessions from abusers. Two big advantages for victims are (1) costs for plaintiff attorneys in class actions are covered by the legal firms on a contingency basis, and (2) judges who hear these cases are less apt to be controlled by powerful political forces

³⁶⁸ Or if there is any question whether or not MLM is an unfair and deceptive practice, read prior chapters

³⁶⁹ In the United States federal courts, class actions are governed by Federal Rules of Civil Procedure Rule 23 and 28 U.S.C.A. § 1332(d).[1]

influenced by organizations like the DSA and can be more impartial in their decisions.

Numerous class actions are reported in this chapter, although given the widespread existence of unfair and deceptive practices in the MLM industry, the potential exists for class actions against dozens, if not hundreds, of MLMs. This should have knowledgeable plaintiff attorneys salivating and wringing their hands at the prospects, assuming victims would come forward.

Lead plaintiffs must be committed long-term. In order for a class action to be successful, key victims must be willing to act as lead plaintiffs and to endure a long process of discovery, interviews, and possible court appearances. They must commit themselves to be patient enough to stand up for the class of victims for an extended period of time.³⁷⁰ Considering the tendency for victims to remain silent, or to give up their demand for redress before a decision or settlement is reached, this can be a challenge for plaintiff attorneys. For more information on class actions, go to Appendix 10C.

A notable success story: Amway/ Quixtar settles for \$55 million.

Again, sometimes the best course for obtaining redress and the satisfaction of seeing a fraudulent company humbled is to pursue a class action against it. For one of the most important class actions against an MLM, I quote from Robert FitzPatrick of Pyramid Scheme Alert in his article titled “*Amway Accused of Fraud; Pays \$150 Million [the final settlement amount was \$55 million]; Where’s the FTC and DOJ?*”³⁷¹

Amway is the largest, oldest and best known representative of “multi-level marketing” (MLM). It is the most prominent member of the Direct Selling Association.

This icon of “direct selling” just announced that it has agreed to pay restitution to consumers and reform costs estimated at over \$150 million. The payments are in response to consumer accusations that

³⁷⁰ In *Capone v. Nu Skin Enterprises*, the case dragged on for eight years before a settlement was finally reached.

³⁷¹ Posted November 11, 2010 on the web site – pyramidschemealert.org

Amway/Quixtar is operating an illegal pyramid scheme. The settlement is the largest in MLM history. . . The suit was filed by the law firm of Boies, Schiller & Flexner.

The size of the settlement astonished some observers, and the news is spreading fast. It was reported on the front page of the [USATodayAmway11.05.10](#). About \$55 million of the total is in actual cash and products as restitution for victims and legal fees. Other elements of the settlement include substantial price reductions to make retail sales feasible, and major changes in the infamous “tools” business that will require Amway to take greater responsibility. These schemes are run by some of Amway’s top recruiters and have been allowed to function at arm’s length, rogue operations, though highly beneficial to Amway.

The huge settlement throws open to question the validity of Direct Selling Association’s “Code of Ethics” and the legitimacy of all other multi-level marketing companies as viable “business opportunities,” based on the Amway model.

Among the accusations made in the Amway class action suit that resulted in Amway’s agreement to pay \$150 million (the suit was technically brought against Quixtar, the now defunct name then used by Amway): Amway is an illegal pyramid scheme. - Amway’s Kingpin companies that sell “motivation and training” products to recruits are also an illegal pyramid scheme.

- Amway criminally violates federal racketeering law. And Amway violates California’s “endless chain” law.
- Amway masks “criminal behavior” with claims that it is in compliance with a federal Amway ruling of more than 25 years ago. In fact, Amway is not in compliance with the ruling.
- Amway induces salespeople to buy thousands of dollars of overpriced products and useless “success tools” and then to recruit others to do the same in an endless chain scheme that dooms, by design, nearly all to losses.
- Amway deliberately deceives consumers to enroll in the pyramid scheme in which they inevitably suffer financial loss.
- Amway’s arbitration rule which is intended to prevent victim lawsuits against it is unfair and “unconscionable”. [Arbitration can be extremely expensive to contest.]
- Amway commits wire fraud and mail fraud.

The 99% Factor. A key aspect of the suit is the charge that Amway misleads

consumers with false income claims and promises for its “business opportunity.” [Pyramid Scheme Alert’s analysis of Amway payouts](#) to distributors shows that more than 99% of all who sign up never earn a profit. When actual costs are factored, including the related “tools” business, some estimates put the loss rates at 99.9%. This 99% loss figure correlates with tax data gathered as early as the 1980s when the state of Wisconsin prosecuted Amway. It was also verified by data gained by federal regulators in England who sued to shut down Amway in that country several years ago.

Under terms of the settlement, Amway will be restating its “income disclosure” to reflect that the figure offered to consumers is “gross income” not net, meaning that it is not “profit” and does not reflect costs that consumers incur when they pursue the scheme. (It should be noted that Amway’s advertised “average income” is also a “mean”, not a median average, so it factors the high incomes of the few at the peak of the pyramid, skewing the “average” upward. Such a skewed “average” can also mislead consumers to think that the “average” participant actually earns a profit, masking the reality that the vast majority earn little or no commissions – and actually lose money.

The real damage to Amway and to the MLM industry from the settlement. Although the amount of the settlement was huge as such actions go, \$150 million is pocket change to Amway. The real damage was to its reputation. And the settlement sent shock waves throughout the industry, as the case can be made that some of these practices – such as the endless chain of recruitment and the inducement to buy overpriced products which result in almost certain loss – are endemic throughout the industry.

Muzzled regulators. Amway has concealed or obscured these devastating losses to consumers, totaling in the tens of billions over time, with elaborate diversions and rationalizations. But, its most effective weapon of mass deception has been its ability to influence politicians who in turn muzzle regulators.

The lack of government prosecutions, along with sophisticated PR spin and misleading income data have given MLM schemes an aura of legitimacy, heightening their ability to fool consumers and the media as well. Gradually, though, the truth about how MLMs have escaped regulation is coming to light. The answer is plain and simple: MLMs

bought influence in Washington and in some state legislatures with campaign contributions and high pressure lobbying.

Amway [has been] ranked as #68 in the 75 top corporate sponsors of Washington politicians³⁷² It ranks ahead of food giant Archer Daniels Midland, pharmaceutical behemoth Bristol Myers Squibb and just behind in ranking of Wal-Mart, General Motors and oil magnate, Koch Industries. . .

Admission of Guilt? Even though the settlement states that Amway admits no wrongdoing, the fact that Amway agreed to pay accusers and incur other remedial costs up to \$150 million and chose not to allow the case to go to trial will be read by many people as compelling evidence of guilt. A settlement of this size can hardly be written off as cheaper than legal defense. In fact, Amway incurred huge legal costs and held up the settlement for three years by arguing not that the accusations were untrue but that the victims had no legal right to bring a suit. When the right to sue was established in court, Amway paid up.

Implications for potential future actions. Obvious questions are raised by the suit and the settlement:

Will the Dept. of Justice now investigate the consumers' charges that Amway engages in criminal behavior?

Will the Federal Trade Commission, finally, investigate the consumers' charge that Amway is operating a pyramid scheme in violation of the Amway ruling of 1979?

Will the California Attorney General begin to investigate the charges that Amway and other MLMs violate its state anti-pyramid scheme law?

The huge settlement and payments to victims follows other actions against Amway. Government regulators in England several years ago sought to close down Amway for defrauding consumers in that country. Criminal charges have also been brought in one state in India against Amway. And Amway is also being sued for deception and fraud in Canada by Canadian consumers.

It is an open question as to how many actions by other governments, consumer lawsuits and evidence of harm are required before the FTC and Dept. of Justice act.

The . . . book, No One Would Listen, by whistle blower, Harry Markopolos, dramatically describes how SEC regulators ignored his

alerts and allowed the Bernard Madoff Ponzi scheme to grow to enormous proportions. Their failure to act caused harm to thousands more people, despite his written and detailed warnings, which he brought to the agency five separate times over an eight-year period of investigating the scam. Additionally, the news media such as the *Wall Street Journal* and *Forbes magazine* also failed to respond to his evidence which he offered them. Madoff was apparently treated as "too big to expose."

Beyond possible new regulatory investigations of Amway, the lawsuit settlement raises another even larger question about other MLM companies: How many other MLM companies are operating exactly as Amway does, which led to this huge payment to victims?

This question is especially relevant to regulators and other law firms since the standard defense of most multi-level marketing companies is that they are legal because they operate just like Amway!

The pyramid issue is a sideshow

Classic 1-2-4-8 no-product pyramid schemes left 14 losers for every winner. But when Amway required purchases of products rather than cash investments, Amway claimed it was not a pyramid scheme. In 1979, a rookie FTC administrative judge agreed, which set a terrible precedent.

Asking if an MLM is a pyramid scheme is like asking if a hybrid car is still an automobile because of its more advanced features. When pyramid schemes evolved into multi-level marketing, investments were laundered or disguised through the sale of exotic products and greatly expanded compensation plans. Where the downline in a classic 1-2-4-8 pyramid scheme had a downline of only 14 people, TOPPs (top-of-the-pyramid promoters) in an MLM may have thousands of people in a downline – almost none of whom earn enough in commissions to cover required purchases and other expenses. Thus, MLMs hugely increased the harm by any measure – loss rates, aggregate losses, and number of victims. If you have been reading this book with an open mind, you would likely agree that *MLMs, as an industry are truly an unfair and deceptive practice – and do far more damage than classic, no-product pyramid schemes.*

³⁷² "Capital Hill's Top 75 Corporate Sponsors" by Dave Gilson, *Mother Jones*, September-October 2010.

Are MLM participants employees – or independent contractors?

Should MLM “direct sellers” be classified as employees or as independent contractors? An issue that has threatened the whole field of direct selling (including MLM) was the possibility of being classified as employees, since control was exercised by the company and training was provided. In my research, I found an extremely enlightening article titled “*All you need to know about MLM: Is MLM a scam?*”³⁷³ The comments at the beginning are quoted below. For more information, read the full article.

In 1982 under President Ronald Reagan ([R] 1981-1989), the IRS added Internal Revenue Code Section 3508, which conveniently gave a statutory exemption to two groups of workers: real estate agents and direct sellers.

IRC Section 3508(b)(2)(*) defines the term "direct seller" to mean any person if – such person – is engaged in the trade or business of selling (or soliciting the sale of) consumer products to any buyer on a buy-sell or deposit-commission basis for resale by the buyer or any other person in the home or in some other place that does not constitute a permanent retail establishment, or – is engaged in the trade or business of selling (or soliciting the sale of) consumer products in the home or in some other place that does not constitute a permanent retail establishment; – paid in cash) for the performance of the services described above is directly related to sales or other output (including the performance of services) rather than to the number of hours worked;

Such person performs the services pursuant to a written contract between such person and the service-recipient and the contract provides that such person will not be treated as an employee with respect to such services for federal tax purposes.

³⁷³ The applicable section titled “1982’s IRC §3508: Lobbyists push bad legislation to reclassify specific employees as independent contractors to those contractors’ detriment” is quoted from the full article, which can be downloaded from the website – <http://www.financialindustryscam.com/mlm.htm>

. While the person who did this research report prefers to remain anonymous (a handicapped woman who fears retaliation), I have found the research to be credible and well worth reading for serious students of the subject.

§3508 in effect only muddled the difference between independent contractors and employees, and I have no doubt lobbying by the MLM and real estate industries had everything to do with it. This was certainly the case in 1996 when the newspaper lobby got Senator Bob Dole [R-KS], who happened to be running for president, to slip a rider into the minimum wage bill that exempted newspaper carriers from all of the labor laws, making them permanent independent contractors like direct sellers regardless of how they were treated. President Bill Clinton signed it into law that same year.

The biggest problem with §3508’s exemptions is that they directly conflict with the IRS’s own criteria for being an independent contractor. Legitimate independent contractors come to their clients pre-hatched. According to the IRS, they:

- already present themselves as professionals in their fields (have all business and professional licenses, are incorporated, and do NOT require training);
- assume responsibility for taxes, workers’ comp, insurance (E&O, health, dental, vision, etc.), expenses (advertising, overhead), and legal liability (bonded);
- are hired on a per-project basis and are paid upon completion of the project;
- can realize a profit or suffer a loss in their business;
- may perform services *for as many clients as they wish* with no restrictions;
- come with all tools necessary to complete jobs; and
- *do not perform work for clients which can impact the success or continuation of the clients’ businesses.*

That last point is crucial. Businesses that utilize the MLM model depend on the services these workers provide; remove these workers, and the business must grind to a halt! And it works in reverse too – take away the company, and these workers’ “businesses” vanish. The last point is also significant in that MLM law directly conflicts with it, actually requiring the MLM to rely on the generation of sales and enrollments exclusively by distributors and not by company “employees”. (This is to satisfy the “Howey Test” of 1946, mentioned in the “Koscot” section in this chapter, which determined that a regulatable security existed when “a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party”.) That alone should tell you there is something very wrong with the MLM model to begin with!

So why do MLMs and other like employers misclassify workers as independent contractors

when those workers should quite clearly be classified as employees of the company? Because it's cheap and lessens legal liabilities. Companies that hire independent contractors generally avoid employer obligations under many state and federal laws.

MLM's terrible problem with legal identity

(This duplicates what I wrote in Chapter 2, as it also applies here. For more clarification on MLM definitions, read all of Chapter 2.)

MLM promoters and defenders have a recurring problem whenever they have to present MLM as a class of business activity. This is because MLM is like a chameleon; it can – and for promoters it often must change colors to suit the situation. For example:

- *Are MLM participants independent contractors – or employees of the company? As discussed above, MLM executives would like to exercise the control of an employer, but don't want to be classified as such because of the costs and legal liabilities. Yet, their contracts have been challenged as exercising too much control for participants to be considered independent contractors. For example, they are not allowed to sell competitors' products along with those of the particular MLM they signed with.*
 - *Are MLM promoters selling investment securities? They talk to prospects about the "residual income," "passive income," or "absentee income" potential of signing up in their MLM – as though it were an investment that was not dependent so much on their own efforts as on the efforts of persons in their downline. But they do not register as securities with the state or federal securities agencies.*
 - *Are MLMs franchises? Though many promoters refer to their MLMs as "like a franchise" or as an "un-franchise" – or even as a "personal franchise," the last thing MLM executives want is to have to comply with franchise disclosure requirements, including a franchise disclosure document that could be hundreds of pages long with financial data, background of founders, etc.*
 - *Are MLMs a form of gambling or a lottery? Some promoters present MLM as an opportunity for the chance of unlimited income. For example: "You never know how*
- much money you will make if you sign up now," or "You may have some people in your downline who are 'business builders' who will make you a lot of money," etc.*
 - *Are MLMs a form of direct selling? Of course, the DSA says it satisfies the criteria of person-to-person selling away from a fixed location, etc. The problem is that the DSA does not specify what legitimate direct selling is not – an endless chain of recruitment of participants as primary customers.*
 - *Are MLMs buyers' clubs? MLM promoters often present their programs as ways to buy from your own business rather than from others – like a buyers' club. The problem is that products from MLMs are almost always far more expensive than from alternative outlets, so they can't qualify as discount buyer's clubs. Also, if personal consumption by participants is the main source of revenues, that strongly suggests a pyramid scheme.*
 - *Are MLMs a type of business opportunity? If so, they must register as such with the applicable state agencies, which may require disclosure of information they don't want to disclose and other requirements with which they would not want to comply. So while MLM promoters often refer to their particular program as a "business opportunity" to prospects, they are careful to refer to it as "direct selling" or an "income opportunity" to regulators – as MLMs did in comments filed to the FTC, objecting to the Business Opportunity Rule when it was first proposed.*
 - *Are MLMs income opportunities? If they were, they should provide a good likelihood a person could earn a significant income from them. However, the opposite is true. As carefully demonstrated in Chapter 7, almost all participants in MLMs – approximately 99.7% of them (where data is available), lose money (99.9% of new recruits). It is more honest to call MLMs money traps that lead to almost certain loss, except for those at or near the top of the pyramid of participants.*
 - *And finally, are MLMs cleverly disguised pyramid schemes? If you are not already convinced, read the other chapters in this book with an open mind and decide for*

yourself. But I can attest that *after analyzing the compensation plans of over 600 MLM schemes, I feel more comfortable than ever labeling them recruitment-driven MLMs, or product-based pyramid schemes – the most extreme class of pyramid schemes.*

IMPORTANT FTC COMMUNICATIONS

Justification for considering pyramid schemes illegal – Why not the same for MLMs?

To be perfectly clear on why I and other informed consumer advocates are convinced the legality of MLM should be questioned, consider this communication from Robert M. Frisby, an FTC staff attorney, in response to my request for the rationale for laws against pyramid schemes:

Section 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. 45(a)(1), states that "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful." While the Federal Trade Commission Act does not specifically address pyramid schemes, such schemes have been deemed unlawful under the Federal Trade Commission Act.³⁷⁴

If you have read the prior chapters, you can see that the same justification exists for action against all MLMs, or product-based pyramid schemes, as for no-product pyramid schemes. The existence of products in an MLM does not make it any less a pyramid scheme, and in fact results in greater harm than no-product schemes by any measure – loss rates, aggregate losses, and number of victims. This is clearly explained in prior chapters. Unfortunately, in 1979 the FTC did not have access to the research or experience we now have.

Since pyramid schemes are considered unlawful because they are unfair and deceptive, why not apply the same standard to MLMs? We have shown that MLMs are unfair and deceptive practices, so by the same standard they should be declared illegal. But

³⁷⁴ Email communication from Robert Frisby of the FTC staff dated May 22, 2001 (in re Kosco Interplanetary, Inc., 86 F.T.C. 1106 (1975))

unfortunately, the DSA/MLM lobby with the cooperation of the FTC, uses the question of whether or not MLM is a pyramid scheme (with a problematic definition³⁷⁵) as a red herring to avoid the truth about MLM as an inherently flawed business model.

MLM promoters and defenders have a recurring problem whenever they have to present MLM as a class of business activity. This is because MLM is like a chameleon; it can – and for promoters it often must – change colors to suit the situation.

Classic speech by the FTC's Debra Valentine.

In a speech on pyramid schemes, Debra A. Valentine, General Counsel for the FTC, stated the following:

Pyramid schemes now come in so many forms that they may be difficult to recognize immediately. However, they all share one overriding characteristic. They promise consumers or investors large profits based primarily on recruiting others to join their program, not based on profits from any real investment or real sale of goods to the public. *Some schemes may purport to sell a product, but they often simply use the product to hide their pyramid structure.*

There are two tell-tale signs that a product is simply being used to disguise a pyramid scheme: inventory loading and a lack of retail sales. Inventory loading occurs when a company's incentive program forces recruits to buy more products than they could ever sell, often at inflated prices. If this occurs throughout the company's distribution system, the people at the top of the pyramid reap substantial profits, even though little or no product moves to market. The people at the bottom make excessive payments for inventory that simply accumulates in their basements.

A lack of retail sales is also a red flag that a pyramid exists. Many pyramid

³⁷⁵ In the 1979 FTC v. Amway decision, the retail rules focused on behavior that is difficult to measure or enforce, rather than on the endless chain structure.

*schemes will claim that their product is selling like hot cakes. However, on closer examination, the sales occur only between people inside the pyramid structure or to new recruits joining the structure, not to consumers out in the general public.*³⁷⁶

While this statement clearly describes virtually all MLMs as typically structured and practiced today, Ms. Valentine goes on to make distinctions between “legitimate multi-level marketing” and pyramid schemes.

Some people confuse pyramid and Ponzi schemes with legitimate multilevel marketing. Multilevel marketing programs are known as MLM's, and unlike pyramid or Ponzi schemes, MLM's have a real product to sell. More importantly, MLMs actually sell their products to members of the general public, without requiring these consumers to pay anything extra or to join the MLM system. MLM's may pay commissions to a long string of distributors, but these commissions are paid for real retail sales, not for new recruits.

Is it any wonder that consumers, attorneys, academia, and the media are confused as to which MLMs should be classified as illegal pyramid schemes? FTC officials condemn pyramid schemes, but seem determined to let product-based pyramid schemes, or MLMs, off the hook – or to selectively label some MLMs as legitimate and some as illegal. The underlying assumption seems to be that there are “good MLMs” and “bad MLMs” – but which are all, as this collection of research demonstrates, disguised pyramid schemes.³⁷⁷

Of course, I have to admit that at one time I believed MLMs were somehow different from pyramid schemes. For several years I searched diligently for what I called “retail MLMs”; i.e., retail-focused MLMs. But analysis of hundreds of MLMs did not turn up any, though promoters often made efforts to make their MLM appear to be

legitimate, or retail focused. Ultimately, careful study of their compensation plans reveals that all MLMs are recruitment-driven and top-weighted, and financed primarily by “pay to play” purchases of participants – making them essentially pyramid schemes.

So I find Ms. Valentine's arguments justifying the Amway decision and the viability of other MLMs – though well-meaning – to be unpersuasive and even uninformed about actual practices across the broad spectrum of the MLM industry. For the full text of Ms. Valentine's speech, go to Appendix 10D.

Staff Advisory Opinion of FTC staff attorney James Kohm.

Without going into detail here, if the MLM is characterized by rewards paid primarily for recruitment of a downline and by purchases primarily by participants rather than by non-participants, it can be considered a pyramid scheme. At the very least, it is a transfer scheme, transferring money from those at the bottom of the pyramid to those at the top; i.e., from losers to winners. Rewards can be in the form of commissions from purchases on a monthly basis to meet requirements to qualify for commissions and bonuses. James Kohm, Acting Director of Marketing Practices, wrote the following in a Staff Advisory Opinion to the DSA³⁷⁸:

Much has been made of the personal, or internal, consumption issue in recent years. In fact, *the amount of internal consumption in any multi-level compensation business does not determine whether or not the FTC will consider the plan a pyramid scheme.* .

.The DSA and its many minions have quoted out of context the highlighted statement above to justify including sales to MLM participants (“internal consumption”) as qualified retail sales. This was a key part of the aforementioned testimony of Misty Fallock before a committee hearing at the 2006 Utah

³⁷⁶ Section of speech titled: “What is a Pyramid Scheme and What is Legitimate Marketing?” from a prepared statement of Debra A. Valentine, General Counsel for the U.S. Federal Trade Commission on “Pyramid Schemes,” presented at the International Monetary Fund's Seminar on Current Legal Issues Affecting Central Banks, Washington, D.C., May 13, 1998

³⁷⁷ See Chapter 2

³⁷⁸ Letter from James Kohm, Acting Director of Marketing Practices, expressing a Staff Advisory Opinion to Neil Offen, President of the Direct Selling Association, January 14, 2004

Legislature in hearings about SB182, which exempted MLMs from prosecution as pyramid schemes. However, when one reads the rest of Mr. Kohm's statement, one gets an entirely different perspective:

. . . The critical question for the FTC is whether the revenues that primarily support the commissions paid to all participants are generated from purchases of goods and services that are not simply incidental to the purchase of the right to participate in a money-making venture.

A multi-level compensation system funded primarily by such non-incidental revenues does not depend on continual recruitment of new participants, and therefore, does not guarantee financial failure for the majority of participants. In contrast, a multi-level compensation system funded primarily by payments made for the right to participate in the venture is an illegal pyramid scheme.

In a pyramid scheme, participants hope to reap financial rewards well in excess of their investment based primarily on the fees paid by members of their "downlines." Downline members pay these fees to join the scheme and meet certain prerequisites for obtaining the monetary and other rewards offered by the program. A participant, therefore, can only reap rewards by obtaining a portion of the fees paid by those who join the scheme later.

The people who join later, in turn, pay their fees in the hope of profiting from payments of those who enter the scheme after they do. In this way, **a pyramid scheme simply transfers monies from losers to winners. For each person who substantially profits from the scheme, there must be many more losing all, or a portion, of their investment to fund those winnings. Absent sufficient sales of goods and services, the profits in such a system hinge on nothing more than recruitment of new participants (i.e., fee payers) into the system.**

The Commission's recent cases, however, demonstrate that the sale of goods and service; [sic] alone does not necessarily render a system legitimate. Modern pyramid schemes generally do not blatantly base commissions on the outright payment of fees, but instead try to disguise these payments to appear as if they are based on the sale of goods or services. The most common means employed to achieve this goal is to require a certain level of

monthly purchases to qualify for commissions. While the sale of goods and services nominally generates all commissions in a system primarily funded by such purchases, in fact, those commissions are funded by purchases made to obtain the right to participate in the scheme. Each individual who profits, therefore, does so primarily from the payments of others who are themselves making payments in order to obtain their own profit. As discussed above, such a plan is little more than a transfer scheme, dooming the vast majority of participants to financial failure. . .³⁷⁹

Modern pyramid schemes generally do not blatantly base commissions on the outright payment of fees, but instead try to disguise these payments to appear as if they are based on the sale of goods or services. The most common means employed to achieve this goal is to require a certain level of monthly purchases to qualify for commissions.
– James Kohm, Acting Director of Marketing Practices

I have analyzed over 600 MLMs that finance their operations in precisely the manner described in the last paragraph! And since that's 100% of those I have analyzed, it seems safe to assume that all MLMs are financed in essentially the same way – through "pay to play" purchases of participants.

Are MLMs expensive buyers' clubs?
 Mr. Kohm then distinguishes between a pyramid scheme and a legitimate buyers' club.

1 A participant's downline usually consists of the people the participant recruits to join the program as well as the people her recruits recruit, and so on through a predetermined number of levels.

³⁷⁹ Op. cit.

2 It is important to distinguish an illegal pyramid scheme from a legitimate buyers club. A buyers club confers the right to purchase goods and services at a discount. If a buyers club is organized as a multi-level reward system, the purchase of goods and services by one's downline could defray the cost of one's own purchases (i.e., the greater the downline purchases, the greater the volume discounts that the club receives from its suppliers, the greater the discount that can be apportioned to participants through the multi-level system). The purchase of goods and services within such a system can, therefore, be distinguished from a pyramid scheme on two grounds.

First, purchases by the club's members can actually reduce costs for everyone (the goal of the club in the first place). Second, the purchase of goods and services is not merely incidental to the right to participate in a money-making venture, but rather the very reason participants join the program. Therefore, the plan does not simply transfer money from winners to losers, having the majority of participants with financial losses.³⁸⁰

Mr. Kohm apparently had not analyzed the compensation plans of many MLMs, and how prices are influenced by the depth of the downline. In standard retail settings, the prices must cover the percentage going to the retailer (who may get anywhere from 10-20% for discount stores to as high as 60-70% for luxury items in exclusive shops) and the wholesaler, who may get only 5-15% – but who has many retailers from which to cover his costs.

With MLM, the pay structure is reversed, with the upline getting most of the commissions, and with several levels in the pay plan, the commissions are funneled even more to the top.³⁸¹ The MLM cannot compete in its pricing with retail outlets because they have to pay commissions on so many levels.

As I have said before, I would have no objection to an MLM promoter selling participation in an MLM, *not as an income opportunity* (since 99% lose money), but as a *buyers' club*³⁸² which allows participants to

pay *more* (not less) for some good, and some highly questionable, products. The DSA should love that suggestion.

As a business model, MLM is likely the most successful con game of all time. The very people who are out recruiting are themselves victims until they run out of money and quit. And because victims seldom file complaints, law enforcement rarely acts against them. It is a vicious cycle: No complaints, no action by law enforcement. No action by law enforcement, no complaints. So the game goes on.

LESSONS FROM LANDMARK CASES³⁸³

The Koscot precedent.

In 1967 Glenn W. Turner began an incredible distribution scheme in Orlando, Florida. His line purported to be cosmetics, featuring mink oil as a special ingredient, but in reality he sold distributorships. A participant paid a fee and became a distributor, entitling him to sell the cosmetic products, but more important, entitling him to sell other distributorships. Little selling of the cosmetics actually took place, for the real money was to be made in the sale of distributorships. Those transactions were essentially the same as in the chain letter, or the airplane or chart games, in that the new participant paid one fee to the party who brought him in, another to the party at the top, and then assumed a position at the bottom of the pyramid.

Over five years, Turner "parlayed \$10,000 into a conglomerate that generated a cash flow of \$200 million, and in which as many as 100,000 people may have invested. Two main business organizations were developed to carry out his activities:

³⁸⁰ Op. cit.

³⁸¹ See Chapter 7.

³⁸² This is said in jest, of course, since MLM would not even qualify as a buyers' club. Buyers' clubs have to

meet certain criteria that would make it a whole different ball game.

³⁸³ For more complete information regarding prominent MLM cases, go to Appendix 10C.

Koscot ('Kosmetics Company of Tomorrow') Interplanetary, Inc., the sales arm, and Dare to Be Great, Inc., the training body."³⁸⁴

I cannot leave the Turner case without quoting the following, which sounds like many typical MLM opportunity meetings today:

Would-be [Dare to Be Great] participants were brought to staged gatherings in places like hotel ballrooms where clean-cut young men, each with a rhinestone pin of a flag . . . attached to his lapel, subjected them to the rigors of high-pressure salesmanship. . . . These gatherings, called "Adventure Meetings" or "Golden Opportunity Meetings," were described by one judge as being like an old-time revival meeting but directed toward the joys of making easy money rather than salvation. Their purpose is to convince prospective purchasers, or 'prospects,' that Dare is a sure route to great riches.

At the meetings are employees, officers, and speakers from Dare, as well as purchasers (now 'salesmen') and their prospects. The Dare people, not the purchaser-'salesmen,' run the meetings and do the selling. They exude great enthusiasm, cheering and chanting; there is exuberant handshaking . . . The Dare people dress in expensive, modern clothes. . . . they drive new and expensive automobiles, which are one of the plans. Films are shown usually involving the 'rags-to-riches' story of Dare founder Glenn W. Turner. The goal of all of this is to persuade the prospect to purchase a plan . . . and thus grow wealthy as part of the Dare organization.³⁸⁵

The Koscot court noted something that has become increasingly significant:

*The Commission has previously condemned so-called "entrepreneurial chains" as possessing an intolerable capacity to mislead.*³⁸⁶ Such schemes are characterized by the payment by participants of money to the company in return for which they receive (1) the right to

sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users. In general such recruitment is facilitated by promising all participants the same "lucrative" rights to recruit.

The language used here is incredibly insightful and prophetic. Anyone who has read Chapter 8 with an open mind would have to agree that this is exactly what has happened since that time. MLMs have demonstrated an intolerable capacity to mislead.

FTC v. Amway, the 1979 decision that facilitated the proliferation of product-based pyramid schemes

Amway led the way in an MLM industry that has caused massive consumer losses. While the practice of multi-level marketing had been evolving for decades, the industry was given a huge boost by a key decision of an FTC administrative judge in 1979. This decision opened a Pandora's Box of MLM look-alikes that have since numbered in the thousands.

Is Amway a pyramid scheme?

According to an FTC release on May 23, 1979, Amway - one of the earliest MLM companies - was ordered by the FTC "to stop fixing retail and wholesale prices and misrepresenting the profitability of Amway distributorships." Since that time Amway Corporation (as a company) has been more careful about making inflated promises to prospects. However, on a far more important issue, Amway and - by extension - an emerging industry triumphed. The complaint that Amway's sales plan was an illegal pyramid scheme was dismissed by the Commission - a mere side issue for the FTC, but a major coup for Amway and for all MLM companies that followed - and a huge setback for consumer protection.

Amway's "retail rules." As part of the agreement with the FTC, Amway agreed to abide by "retail rules,"³⁸⁷ such as the "ten-

³⁸⁴ | Joseph Bullgatz, *Ponzi Schemes, Invaders from Mars, and More Extraordinary Popular Delusions* (New York: Harmony Books, 1992), p. 42-3

³⁸⁵ *Ibid.*, p. 42-3

³⁸⁶ Holiday Magic, Inc., Docket No. 8834, slip op. pp. 11-14 [84 F.T.C. 748 at pp. 1036-1039] (Oct. 15, 1974); Ger-Ro-Mar, Inc., Docket No. 8872, slip op. pp. 8-12 [84 F.T.C. 95, at pp. 145-149] (July 23, 1974), rev'd in part 518 F.2d 33 (2d Cir. 1975), page 1181.

³⁸⁷ In the Matter of Amway Corp., 93 F.T. C. 618 (1979)

customer rule” (10 customers outside the network of distributors), the “70% rule (70% of products purchased are sold at retail), and a buyback policy. Amway assured the FTC it had procedures in place to assure compliance with these rules. However, the retail rules have never been consistently enforced. Except for the buyback policy, Amway and other MLMs have essentially ignored the retail rules accepted by the FTC. Both company officials and participants employ a “wink-wink, nod-nod” attitude towards compliance. In fact, the image of Amway as distributors of patented soap products has yielded to the reality of a pseudo-business of opportunity or of “entrepreneurial chains.”

The FTC’s 1979 Amway ruling³⁸⁸ gave credence to MLM and led to enormous growth in an industry that in the past three decades (if you understand the math in Chapter 7) has cost consumers worldwide hundreds of billions of dollars and left hundreds of millions of participants holding the bag of broken promises – and in many cases – broken lives. This has been accomplished through a whole litany of misrepresentations – over 110 of them listed in Chapter 8. Taken together, MLM constitutes one of the most massive and successful con games in history.

Amway’s “retail rules” focused on behavior, not the underlying structural flaws. As discussed in earlier chapters, MLMs typically incentivize unlimited recruitment of a whole network of endless chains of recruitment of participants as primary customers. Promoters and participants ignore proven laws of supply and demand. Their compensation plans are dependent upon the fallacious assumption of unlimited markets, making them inherently flawed, uneconomic, and deceptive.

In focusing on the behavior of participants, the FTC’s Amway decision failed to address these inherent structural flaws that many believe should have led to a decision that MLM is per se an unfair and deceptive trade practice, and therefore illegal. The end

³⁸⁸ For more information on this legislative history, read the treatise by Robert FitzPatrick, President of Pyramid Scheme Alert, titled “Pyramid Nation – The Growth, Acceptance, and Legalization of Pyramid Schemes in America.

result is an 800-pound gorilla in the Commission chambers. Thousands of MLMs have sprung up since 1979, resulting in losses of literally hundreds of billions of dollars suffered by hundreds of millions of participants worldwide.³⁸⁹

The end result (of the Amway decision) is an 800-pound gorilla in the Commission chambers. Thousands of MLMs have sprung up since 1979, resulting in losses of literally hundreds of billions of dollars suffered by hundreds of millions of participants worldwide

Perspective of a former SEC official.

Gary Langan Goodenow, Sr., a former senior trial attorney in the SEC enforcement division, wrote:³⁹⁰

The FTC, not the SEC, first went to court to combat the “serious potential hazards of entrepreneurial chains” and urged the “summary exclusion of their inherently deceptive elements, without the time-consuming necessity to show occurrence of the very injury which justice should prevent.” FTC In Koscot Interplanetary case, the FTC enjoined a promoter from “offering, operating, or participating in, any marketing or sales plan or program wherein a participant is given or promised compensation for inducing other persons to become participants in the plan or program”.

This FTC opinion had nothing to do with the federal securities laws. The holding was based on common law fraud concepts on the theory that such programs will inexorably fail because eventually there are not enough people on earth to support it.

³⁸⁹ These figures are based on DSA figures of direct sales worldwide. What the DSA calls “sales revenues” may be sales revenues for the companies, but since 99% of participants lose money, they represent losses for the participants, nearly all of whom are victims.

³⁹⁰ Mr. Goodenow, a former senior trial attorney in the SEC enforcement division, is licensed to practice in the Florida and the District of Columbia. This quotation is posted on Dr. Stephen Barrett’s MLM Watch web site at – www.mlmwatch.org/11Legal/sec.html

The FTC test for determining what constitutes an illegal pyramid scheme holds that they “are characterized by the payment by participants of money to the company in return for which they receive the right to sell a product and the right to receive in return for recruitment, rewards which are unrelated to sale of the product to ultimate users.”

The key concept is the “unrelated” idea – that the program is so divorced from economic reality or mercantile endeavor, as to be merely a chain letter passing around money. The FTC later recognized the distinction of “saturation” between legitimate pyramid structured programs and illegal pyramid schemes. In 1979, the FTC determined that the MLM program operated by Amway was neither fraudulent nor illegal. The FTC found that Amway Corporation was essentially structured as a pyramid, not a Ponzi scheme, with an ever increasing downline privity of recruits. Nonetheless, the FTC determined that the plan did not constitute an illegal pyramid because certain Amway rules ensured a focus on retailing merchandise over pyramiding of members.

The FTC found that this effort at retailing meant that the program would never be ‘saturated’ with members sending’ money to each other until there were no further people to join. These “anti-saturation” rules saved Amway from the ambit of the anti-Ponzi and pyramid scheme rules, not the specific structure of the enterprise. So, an Amway-like program that happened to pay participants a small fixed fee for bringing in recruits could constitute a “pyramid” but not a scheme to defraud because saturation will not occur.³⁹¹

[Note by Jon Taylor: This reasoning resonates in decisions today, since it has legal precedence, even though the reasoning is based on a weak understanding of how markets work. In Chapter 3, I explained the difference between total saturation and market saturation. In a town of 100,000 people, the notion of total saturation of 100,000 distributors would be absurd. But the market could be said to be saturated with 10 or 20 distributors, after which adding more distributors would mean less and less opportunities for them to thrive in the market because the market is too saturated. So market saturation could be said to exist, and market saturation can happen very quickly in

³⁹¹ See Chapter 3 for a discussion of the fallacies underlying this logic.

a population, especially so in MLM, since hundreds of overlapping MLMs are now saturating the market with such schemes and must “re-pyramid” into other markets.^{392]}

Insights from Bruce Craig, former assistant AG in Wisconsin. Bruce A Craig, an assistant attorney general for the State of Wisconsin Department of Justice has questioned the logic of not considering Amway an illegal pyramid scheme. His comments deserve serious consideration because, during 30 years of service he has prosecuted a significant number of pyramid schemes, including the Koscot case. In a letter to Robert Pitofsky, the FTC Chairman who wrote the final Amway opinion, Mr. Craig noted that since the Amway decision, “investments in pyramid type offerings have resulted in billions of dollars over the years.” Quoting Goodenow³⁹³ of the SEC again:

The FTC Amway decision has created a good deal of uncertainty in respect to private and public legal efforts to deal with abuses of pyramid plans that “will only increase with the onset of marketing over the Internet.”

I certainly agree. Every time I prosecuted a pyramid or Ponzi for the SEC, the first words out of the founder’s mouth were: “I set this up just like Amway.”

Craig has urged the FTC to re-examine the aspects of Amway that make it legal because “the premise of ‘multilevel vs. pyramid’ may well represent a distinction without a difference.” I believe Craig is correct when he asks “whether these exculpatory factors can be effectively evaluated in time to prevent losses to the consuming public.” He observed that the fraudsters know that; and that is why, unfortunately, when the FTC Enforcement Division comes in with an asset freeze, the money is long gone.

Pitofsky tries to redeem the agency for the Amway decision.³⁹⁴ In 1995 Clinton

³⁹² See Chapter 3 for an explanation of the term “re-pyramid.”

³⁹³ MLM Watch article previously cited.

³⁹⁴ The initial decision was made by James P. Timothy, Administrative Law Judge at the time., but O wrote the final decision on behalf of the Commission.

appointed FTC Chairman Robert Pitofsky [D], who had noted the meteoric rise in "business opportunity" frauds about which consumer complaints surged in the 1980s and early 1990s, and in April 1995 Pitofsky began soliciting public comments about the possible inadequacy of the Franchise and Business Opportunity Rule (the "Franchise Rule" or "The Biz Op Rule"). He described the "business opportunity" problem in a February 1996 warning to consumers thusly:

Lured by deceptive promises of independence and easy income, many would-be entrepreneurs are jumping into the arms of con artists who claim: 'we are not just selling you a business, we put you in business', further calling the problem "epidemic."

Still, MLM misrepresentations continued unabated. But it would be disingenuous to be critical of Pitofsky as being too soft, as he became more active in this arena during the remainder of his six-year term (likely to atone for his role in the 1979 Amway decision) until President Bush replaced him with (former Amway attorney) Timothy Muris in 2001 – after which new MLM cases came to a virtual halt.

The MLM industry did note the pattern under Pitofsky: MLMs were ambushed, with the FTC often gaining injunctions that froze assets as it fined the targeted MLM for FTC violations, often to the point of bankruptcy, and without the MLM ever admitting guilt. Pitofsky successfully applied the FTC Act and Franchise and Business Opportunity Rule to end many MLMs and other packaged "business opportunities," also including promoters selling "franchises" of vending machines, pay telephones, and medical billing and envelope-stuffing schemes.

The premise of "multilevel vs. pyramid" may well represent a distinction without a difference.
– Bruce Craig, formerly assistant Attorney General in Wisconsin

Webster v. Omnitrition challenges "personal use"

The 1979 Amway decision did not specify that the Amway requirement that 70% of retail sales must be to non-participants, which left the door open to sales by "internal consumption" or "personal use" of participants only. Fortunately, this was clarified in later federal decisions, beginning with the Webster v. Omnitrition decision, in which the U.S. Ninth Circuit Court of Appeals in 1996 reversed some of the findings of a U.S. District court in Northern California. Quoting from the 9th Circuit Court of Appeals in 1996:

"The key to any anti-pyramiding rule in a program like Omnitrition's, where the basic structure serves to reward recruitment more than retailing, is that the rule must serve to tie recruitment bonuses to actual retail sales in some way."³⁹⁵

The "basic structure" likely refers to the potential for growth of an expanding downline, or pyramid, of participants in exponential fashion so that – even though the commissions from each downline participant is small, the aggregate commissions can grow to rapidly increasing amounts with each additional level of participants. This makes retailing of products to non-participants in the scheme a comparative waste of time for those seeking to maximize their gain.

Quoting further from the Judge's Opinion:

Whether Omnitrition's program runs afoul of California's laws against false advertising, unfair business practices and fraud is determined under California's statutory definition of "Endless Chain" marketing schemes. California Penal Code § 327 makes it a public offense for any person to operate 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. .³⁹⁶

³⁹⁵ Webster v. Omnitrition, IIB, filed in the Appeals court for the 9th U.S. District Court for the Northern District of California, March 4, 1996. (79 F. 3d 776)

³⁹⁶ California Penal Code § 327 (West 1995).

This definition is equivalent, if not identical, to the *Koscot* test. Because there is sufficient evidence for a jury to conclude the Omnitrition program fails the *Koscot* test, there also is a genuine issue of material fact as to whether it is an "Endless Chain" scheme under §327.

Indeed, at least one of the Omnitrition's Amway protections is less salient under the California statute. Omnitrition's "70% Rule" allows supervisors to count products sold at wholesale to their own downlines toward their 70 percent sales requirement. *This allows supervisors to be compensated on the basis of sales other than "sales made to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme."* Id. This is expressly prohibited by the California statute, while it is only implicit in the Amway "retail sales" defense.

And now *Omnitrition's in dicta* language which referenced *Koscot*:

"[...] plaintiffs have produced evidence that the [Amway] 70% rule can be satisfied by a distributor's personal use of the products. If *Koscot* is to have any teeth, such a sale cannot satisfy the requirement that sales be to 'ultimate users' of a product."³⁹⁷

In this context, it is interesting to note that it was disclosed in a recent California case involving Quixtar's (Amway's) "top guns" that only 3.4% of sales were to non-participants!³⁹⁸

" . . . plaintiffs have produced evidence that the [Amway] 70% rule can be satisfied by a distributor's personal use of the products. If Koscot is to have any teeth, such a sale cannot satisfy the requirement that sales be to 'ultimate users' of a product."
– In Webster v. Omnitrition

³⁹⁷ In re Webster v. Omnitrition International. Fed. Sec. L. Rep. P 99,071,96 Cal. Daily Op. Serv. 1 419,96 Dily Journal D.A.R. 2427

³⁹⁸ Notice of Errata re exhibits E, F and G to Affidavit of Billy Florence submitted with complaint, US Dist. Ct., Central District of Calif., Western Div., Case No. CV 07-05194), § 97) p. 13

Equinox Int'l settled with FTC and eight states, for nearly \$40 million in restitution for victims – important lessons learned

Rather than comment on this famous case, I quote from the insightful article titled "10 Lessons for Consumers from the Equinox Case," by Robert FitzPatrick.³⁹⁹

In April, 2000, the FTC and eight states successfully prosecuted Equinox International, one of the nation's largest multi-level marketing companies. In the suit filed jointly with the states on August 3, 1999, the FTC alleged that the defendants operated an illegal pyramid scheme, made deceptive earnings claims, and provided distributors with the means and instrumentalities to violate federal law.

State law enforcers alleged violations of state securities laws, deceptive trade practices laws, false advertising laws, pyramid laws, and licensing requirements laws. The settlement resulted in shutting down the company which was founded in 1991, restitution of about \$40 million to victims, and the banning of the company founder, Bill Gould, from the MLM business forever.

What are consumers to learn from this prosecution and settlement? Here are 10 points and lessons to consider:

1. **Some of the largest and most successful MLMs may be pyramid schemes.** Equinox was one of the largest in the MLM industry. Sales topped \$200 million with hundreds of thousands of distributors. Yet, it is now shut down and disgraced as a pyramid scheme
Lesson: *An MLM company's "success" is not a reliable indicator of its legitimacy.*
2. **DSA membership is no assurance of an MLM's legality.** Equinox was a dues paying member of the Direct Selling Association (DSA), the official association of the MLM industry. One of the witnesses who testified on behalf of Equinox was formerly a member

³⁹⁹ "10 Lessons for Consumers from the Equinox Case," by Robert FitzPatrick, President of Pyramid Scheme Alert – posted on his False Profits web site at – <http://www.falseprofits.com/equinoxlessons.html>

of the Board of the Direct Selling Association Education Foundation.

Lesson: That Equinox, one of DSA's larger members, was successfully prosecuted as an illegal pyramid scheme ought to be a red flag that others may also be operating as pyramid schemes. It also indicates that the DSA cannot be relied upon to "self-police" the MLM industry.

3. **Rapid growth, profitability and "momentum," key factors that MLMs use to lure distributors, may be signs of pyramid schemes, not legitimate enterprises.** Pyramid schemes are notorious for their meteoric rise in sales and numbers of followers. In fact, they must show growth or they quickly die. Between 1990 and 1995, Equinox revenue grew from \$545,000 to \$195 million and its number of employees rose from just 10 to 218. Equinox posted a 10% profit margin.
4. **Exposure and bad publicity are not enough to inform or protect consumers from MLM scams.** Equinox was previously fined by several states for deception and it was raked over the coals in a 1996 segment of 20-20 that was seen by millions of TV viewers across the country. The company continued to attract hundreds of thousands of victims for four more years.
5. **The nation's most authoritative business magazines do not understand MLM, and their reporting of it is often misleading and inaccurate.** INC Magazine listed Equinox #1 in its 1996 "Inc 500" list of the fastest growing privately held companies. The edition that listed Equinox as #1 winner, also featured pyramid scheme perpetrator, Bill Gould, on the cover and included a glowing interview with him. It included a long article touting the power and value of the MLM sales system. One of the other companies it referenced as an example of MLM's marketing success was Jewelway. Jewelway has also been prosecuted by the FTC as an illegal pyramid scheme.

Lesson: Don't believe all the positive hype about MLM in business magazines. Few of them ever focus on the plight of the average distributor whose financial investments and losses are the real sources of the financial "success" of pyramid scheme perpetrators and the MLM corporate profits.
6. **The people very close to the top of MLMs really might not know what's going on and are therefore not necessarily useful guides - even when they quit the organization.** One of Equinox's top

trainers and upliners, Robert Styler, left the company and wrote an exposé book about working under Bill Gould. But Styler did not accuse the company of being an illegal pyramid scheme. In fact, in reviewing his own book for Amazon.com, he stated, "I want to make it clear that I love network marketing and am still in the business full time -- just not with Equinox. As I reached the top of the Equinox system, like pulling the curtain back from the Wizard of Oz, I saw things I did not want to see. I do not feel Equinox is a 'bad' company. There are some wonderful people that are part of that organization. There are also some aspects to the company that I do not agree with and could no longer support."

Lesson: Distributors at the bottom of the downline (who make up 90% of all MLMs) need to think for themselves.

7. **The Federal Government may not have enough money to prosecute the larger MLMs.** Equinox was one of the largest MLMs prosecuted by the FTC in the last 25 years. The Federal regulators and the State Attorneys General who prosecuted Equinox were seeking a court ruling that would strengthen future cases against MLM pyramid schemes. The case was very strong and did result in getting the company shut down, the owner banned from the industry, and millions paid back to victims.

But, in the end, the FTC and the states "settled," rather get a formal court ruling. One key factor that led to the decision to abandon getting a ruling was the extreme cost of prosecution. MLM owners and top ranking upliners can pour millions into legal defense. The FTC faced years of appeals and extraordinary costs to pursue Equinox to the end. To get a quicker and more affordable settlement, they had to lose the opportunity to gain a stronger, definitive court ruling.
8. **The claim that "We are operating just like Amway" is not a valid defense for MLMs.**

Equinox pleaded that it operated just like Amway and Amway was legal, so it should be legal too. This is the main defense used by most MLMs. The judge ruled that the Amway defense was not necessarily relevant to Equinox and the Amway decision of 1979 was not a court decision, but an FTC action.

Lesson: If companies who turn out to be pyramid schemes claim they are "just like Amway" shouldn't the FTC be looking at Amway?

9. **MLMs that don't gain most of their sales revenues from retail sales to non-distributors are probably pyramid schemes.** The FTC and the states that prosecuted Equinox used this definition of a pyramid scheme:

"Pyramid scheme" means a sales scheme, Ponzi scheme, chain marketing scheme, or other marketing plan or program in which participants pay money or valuable consideration to the company in return for which they receive: (1) the right to sell a product or service; and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of products or services to ultimate users. For the purposes of this definition, "sale of products or services to ultimate users" does not include sales to other participants or recruits in the multi-level marketing program or to participants' own accounts."

The FTC experts showed that Equinox's rebate payments to upliners, which amounted to 48% of all wholesale sales to distributors, were really just "payments for recruiting." Only a small percentage of Equinox sales were ever retailed to people who were not also recruited as distributors.

Lesson: *If you are in a MLM that does not emphasize retailing over recruiting, you are very likely a party to an illegal scam.*

10. **Starting and running an MLM that is prosecuted as an illegal pyramid scheme by the FTC can be a very profitable business, even if you get shut down.**

Equinox founder, Bill Gould, got to keep two luxury houses in Boca Raton, Florida, plus furnishings, a Rolex watch valued at \$11,000, a luxury car, and up to \$8 million.

Lesson: *The FTC needs a specific ruling on MLMs so that scams can't be started and run for years before being closed down. With the current lack of regulation, pyramid perpetrators can make millions even if the government finally catches up with them and eventually shuts down their frauds. The lack of a clear ruling on MLM results in much higher costs to prosecute MLM frauds. The higher costs may lead to less protection for the public. (see #7 and #8 above.)*

It should be noted that many of these same observations would apply to other MLMs – and to the industry as a whole.

Most of the laws that might implicate MLMs as pyramid schemes are based on one or more effects of the scheme (such as whether or not sales are made to non-participating consumers) and not the structural causes of the problems; i.e., the underlying endless chain structure, or compensation plan. As explained in Chapter 2, rewards drive behavior.

Fortune Hi-Tech Marketing shut down as alleged pyramid scheme

After a long hiatus of inactivity in prosecuting MLMs, which had been proliferating at an alarming rate, the FTC announced it was shutting down the alleged pyramid scheme FHTM (Fortune Hi-Tech Marketing). In a press release dated January 28, 2013, the FTC announced the action taken in conjunction with the states of Illinois, Kentucky, and North Carolina. What is striking about the complaints against FHTM is how similar their practices are to those of hundreds of other MLMs. (For details on FHTM and rare recent MLM cases, such as BurnLounge, Vemma, and Herbalife, go to Appendix 10E.)

Same fundamental flaws in surviving MLMs as those shut down.

As I have analyzed by now over 600 MLMs, I have been struck with the fact that they all have the same four causative and defining characteristics in their compensation plan as those that have been shut down.

1. All are dependent on unlimited recruitment of a network of endless chains of participants as primary customers.
2. Rank advancement in all of them is achieved by recruitment and product volume, not by appointment.
3. All have significant "pay to play" requirements to qualify for commissions or for rank advancement.

4. All are top-weighted, with those at the top enriched by the losses of those at the bottom.

In addition, most have more levels of rank than are functionally justified to manage the sales function, but which greatly increase the amount of commissions going to TOPPs (top-of-the-pyramid promoters).

As a result of these fundamental flaws, the MLMs I have analyzed also display behavioral characteristics that can be considered illegal, such as sales mostly to participants, misrepresenting income and other deceptions used in recruitment, etc.,

None of this should surprise the reader who understands of the MLMs' inherent flaws. As explained in Chapter 2.

For more information on MLM cases, go to Appendix 10E. For additional background and history on case law relative to pyramid schemes/MLMs, go to Appendix 10G.

Internal consumption a key issue in current regulatory actions.

In recent cases such as those discussed here, the key issue seems to be the percentage of sales accounted for by participants (internal consumption) versus sales to non-participants as end users. While this breakdown is difficult to determine, given the reluctance of MLM officials to gather such information and the reluctance of regulators to provide it, there are ways to ascertain where the emphasis lies.

Having analyzed the compensation plans of hundreds of MLMs and the resultant average incomes (usually losses) of participants, I find that a consistent pattern of effects emerges. And I can say with complete confidence that in all of these compensation plans, the structure of the plan itself incentivizes and therefore portends an emphasis on self-consumption to cover expenses, to say nothing of realizing the promised rewards. Therefore, the MLM company should bear the burden of proof that at least 50% of sales are to non-participants.

***“The Commission has previously con-demned so-called “entrepreneurial chains” as possessing an intolerable capacity to mislead.”
– FTC attorney, Koscot case***

Why MLM is an unfair and deceptive practice

Every one of the compensation plans of the hundreds of MLMs I have analyzed assumes an infinite market – which does not exist in the real world. They also assume virgin markets, which don't exist for long, necessitating that the MLM promoters enter – or “re-pyramid” – into new markets with the same deceptive promises of “residual” or even “unlimited” income.

MLM's top-weighted pay plans appear fair, but are unfairly top weighted. So MLM is unprofitable for almost all participants, except for those at or near the top of the pyramid – who are usually the first ones to join and who may profit from the purchases of what is often a huge “downline” of recruits churning beneath them. Typically, MLMs have little sustainable customer base and are primarily dependent for revenues on purchases of a network of participants – 99% of whom actually lose money.

Where we were able to obtain average earnings data from MLM companies, we found that an average of 99.7% of participants lose money. And if you remove the TOPPs (top-of-the-pyramid promoters – who skew any averages) from the calculations, the loss rate is closer to 99.9%. The odds of profiting from a single roll of the dice in craps, or betting on a single number in a game of Roulette, are far greater than with MLM – and without spending one's social capital.

Thus, MLM as a system is fundamentally flawed, unfair, and deceptive. In addition, worldwide feedback suggests that MLM is extremely viral and predatory. The evidence from independent research and analysis – as reported in this book – clearly supports these conclusions.

New CFPB agency watches for “abusive” practices

The Consumer Financial Protection Bureau was founded as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act which passed during the 111th U.S. Congress in response to the Late-2000s recession and financial crises. The bureau’s jurisdiction included primarily financial institutions but could conceivably apply to abuses of MLMs that are promoted as financial products.

Under Dodd-Frank, Congress expanded the CFPB’s jurisdiction from UDAP to UDAAP such that it includes “Abusive”. Here is the text from the bill:

ABUSIVE.—The Bureau shall have no authority under this section to declare an act or practice abusive in connection with the provision of a consumer financial product or service, unless the act or practice—

- (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or*
- (2) takes unreasonable advantage of—*
 - (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;*
 - (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or*
 - (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.*

Dodd-Frank Act. SEC. 1031(d)

If remains to be seen to what extent this act will be applied to MLM abuse.

CONCLUSIONS

In my view, it would be difficult for anyone to read the information in this book with an open mind without concluding that MLM is the epitome of an unfair and deceptive marketing practice. Glowing reports of “residual income” and the “time freedom” to do as one pleases are presented to prospects without disclosing that 99% of all participants lose money – and close to 100% of new recruits.

Based on the FTC’s mission to protect against unfair and deceptive practices, MLM should be illegal per se, as are “pay to play” chain letters and no-product pyramid schemes. MLMs would also technically be illegal under many state statutes if strictly enforced, as becomes apparent in Appendix 10G.

It appears that for the time being, legal actions will hinge primarily on behaviors of participants, rather than on fundamental flaws in the business model that make MLMs inherently unfair and deceptive. Primary among these is the determination of whether sales are primarily to participants or to end users who are not part of the network of participants; i.e., whether the rewards are weighted more for selling or for recruitment. While such emphasis can be determined by careful analysis of the compensation plan, as explained in Chapter 2, courts and regulators today tend to look for evidence of sales outside of the network of distributors. This can be very difficult to ascertain, since MLM officials are loathe to seek or disclose such data, fearing such information would confirm that its core business is recruitment, not sales to non-participants.

In my view, it would be difficult for anyone to read the information in this book with an open mind without concluding that MLM is the epitome of an unfair and deceptive marketing practice. And many MLMs are also extremely viral and predatory.

Appendix 10A: The \$10,000 “unfair and deceptive practices” challenge

By Jon M. Taylor, MBA, Ph.D., President, Consumer Awareness Institute

According to the web site for the FTC (Federal Trade Commission):

*The basic consumer protection statute enforced by the Commission is Section 5(a) of the FTC Act, which provides that "unfair or deceptive acts or practices in or affecting commerce...are...declared unlawful." (15 U.S.C. Sec. 45(a)(1)). . . "Unfair" practices are defined as those that "cause or [are] likely to cause **substantial injury** to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.*

Having gathered decades of research, experience, and worldwide feedback on problems related to multi-level marketing (MLM), in 2013, I published a challenge, pledging \$10,000 from my limited retirement funds to be paid to the favorite charity of anyone in law enforcement, consumer advocacy, the media, or academia who can by the deadline identify any class of company-sponsored income or business opportunities that is verifiably more unfair and deceptive, more viral and predatory than recruitment-driven MLMs⁴⁰⁰.

Below are the requirements and criteria which I posted online for the reward:

To qualify, you must first read my articulation of the problems associated with MLM in my book [Multi-level Marketing Unmasked](#), which summarizes thousands of pages of research and worldwide feedback. It can be downloaded from my research-based web site – mlm-thetruth.com. The website offers numerous other reports that will aid you in your basic understanding of this flawed business model and in clearing up any questions you may have about MLM industry practices and effects. You will also find much useful information at other web sites linked from our [annotated list of recommended web sites](#).

To be considered for the award, the minimum criteria in the table on the next page – based on extensive research on the MLM industry – would have to be met. If anyone in law enforcement, consumer advocacy, the media, or academia – after reading *Multi-level Marketing Unmasked* – can identify any class of company-sponsored income or business opportunities that – over ten years as an identifiable industry – is verifiably more unfair and deceptive, more viral and predatory (causing participants to suffer more aggregate losses) than recruitment-driven MLMs⁴⁰¹, based on the criteria in the table, please send details to Dr. Jon Taylor at the following email address – jonmtaylor@juno.com. Any submissions that meet the minimum criteria will be submitted to a panel of experts from the International Coalition of Consumer Advocates (an ad hoc group of independent and informed consumer advocates) to determine if the award is merited.

This challenge is in effect until September 1, 2015. If the challenge is not met by then, those of us advocating for consumers will be even further justified in concluding that MLM as a business model and as an industry is an unfair and deceptive practice that is causing substantial injury to consumers and is therefore in violation of Section 5 of the FTC Act, as well as many state statutes. This would also underscore the need for adequate disclosure of information crucial to decisions by prospects on whether or not to participate, a 7-day waiting period before investing, and restrictions on posting potential income.

This challenge was posted on my web site in 2013. In February of 2015, I mailed it with this book and a CD of associated research to Commissioners of the FTC and to 17 other FTC officials of the Bureau of Consumer Protection and Bureau of Economics. An abridgement of my book and a CD of my research was also mailed with this challenge to the offices of Attorney General or of Consumer Protection of the 50 states. Not one of these officials met the challenge by the deadline of September 1, 2015.

⁴⁰⁰ “Recruitment-driven MLMs” would include virtually all MLMs, as I have not as yet found any MLMs that are not recruitment-driven. See chapter 2 in my book – “MLM DEFINITIONS AND LEGITIMACY”

⁴⁰¹ Same as Footnote 1

Criteria that would have to be exceeded to meet the \$10,000 MLM “unfair and deceptive business practices”⁴⁰² challenge

Name and title _____ Organization _____

Address:

I read the book *Multi-level Marketing Unmasked*, by Dr Jon M. Taylor Yes ___ No ___

Please check (√) “Yes” or “No” to the left of each item below. See footnotes for explanations, such as how MLM satisfies each criteria. If “Yes” is checked for all of the criteria below, be prepared to provide detailed evidence.

Please specify the type of income or business opportunity to which you are referring:

Yes	No	For an income or business opportunity – as an industry of company sponsored programs – to be more unfair and deceptive, more viral and predatory (causing participants to suffer more aggregate losses, or injury) than recruitment-driven MLMs⁴⁰³, it would have to meet or exceed the following criteria:
		It would be so <u>unfair and deceptive</u> that although promoters from companies in this industry would tout it as a great income or business opportunity, <i>at least 99% of participants lose money, and at most 1% profit⁴⁰⁴</i> – with those at the top income levels profiting from the losses of those at the bottom levels.
		It would be so <u>deceptive</u> that a total of over 100 typical misrepresentations would be used in promoting and defending it. ⁴⁰⁵
		It would be so <u>viral</u> that some of the companies in the industry would spread quickly from state to state and country to country, impoverishing the vast majority of those who come in later and those who make large investments in the program. Several hundred separate companies in the industry would have started up in the past ten years. ⁴⁰⁶
		4. It would also be so <u>predatory (injurious)</u> that over ten million victims of such companies would have suffered aggregate losses exceeding \$10 billion per year for at least ten years in the U.S. alone, plus millions of victims in vulnerable markets overseas suffering billions of dollars in aggregate losses annually. ⁴⁰⁷ And in spite of its abysmal loss rates, its promoters would tout it as a good income option for those struggling to survive during hard times.

⁴⁰² The primary mission of the Consumer Protection Div. of the FTC is to protect against “unfair and deceptive trade practices.”

⁴⁰³ “Recruitment-driven MLMs” include virtually all MLMs, See chapter 2 in my book – “MLM Definitions and Legitimacy”

⁴⁰⁴ See Chapters 4 through 7 of the book to see how I calculated that a minimum of 99% of MLM participants lose money.

⁴⁰⁵ See Chapter 8 for over 100 typical MLM misrepresentations used by MLM promoters and defenders.

⁴⁰⁶ Viral growth in itself is not a bad thing, but when a program defrauds most of those who join, viral growth can dramatically increase the aggregate losses of participants.

⁴⁰⁷ See Chapter 7.

Appendix 10B: Prohibitions and restrictions by federal agencies applicable to MLM – and those in the statutes of the 50 states⁴⁰⁸

Prohibitions or restrictions applicable to pyramid promotional schemes, chain distribution schemes, multi-level marketing, etc.	FTC	SEC	USPS	Alabama	Alaska	Arizona	Arkansas	California	Colorado	Connecticut	Delaware	Florida	Georgia ⁴⁰⁹
Unfair and deceptive practices	X				X				X				
Misrepresentations or no documentation of earnings or marketability claims				X									X
Initial investment above threshold	X ⁴¹⁰ \$500			X \$100					X \$50			X \$100	X \$500
Unreasonable quota of purchases req'd to participate (inventory loading)													
Establishing or promoting pyramid scheme, chain distributor schemes or referral sales plans				X	X				X	X ⁴¹¹	X	X	
Pyramid or chain referral scheme – primary income from recruitment rather than sales to non-participants	X ⁴¹²			X	X	X	X	X	X				X
Establishing endless chain or referral sales													
Pyramid scheme as lottery, whereby income dependent on chance over skill or judgment of participant						X ⁴¹³		X					X
Earnings contingent on procurement of customers or occurrence of some event after purchase										X			
Participants not contributing to sales efforts to qualify for commissions, etc., from sales of others (downline)													X
Mail or wire fraud			X										
No repurchase (buyback) provision													
Repurchase (buyback) provision misrepresented													X
Misrepresentation of products in source, quality, certification, etc.,									X				
Implications of approval or endorsement by any agency of the state													X
Misrepresentations on financial reports or statements to investors		X ⁴¹⁴											
Purchase discounts, other incentives to refer others													
Failure to file disclosures to state													
Failure to provide disclosures to recruits													

⁴⁰⁸ These could change as the DSA/MLM “cartel” lobbies to weaken such laws to benefit the MLM industry.

⁴⁰⁹ In Georgia, extensive disclosures (including signed statements), records retention, and \$75,000 bond required if threshold exceeded

⁴¹⁰ If an MLM exceeds the threshold of \$500 over six months (laundering investment via “pay to play” purchase requirements, etc.), it could be subject to franchise regulations

⁴¹¹ In Connecticut, contingent consideration is void; i.e., payments for rights, etc. contingent on procurement (recruitment) of other persons with similar rights, etc.

⁴¹² Requirement for sales to non-participants clarified in recent rulings and staff communications

⁴¹³ In Arizona, participants can satisfy the law by selling consumable products to anyone, including participants (language similar to that initiated by the DSA, as in the 2006 amendment to Utah’s Pyramid Scheme Act)

⁴¹⁴ MLMs must avoid franchise classification, including threshold

Prohibitions or restrictions applicable to pyramid promotional schemes, chain distribution schemes, multi-	Hawaii	Idaho	Illinois	Indiana	Iowa	Kansas	Kentucky	Louisiana	Maine	Maryland	Massachusetts	Michigan	Minnesota	Mississippi	Missouri	Montana
Unfair and deceptive practices			X		X	X						X	X			
Misrepresentations or no documentation of earnings or marketability claims										X	X		X			
Initial investment above threshold				X \$100										X \$100		
Unreasonable quota of purchases req'd to participate (inventory loading)											X					X
Establishing or promoting pyramid scheme, chain distributor schemes or referral sales plans		X ⁴¹⁵	X ⁴¹⁶	X			X ⁴¹⁷	X ⁴¹⁸		X ⁴¹⁹		X		X	X	X ⁴²⁰
Pyramid or chain referral scheme – primary income from recruitment rather than sales to non-participants	X			X					X		X		X	X		
Establishing endless chain or referral sales																
Pyramid scheme as lottery, whereby income dependent on chance over skill or judgment of participant									X		X					
Earnings contingent on procurement of customers or occurrence of some event after purchase				X	X	X						X	X			
Participants not contributing to sales efforts to qualify for commissions, etc., from sales of others (downline)											X					
Mail or wire fraud																
No repurchase (buyback) provision		X						X		X			X			X
Repurchase (buyback) provision misrepresented											X					
Misrepresentation of products in source, quality, certification, etc.,																
Implications of approval or endorsement by any agency of the state																X
Misrepresentations on financial reports or statements to investors										X		X				
Purchase discounts, other incentives to refer others																X
Failure to file disclosures to state																

⁴¹⁵ In Idaho, sales to participants exempts an MLM from classification as a pyramid scheme – due to amendment initiated by DSA and/or its members

⁴¹⁶ In Illinois, MLM is not classified as a pyramid scheme if sale is to persons for purpose of resale. The statute does not specify that these sales must be to non-participants.

⁴¹⁷ In Kansas, sales to participants exempts an MLM from classification as a pyramid scheme

⁴¹⁸ In Louisiana, sales to participants exempts an MLM from classification as a pyramid scheme – due to amendment initiated by DSA and/or its members (same language as in Utah's statute, which was changed through DSA lobbying)

⁴¹⁹ Maryland's definition of pyramid promotional scheme excludes sales by participants or others introduced into the scheme

⁴²⁰ In Montana, illegality of pyramid schemes is only implied, but programs with consumable products are exempt

Prohibitions or restrictions applicable to pyramid promotional schemes, chain distribution schemes, multi-level marketing, etc.	Nebraska	Nevada	New Hampshire	New Jersey	New Mexico	New York	No. Carolina	No. Dakota	Ohio	Oklahoma	Oregon	Oklahoma	Oregon	Pennsylvania	Rhode Island
Unfair and deceptive practices				X										X	
Misrepresentations or no documentation of earnings or marketability claims															
Initial investment above threshold									X \$25					X \$25	
Unreasonable quota of purchases required to participate (inventory loading)	X														
Establishing or promoting pyramid scheme, chain distributor schemes or referral sales plans	X ⁴²¹	X	X		X ⁴²²	X ⁴²³		X ⁴²⁴		X ⁴²⁵	X ⁴²⁶	X ⁴²⁷	X ⁴²⁸	X ⁴²⁹	
Pyramid or chain referral scheme – primary income from recruitment rather than sales to non-participants		X					X		X						
Establishing endless chain or referral sales															
Pyramid scheme as lottery, whereby income dependent on chance over skill or judgment of participant							X								
Earnings contingent on procurement of customers or occurrence of some event after purchase								X			X		X	X	
Participants not contributing to sales efforts to qualify for commissions, etc., from sales of others (downline)															
Mail or wire fraud															
No repurchase (buyback) provision	X									X		X			
Repurchase (buyback) provision misrepresented															
Misrepresentation of products in source, quality, certification, etc.,															
Implications of approval or endorsement by any agency of the state															
Misrepresentations on financial reports or statements to investors															X
Purchase discounts, other incentives to refer others															
Failure to file disclosures to state															X

⁴²¹ Nebraska exempts sales to participants in definition of pyramid schemes
⁴²² New Mexico exempts sales to participants in definition of pyramid schemes
⁴²³ In New York, chain distributor schemes constitute a security and are subject to law for such
⁴²⁴ North Dakota exempts sales to participants in definition of pyramid schemes
⁴²⁵ Oklahoma exempts sales to participants in definition of pyramid schemes
⁴²⁶ Oregon uses the term “pyramid club.”
⁴²⁷ Oklahoma exempts sales to participants in definition of pyramid schemes
⁴²⁸ Oregon uses the term “pyramid club.”
⁴²⁹ Pennsylvania uses the term “pyramid club.”

Prohibitions or restrictions applicable to pyramid promotional schemes, chain distribution schemes, multi-level marketing, etc.	So. Carolina	So. Dakota	Tennessee	Texas	Utah	Vermont	Virginia	Washington	W. Virginia	Wisconsin	Wyoming
Unfair and deceptive practices	X	X	X	X	X	X	X				
Misrepresentations or no documentation of earnings or marketability claims											
Initial investment above threshold											
Unreasonable quota of purchases required to participate (inventory loading)		X									
Establishing or promoting pyramid scheme, chain distributor schemes or referral sales plans	X ⁴³⁰	X ⁴³¹		X ⁴³²	X ⁴³³	X ⁴³⁴	X ⁴³⁵	X ⁴³⁶	X	X	
Pyramid or chain referral scheme – primary income from recruitment rather than sales to non-participants			X ⁴³⁷								X
Establishing endless chain or referral sales											X
Pyramid scheme as lottery, whereby income dependent on chance over skill or judgment of participant											
Earnings contingent on procurement of customers or occurrence of some event after purchase		X	X	X							
Participants not contributing to sales efforts to qualify for commissions, etc., from sales of others (downline)											
Mail or wire fraud											
No repurchase (buyback) provision		X		X							X
Repurchase (buyback) provision misrepresented											
Misrepresentation of products in source, quality, certification, etc.,											
Implications of approval or endorsement by any agency of the state											
Misrepresentations on financial reports or statements to investors											
Purchase discounts, other incentives to refer others											
Failure to file disclosures to state											X

NOTE: For excerpts from actual statutes relating to MLM and pyramid schemes, see Appendix 10G.

⁴³⁰ South Carolina uses the term “pyramid club,” and prohibits chain process of advancement by recruitment

⁴³¹ South Dakota exempts sales to participants in definition of pyramid schemes

⁴³² Texas exempts sales to participants in definition of pyramid schemes

⁴³³ Utah’s Pyramid Scheme Act was amended in 2006 with bill initiated by DSA members, using deceptive arguments (witnessed by the author) and reinforced by heavy donations to Utah’s Attorney General, who spoke in favor of the bill.

⁴³⁴ Vermont statute clearly describes uneconomic nature and harmful effects of “chain distributor schemes.”

⁴³⁵ Virginia exempts sales to participants in definition of pyramid schemes

⁴³⁶ Washington exempts sales to participants in definition of pyramid schemes

⁴³⁷ Tennessee uses the terms “pyramid distributorship” and “chain referral sales plan.

Appendix 10C: Class actions governed by Rule 23

Rule 23 of the Federal Rules of Civil Procedure governs class actions, which have certain prerequisites. The Federal Rules of Civil Procedure (FRCP) govern civil procedure (i.e. for civil lawsuits) in United States district (federal) courts. Rule 23 spells out the prerequisites for a class action to be certified.⁴³⁸ Most of the rest of this section is summarized from information provided by the Legal Information Institute (with my comments [JMT] italicized and in brackets):

(a) Prerequisites. One or more members of a class may sue or be sued as representative parties on behalf of all members only if:

(1) The class is so numerous that joinder of all members is impracticable. *[MLMs are so viral that a case could easily involve thousands, and even tens of thousands of victims.]*

(2) There are questions of law or fact common to the class. *[Since each MLM is typically governed by a unified compensation plan and policies and procedures manual, and since the same laws are broken across the entire spectrum of participants, this prerequisite is easily satisfied.]*

(3) The claims or defenses of the representative parties are typical of the claims or defenses of the class. *[The root cause of MLM fraud and abuse is the perverse system of rewards as articulated in the company-wide compensation plan, and this applies to all who are in the class.]*

– and **(4) The representative parties will fairly and adequately protect the interests of the class.** *[Lead plaintiffs should be selected who are not merely expressing a personal gripe against just a select few perpetrators, but whose complaints are typical of a broad cross-section of victims. Since the policies of the MLM program are typically practiced company-wide, this should not be a difficult challenge for plaintiff attorneys.]*

[JMT: Though I am not an attorney, it appears to me that in general, cases against MLMs could satisfy all of the above.]

(b) Types of Class Actions. A class action may be maintained if Rule 23(a) is satisfied and if:

(1) Prosecuting separate actions by or against individual class members would create a risk of:

(A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or

(B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;

(2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or

(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:

(A) the class members' interests in individually controlling the prosecution or defense of separate actions;

(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

(D) the likely difficulties in managing a class action.

(c) Certification Order; Notice to Class Members; Judgment; Issues Classes; Subclasses.

(1) Certification Order.

(A) Time to Issue. At an early practicable time after a person sues or is sued as a class representative, the court must determine by order whether to certify the action as a class action.

(B) Defining the Class; Appointing Class Counsel. An order that certifies a class action

⁴³⁸ Extracted from "Federal Rules of Civil Procedure, Rule 23. Class Actions." Legal Information Institute, Cornell University Law School. For a more complete discussion of class actions, go to – <http://www.law.cornell.edu/rules/frcp/Rule23.htm>

must define the class and the class claims, issues, or defenses, and must appoint class counsel under Rule 23(g).

(C) Altering or Amending the Order. An order that grants or denies class certification may be altered or amended before final judgment.

(2) Notice.

(A) For (b)(1) or (b)(2) Classes. For any class certified under Rule 23(b)(1) or (b)(2), the court may direct appropriate notice to the class.

(B) For any class certified under Rule 23(b)(3), the court must direct to class members the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice must clearly and concisely state in plain, easily understood language:

- (i) the nature of the action;
- (ii) the definition of the class certified;
- (iii) the class claims, issues, or defenses;
- (iv) that a class member may enter an appearance through an attorney if the member so desires;
- (v) that the court will exclude from the class any member who requests exclusion;
- (vi) the time and manner for requesting exclusion; and
- (vii) the binding effect of a class judgment on members under Rule 23(c)(3).

(3) Judgment. Whether or not favorable to the class, the judgment in a class action must:

(A) for any class certified under Rule 23(b)(1) or (b)(2), include and describe those whom the court finds to be class members; and

(B) for any class certified under Rule 23(b)(3), include and specify or describe those to whom the Rule 23(c)(2) notice was directed, who have not requested exclusion, and whom the court finds to be class members.

(4) Particular Issues.

When appropriate, an action may be brought or maintained as a class action with respect to particular issues.

(5) Subclasses.

When appropriate, a class may be divided into subclasses that are each treated as a class under this rule.

(d) Conducting the Action.

(1) **In General.** In conducting an action under this rule, the court may issue orders that:

(A) determine the course of proceedings or prescribe measures to prevent undue repetition or complication in presenting evidence or argument;

(B) require — to protect class members and fairly conduct the action — giving appropriate notice to some or all class members of:

- (i) any step in the action;
- (ii) the proposed extent of the judgment; or
- (iii) the members' opportunity to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or to otherwise come into the action;

(C) impose conditions on the representative parties or on intervenors;

(D) require that the pleadings be amended to eliminate allegations about representation of absent persons and that the action proceed accordingly; or

(E) deal with similar procedural matters.

(2) Combining and Amending Orders. An order under Rule 23(d)(1) may be altered or amended from time to time and may be combined with an order under Rule 16.

(e) Settlement, Voluntary Dismissal, or Compromise. The claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court's approval. The following procedures apply to a proposed settlement, voluntary dismissal, or compromise:

(1) The court must direct notice in a reasonable manner to all class members who would be bound by the proposal.

(2) If the proposal would bind class members, the court may approve it only after a hearing and on finding that it is fair, reasonable, and adequate.

(3) The parties seeking approval must file a statement identifying any agreement made in connection with the proposal.

(4) If the class action was previously certified under Rule 23(b)(3), the court may refuse to approve a settlement unless it affords a new opportunity to request exclusion to individual class members who had an earlier opportunity to request exclusion but did not do so.

(5) Any class member may object to the proposal if it requires court approval under this subdivision (e); the objection may be withdrawn only with the court's approval.

(f) Appeals. A court of appeals may permit an appeal from an order granting or denying class-

action certification under this rule if a petition for permission to appeal is filed with the circuit clerk within 14 days after the order is entered. An appeal does not stay proceedings in the district court unless the district judge or the court of appeals so orders.

(g) Class Counsel.

(1) Appointing Class Counsel.

Unless a statute provides otherwise, a court that certifies a class must appoint class counsel. In appointing class counsel, the court:

(A) must consider:

(i) the work counsel has done in identifying or investigating potential claims in the action;

(ii) counsel's experience in handling class actions, other complex litigation, and the types of claims asserted in the action;

(iii) counsel's knowledge of the applicable law; and

(iv) the resources that counsel will commit to representing the class;

(B) may consider any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class;

(C) may order potential class counsel to provide information on any subject pertinent to the appointment and to propose terms for attorney's fees and nontaxable costs;

(D) may include in the appointing order provisions about the award of attorney's fees or nontaxable costs under Rule 23(h); and

(E) may make further orders in connection with the appointment.

(2) Standard for Appointing Class Counsel. When one applicant seeks appointment as class counsel, the court may

appoint that applicant only if the applicant is adequate under Rule 23(g)(1) and (4). If more than one adequate applicant seeks appointment, the court must appoint the applicant best able to represent the interests of the class.

(3) Interim Counsel. The court may designate interim counsel to act on behalf of a putative class before determining whether to certify the action as a class action.

(4) Duty of Class Counsel. Class counsel must fairly and adequately represent the interests of the class.

(h) Attorney's Fees and Nontaxable Costs. In a certified class action, the court may award reasonable attorney's fees and nontaxable costs that are authorized by law or by the parties' agreement. The following procedures apply:

(1) A claim for an award must be made by motion under Rule 54(d)(2), subject to the provisions of this subdivision (h), at a time the court sets. Notice of the motion must be served on all parties and, for motions by class counsel, directed to class members in a reasonable manner.

(2) A class member, or a party from whom payment is sought, may object to the motion.

(3) The court may hold a hearing and must find the facts and state its legal conclusions under Rule 52(a).

(4) The court may refer issues related to the amount of the award to a special master or a magistrate judge, as provided in Rule 54(d)(2)(D).

Appendix 10D: Statement on “Pyramid Schemes” by Debra A. Valentine, General Counsel for the U.S. Federal Trade Commission

Presented at the International Monetary Fund's Seminar on Current Legal Issues
Affecting Central Banks, Washington, D.C., May 13, 1998

I would like to thank you for the opportunity to speak about the growing international problem of pyramid schemes. What is striking about these schemes is that while they are very old forms of fraud, modern technology has vastly multiplied their potential for harming our citizens. The Internet in particular offers pyramid builders a multi-lane highway to world-wide recruits in virtually no time.

Introduction

First, let me tell you about the Federal Trade Commission.⁽¹⁾ The Commission is an independent government agency that Congress established in 1914. We perform a core function of government -- ensuring that free markets work. This requires competition among producers and accurate information in the hands of consumers in order to generate the best products at the lowest prices, spur efficiency and innovation, and strengthen the economy.

For competition to thrive, consumers must be knowledgeable about available products and services. Our Consumer Protection Bureau ensures that consumer information in the marketplace is not deceptive or misleading. A free market also means that consumers have a choice among products and services at competitive prices. Our Competition Bureau ensures that the marketplace is free from anti-competitive mergers and other unfair business practices such as price-fixing or placing floors on retail prices.

With the exception of a few areas like air travel and insurance, the Commission has broad law enforcement authority over virtually every sector in our economy. Unfortunately, we now see pyramid schemes invading many of the sectors that we oversee.

What is a Pyramid Scheme and What is Legitimate Marketing?

Pyramid schemes now come in so many forms that they may be difficult to recognize immediately. However, they all share one overriding characteristic. They promise consumers or investors large profits based primarily on recruiting others to join their program, not based on profits from any real investment or real sale of goods to the public. Some schemes may purport to sell a product, but they often simply use the product to hide their pyramid structure. *There are two tell-tale signs that a product is simply being used to disguise a pyramid scheme: inventory loading and a lack of retail sales. Inventory loading occurs when a company's incentive program forces recruits to buy more products than they could ever sell, often at inflated prices. If this occurs throughout the company's distribution system, the people at the top of the pyramid reap substantial profits, even though little or no product*

moves to market. The people at the bottom make excessive payments for inventory that simply accumulates in their basements. A lack of retail sales is also a red flag that a pyramid exists. Many pyramid schemes will claim that their product is selling like hot cakes. However, on closer examination, the sales occur only between people inside the pyramid structure or to new recruits joining the structure, not to consumers out in the general public.

A Ponzi scheme is closely related to a pyramid because it revolves around continuous recruiting, but in a Ponzi scheme the promoter generally has no product to sell and pays no commission to investors who recruit new "members." Instead, the promoter collects payments from a stream of people, promising them all the same high rate of return on a short-term investment. In the typical Ponzi scheme, there is no real investment opportunity, and the promoter just uses the money from new recruits to pay obligations owed to longer-standing members of the program.

In English, there is an expression that nicely summarizes this scheme: It's called "stealing from Peter to pay Paul." In fact some law enforcement officers call Ponzi schemes "Peter-Paul" scams. Many of you may be familiar with Ponzi schemes reported in the international financial news. For example, the MMM fund in Russia, which issued investors shares of stock and suddenly collapsed in 1994, was characterized as a Ponzi scheme.⁽²⁾

Both Ponzi schemes and pyramids are quite seductive because they may be able to deliver a high rate of return to a few early investors for a short period of time. Yet, both pyramid and Ponzi schemes are illegal because they inevitably must fall apart. No program can recruit new members forever. Every pyramid or Ponzi scheme collapses because it cannot expand beyond the size of the earth's population.⁽³⁾ When the scheme collapses, most investors find themselves at the bottom, unable to recoup their losses.

Some people confuse pyramid and Ponzi schemes with legitimate multilevel marketing. Multilevel marketing programs are known as MLM's,⁽⁴⁾ and unlike pyramid or Ponzi schemes, MLM's have a real product to sell. More importantly, MLMs actually sell their product to members of the general public, without requiring these consumers to pay anything extra or to join the MLM system. MLM's may pay commissions to a long string of distributors, but these commission are paid for real retail sales, not for new recruits.

How Pyramid Schemes Operate

Let's look at how a pyramid scheme operates from three points of view: the potential investor, the

promoter or con artist, and the victim. Many pyramid schemes will present a payout formula or matrix much like this one:

Payment of \$500	#		
Level 1 \$150 x 3 = \$450	#	#	#
Level 2 \$30 x 9 = \$270	###	###	###
Level 3 \$30 x 27 = \$810	#####	#####	#####
	#####	#####	#####
Level 4 \$30 x 81 = \$2430	#####	#####	#####
	#####	#####	#####

	\$3960		

This example illustrates what is known as a three by four matrix. Each investor pays \$500 to the promoter and is told to build a "downline" by recruiting three new members, who then each should recruit three more members. The investor is told that he will be paid \$150 for each of the three members whom he enlists at the first level. The investor is also promised a \$30 commission for each recruit at the next three levels. Thus, the investor should receive commissions for four levels of recruits below him, each of whom must recruit three more members, hence the name -- a three by four matrix.

To the potential investor/recruit this may look like a very appealing opportunity. The pyramid promoter is likely to persuade the investor that he is "getting in early" and that he should consider himself at the top of the matrix. From this perspective, it appears that he can earn \$3,960 on an investment of \$500, a whopping 792 percent return. You can do the math easily: \$150 from the first level of 3 recruits is \$450; \$30 from the next 3 levels of recruits is \$270 (\$30 x 9), plus \$810 (\$30 x 27), plus \$2,430 (\$30 x 81). Not a bad deal.

Yet, consider the matrix from the promoter/con artist's point of view. He is the person at the top of the pyramid but in fact looks at the scheme from the bottom. He views each new investor as a predicable set of revenues and expenses, with the revenues flowing down to him. The con artist receives \$500 for each new member, and at most he will have to pay \$240 in commissions to earlier investors in the new recruit's "upline," i.e. those people responsible for bringing him into the system. So when an investor joins the system in the last level, the promoter will receive \$500, but he will pay only \$150 to the person who recruited the new investor, and \$30 each to three longer-standing members in the new investor's "upline," for a total of \$240. Thus, the con artist will keep over half of every \$500 membership fee paid.

Let's assume that this scheme collapses after the fourth level of recruits is filled. The con artist will have made \$500 from the first investor in the pyramid (\$500 with no commissions paid out), \$350 from the 3 at the next level (\$500 minus commission of \$150), \$320 from the 9 at the next level (\$500 minus commissions of \$150 + \$30), \$290 from the 27 at the next level (\$500 minus \$150 + \$30 + \$30), and \$260 from the 81 newest investors (\$500 minus commissions of \$150 + \$30 + \$30 + \$30). The simple

math -- \$33,320 flowed down to the con artist -- and all he did was attract one investor!

Now consider the pyramid from the investor/victim's perspective -- after the entire scheme has collapsed around him. The victim, like the first investor, thought of himself at the top of the pyramid but suddenly realizes that he is actually at the bottom, unable to find people interested in the program to build out his downline. He is not alone because mathematics shows that MOST investors will find themselves at the bottom of the pyramid when it collapses. The very structure of this matrix dictates that whenever the collapse occurs, at least 70 percent will be in the bottom level with no means to make a profit. They all will be out \$500. In our example, even those people one level above the bottom will not have recouped their investment. They each will have paid a membership fee of \$500 and collected commissions of \$150 for each of three recruits, leaving each investor in the second-from-the-bottom tier at least \$50 shy of his break-even point. In short, when the pyramid collapses all the investors in the bottom two levels will be losers. *Adding together the number of victims from these bottom two levels shows that 89 percent of all the pyramid's participants (108 of 121 investors) are doomed to lose money.*

A Ponzi scheme could yield even worse results for investors, because it does not pay out any commissions at all. This can have disastrous consequences, as exemplified by Charles Ponzi's infamous fraud in the 1920s. Charles Ponzi, an engaging ex-convict, promised the Italian-American community of South Boston that he would give them a 50 percent return on their money in just 45 to 90 days.⁽⁵⁾ Mr. Ponzi claimed that he could pay such a high rate of return because he could earn 400 percent by trading and redeeming postal reply coupons. These coupons had been established under the Universal Postal Convention to enable a person in one country to pre-pay the return postage on a package or letter sent back from another country.

For a short time after World War I, fluctuations in currency exchange rates did create a disparity between the cost and redemption value of postal reply coupons among various countries. However, Mr. Ponzi discovered that he could only make a few cents per coupon and that handling large volumes of coupons cost more than they were worth. He stopped redeeming any coupons but continued to collect investors' money. When he actually paid a 50 percent return to some early investors, his reputation soared and more money flowed in from around the country. Mr. Ponzi bought a stylish house in the best part of town and purchased a large minority interest in his local bank, the Hanover Trust Company.

Eventually his scheme began to unravel, bringing ruin to the bank and thousands of investors. When Mr. Ponzi began to overdraw his accounts at Hanover Trust, the Massachusetts Banking Commissioner ordered Hanover Trust to stop honoring Ponzi's checks. The bank refused and even issued back-dated certificates of deposit to cover Mr. Ponzi's overdrafts. A few days later, the Banking Commission took over Hanover Trust, and Mr. Ponzi was arrested for mail fraud. In the end, Charles Ponzi owed investors over \$6 million, an enormous sum of

money for that time. He was convicted of fraud in both state and federal court and served ten years in prison.(6)

Law Enforcement Partners

The legacy of Mr. Ponzi lives on as pyramid and Ponzi schemes continue to plague us and challenge the law enforcement community. Fortunately, in the U.S., the Federal Trade Commission is just one among many agencies that have the authority to file suit to stop this type of fraud. The Securities and Exchange Commission also pursues these schemes, obtaining injunctions against so-called "financial distribution networks" which in fact sell unregistered "securities."(7) The U.S. Department of Justice, in collaboration with investigative agencies like the FBI and the U.S. Postal Inspection Service, prosecutes pyramid schemes criminally for mail fraud, securities fraud, tax fraud, and money laundering.(8)

State officials independently file cases in state court, often under specific state laws that prohibit pyramids. California defines pyramids as "endless chains" and prohibits them under its laws against illegal lotteries.(9) In a slightly different vein, Illinois classifies pyramid schemes as criminal acts of deception directed against property.(10) Some states like Georgia prohibit pyramid schemes under a statutory framework that regulates business opportunities and multilevel marketing.(11)

At the Commission, we bring cases against pyramid schemes under the FTC Act, which broadly prohibits "unfair or deceptive acts or practices in or affecting commerce."(12) That Act allows the Commission to file suit in federal court and seek a variety of equitable remedies, including injunctive relief, a freeze over the defendants' assets, a receivership over the defendants' business, and redress or restitution for consumers.

FTC Precedent from the 1970s

The Commission took its first concerted action against pyramid schemes in the 1970s during a boom in home-based business and MLM or direct selling. One-on-one marketing became common for many consumer items -- from cosmetics to kitchenware, and Tupperware™ parties became an icon of the era. Unfortunately, the rise in legitimate multilevel marketing was accompanied by a surge in pyramid schemes. Those schemes played off the popularity of MLM or network sales but paid more attention to networking than to selling actual goods. Pyramid schemes became so notorious that then-Senator Walter Mondale sponsored a federal anti-pyramiding bill. It passed the United States Senate twice in the 1970s, but never became law.(13)

One of the Commission's first cases was In re Koscot Interplanetary, Inc.,(14) which involved a company that offered the opportunity to become a "Beauty Advisor" and sell cosmetics. The company's incentive structure really did not encourage retail sales. Instead, it encouraged people to pay \$2000 for the title of "Supervisor" and purchase \$5400 in Koscot cosmetics, and then to earn bonuses by recruiting

others to make the same investments.(15) The Commission found that Koscot operated an illegal "entrepreneurial chain" and articulated a definition of illegal pyramiding that our agency and the federal courts continue to rely on.(16) The Commission found that pyramid schemes force participants to pay money in return for two things. First is "the right to sell a product", second is "the right to receive, in return for recruiting other participants into the program, rewards which are unrelated to sale of the product to ultimate users. (emphasis added)"(17) The Commission explained that paying bonuses for recruiting:

. . . will encourage both a company and its distributors to pursue that side of the business, to the neglect or exclusion of retail selling. The short-term result may be high recruiting profits for the company and select distributors, but the ultimate outcome will be neglect of market development, earnings misrepresentations, and insufficient sales for the insupportably large number of distributors whose recruitment the system encourages."(18)

In In re Amway Corp.,(19) another landmark decision from the 1970s, the FTC distinguished an illegal pyramid from a legitimate multilevel marketing program. At the time, Amway manufactured and sold cleaning supplies and other household products. Under the Amway Plan, each distributor purchased household products at wholesale from the person who recruited or "sponsored" her. The top distributors purchased from Amway itself. A distributor earned money from retail sales by pocketing the difference between the wholesale price at which she purchased the product, and the retail price at which she sold it. She also received a monthly bonus based on the total amount of Amway products that she purchased for resale to both consumers and to her sponsored distributors.(20)

Since distributors were compensated both for selling products to consumers and to newly-recruited distributors, there was some question as to whether this was a legitimate multilevel marketing program or an illegal pyramid scheme. The Commission held that, although Amway had made false and misleading earnings claims when recruiting new distributors,(21) the company's sales plan was not an illegal pyramid scheme.

Amway differed in several ways from pyramid schemes that the Commission had challenged. It did not charge an up-front "head hunting" or large investment fee from new recruits, nor did it promote "inventory loading" by requiring distributors to buy large volumes of nonreturnable inventory. Instead, Amway only required distributors to buy a relatively inexpensive sales kit. Moreover, Amway had three different policies to encourage distributors to actually sell the company's soaps, cleaners, and household products to real end users. First, Amway required distributors to buy back any unused and marketable products from their recruits upon request. Second, Amway required each distributor to sell at wholesale or retail at least 70 percent of its purchased inventory each month -- a policy known as the 70% rule. Finally, Amway required each sponsoring distributor to make at least one retail sale to each of 10 different customers each month, known as the 10 customer rule.(22)

The Commission found that these three policies prevented distributors from buying or forcing others to buy unneeded inventory just to earn bonuses. Thus, Amway did not fit the Kosco definition: Amway participants were not purchasing the right to earn profits unrelated to the sale of products to consumers "by recruiting other participants, who themselves are interested in recruitment fees rather than the sale of products."[\(23\)](#)

Pyramid Schemes in the 1990s

The 1990s first brought an important refinement in the law. As the Commission pursued new pyramid cases, many defendants proclaimed their innocence, stating that they had adopted the same safeguards -- the inventory buy-back policy, the 70% rule, and the 10 customer rule -- that were found acceptable in Amway. However, an appellate court decision called Webster v. Omnitrition Int'l, Inc.,[\(24\)](#) pointed out that the Amway safeguards do not immunize every marketing program. *The court noted that the "70% rule" and "10 customer rule" are meaningless if commissions are paid based on a distributor's wholesale sales (which are only sales to new recruits), and not based on actual retail sales.*[\(25\)](#) The court also noted that an inventory buy-back policy is an effective safeguard only if it is actually enforced.[\(26\)](#)

While new cases were refining the law in the 1990s, radical changes were underway in the marketplace. Pyramid schemes came back with a vengeance. Like most economic activity, fraud occurs in cycles, and new pyramid schemes exploited a new generation of consumers and entrepreneurs that had not witnessed the pyramid problems of the 1970s. Also, the globalization of the economy provided a new outlet for pyramidizing. Pyramids schemes found fertile ground in newly emerging market economies where this type of fraud had previously been scarce or unknown.[\(27\)](#) In Albania, for example, investors poured an estimated \$1 billion into various pyramid schemes -- a staggering 43% of the country's GDP.[\(28\)](#)

In the U.S., probably nothing has contributed to the growth of pyramid schemes as much as Internet marketing. The introduction of electronic commerce has allowed con artists to quickly and cost-effectively target victims around the globe. After buying a computer and a modem, scam artists can establish and maintain a site on the World Wide Web for \$30 a month or less, and solicit anyone in the world with Internet access. Pyramid operators can target specific audiences by posting messages in specialized news groups (e.g., "alt.business.home" or "alt.make.money.fast"). In addition, through unsolicited e-mail messages -- known on the Internet as "spam" -- pyramid operators can engage in cheap one-on-one marketing. Whereas it might cost hundreds or thousands of dollars to rent a mailing list and send 10-cent post cards to potential recruits, it costs only a fraction of that to send out similar e-mail solicitations. On the Internet, you can acquire one million e-mail addresses for as little as \$11 and spend nothing on postage.[\(29\)](#)

The Federal Trade Commission's current law enforcement efforts reflect this new wave in pyramidizing. The Commission has brought eight cases against pyramid schemes in the last two years,[\(30\)](#) and six of those have involved Internet marketing.[\(31\)](#) One recent case, FTC v. FutureNet, Inc., is particularly instructive because it starkly reflects the potential for abuse in hi-tech and newly deregulated industries. FutureNet allegedly claimed that, for payment of \$195 to \$794, investors could earn between \$5000 and \$125,000 per month as distributors of Internet access devices like WebTV. *The FTC filed suit, charging that FutureNet's earnings claims were false because the company really operated an illegal pyramid scheme.* Near the time of filing, FTC investigators discovered that FutureNet had begun to sell electricity investments as well, riding a wave of speculation in advance of the deregulation of California's electricity market.

The Commission obtained a TRO and an asset freeze over the defendants' assets and eventually reached a \$1 million settlement with the corporate defendants and two individual officers. The settlement requires the defendants to pay \$1 million in consumer redress, bars them from further pyramidizing activity of any kind, requires them to post a bond before engaging in any network marketing, and requires them to register with state utility officials before engaging in the sale of electricity. The Commission continues to litigate its case against three non-settling individual defendants.[\(32\)](#)

The Impact of Pyramids on Banking

Pyramid schemes not only injure consumers. In many cases, they affect the daily operations of banks and taint the banking industry's overall reputation for safety and soundness. Many pyramid promoters disparage the bank industry and promote their own program as a superior alternative to traditional banking and investment. Melvin Ford, a defendant in the SEC's recent case against International Loan Network, stated that his company's bonus program was "the most powerful financial system since banking."[\(33\)](#) At the height of his popularity, Charles Ponzi actually proclaimed that he would form a new banking system and divide profits equally between depositors and shareholders.[\(34\)](#)

In FTC v. Cano,[\(35\)](#) the Commission observed first-hand the impact of pyramid schemes on the banking system and individual banks. In that case, the Commission targeted an alleged Internet pyramid scheme that operated under the name Credit Development International ("CDI"). For an initial payment of \$130 and subsequent monthly payments of \$30, consumers could join CDI's "Platinum Infinity Reward Program" and become a participant in its "3x7 Forced Matrix" -- a structure that promised commissions going seven layers deep and that required each participant to recruit just three new members. CDI represented that participants could earn more than \$18,000 per month in this program.

Besides the promise of high profits, the real attraction of CDI was its offer of an unsecured Visa or MasterCard, with a \$5000 credit limit and a low 6.9%

annual financing rate. This offer was especially attractive to consumers with poor credit histories, to whom CDI advertised saying "Guaranteed Approval, No Security Deposit! No Credit Check, No Income Verification and Bankruptcies No Problem!"⁽³⁶⁾

CDI representatives claimed that they could offer such attractive terms because they had a special marketing relationship with a large overseas bank, the Banque Nationale de Paris (BNP). According to the transcript of a taped sales meeting, CDI hinted that a broad conspiracy prevented U.S. banks from offering such favorable terms. A CDI representative claimed, "normal banks do not want people to know that they could have a 6.9 [percent] credit card."⁽³⁷⁾ In the same meeting, CDI painted itself an alternative to a regular bank and said "our whole concept is to have the largest membership credit union in the world."⁽³⁸⁾ "We're the bank."⁽³⁹⁾

In fact, according to the Commission's evidence, CDI had no business relationship with Visa, MasterCard, or BNP, and no relationship with any bank willing to issue credit cards to CDI members. Our evidence also showed that the defendants likely misled the one bank with which they did have a relationship. When investors paid by credit card to join CDI, the defendants apparently processed these payments, not through CDI but through a different "front" company with a VISA merchant account. Consequently, the defendants put their own merchant bank at risk for any charge backs that VISA might credit to angry investors.

In the end, CDI members never received their credit cards, and according to a Commission economist, at least 89 percent of them would never have made enough money to recoup their initial investment. Last autumn, the Commission obtained a temporary restraining order and a preliminary injunction against the CDI defendants, as well as a freeze over their assets. The Commission estimates that over the five-month life of CDI, more than 30,000 consumers from the U.S., Europe, Australia, and Southeast Asia lost \$3 to \$4 million dollars in this alleged scam. The matter is still in litigation; the Commission is now seeking to amend its complaint and name additional defendants.

In the largest pyramid case brought by the Commission in the 1990s, we witnessed how pyramid operators often try to use the international banking system to hide their assets. In FTC v. Fortuna Alliance,⁽⁴⁰⁾ the defendants allegedly promised consumers that, for a payment of \$250, they would receive profits of over \$5,000 per month. The program spawned numerous web sites on the Internet and victimized thousands of investors across 60 different countries. Although the defendants initially operated out of the United States, the Commission discovered they had secreted millions of dollars to offshore bank accounts in Antigua. But international cooperation saved the day. With the aid of the courts and banks in Antigua, the Commission obtained an order against the defendants, requiring them to repatriate over \$2 million in offshore assets and pay approximately \$7 million in redress to consumers from 60 countries.

Consumer Education

Law enforcement is the cornerstone of the Commission's fight against pyramid schemes; however, we also try to educate the public so that they can protect themselves. In our educational efforts, we have tried to take a page from the con artists' book and use new online technology to reach consumers and new entrepreneurs. For example, on the agency's web site at "www.ftc.gov", the Commission has posted several alerts regarding pyramid schemes and multilevel marketing problems. The Commission records over 2 million "hits" on its home page every month and receives several thousand visitors on its pyramid and multilevel marketing pages.

The staff of the Commission also has posted several "teaser" web sites, effectively extending a hand to consumers at their most vulnerable point -- when they are surfing areas of the Internet likely to be rife with fraud and deception. The "Looking for Success" site is one example. It advertises a fake pyramid scheme. The home page of "Looking for Success" promises easy money and talks in glowing terms about achieving "financial freedom." On the second page, the consumer finds a payout plan common to pyramid schemes, as well as typical buzz words like "forced matrix," "get in early," and "downline." Clicking through to the third and final page in the series, however, brings the consumer to a sobering warning: "If you responded to an ad like this one, you could get scammed." The warning page provides a hyper-text link back to FTC.GOV, where consumers can learn more about how to avoid pyramid schemes.

Business Education

In an effort to provide information to new entrepreneurs, especially those who may unwittingly violate the law, the Commission has conducted a number of "Surf Days" on the Internet. The first Surf Day, conducted in December 1996, focused on pyramid schemes. Commission attorneys and investigators enlisted the assistance of the SEC, the U.S. Postal Inspection Service, the Federal Communications Commission, and 70 state and local law enforcement officials from 24 states. This nationwide ad hoc task force surfed the Internet one morning, and in three hours, found over 500 web sites or newsgroup messages promoting apparent pyramid schemes. The Commission's staff e-mailed a warning message to the individuals or companies that had posted these solicitations, explaining that pyramid schemes violate federal and state law and providing a link back to FTC.GOV for more information.

In conjunction with the New York Attorney General's Office and the Interactive Service Association, the Commission announced the results of Internet Pyramid Surf Day at a televised press conference in New York City. A month later, the Commission's investigative staff revisited web sites or newsgroups identified as likely pyramids during Surf Day and found that a substantial number had disappeared or improved their representations and claims made to consumers.

More recently in October 1997, the Commission helped coordinate the first "International Internet Surf Day." Agencies from 24 countries joined this effort and targeted "get-rich-quick" schemes on the Internet, including pyramid schemes.⁽⁴¹⁾ Australia's Competition and Consumer Commission oversaw the world-wide effort while the FTC led the U.S. team consisting of the SEC, the Commodities Futures Trading Commission ("CFTC") and 23 state agencies.

In February of this year, the Commission announced yet another innovative use of the Surf Day concept, this time targeting deceptive e-mail solicitations. The Commission collects unsolicited commercial e-mail from annoyed consumers and other sources. A large percentage of these e-mails contain apparent chain letters or pyramid schemes. The Commission searched its e-mail database, topic by topic, and along with the Postal Inspection Service sent a warning letter to over 1000 individuals or companies identified as potentially responsible for promoting pyramids or other get-rich-quick schemes.

Looking Ahead

Unfortunately, pyramid schemes are likely to continue to proliferate both here and abroad in the near future. However, we can all help stem the tide by working together. Members in the banking or financial sector can help law enforcement agencies in several ways. First, if your country does not have a law that makes pyramid schemes illegal, you should encourage your government to enact the necessary legislation and provide sufficient resources for enforcers to pursue pyramid schemes. Associations of reputable bankers or insurers, whose businesses can be jeopardized by the illicit schemes of unlicensed insurers or securities dealers, can be effective allies.

Recent history in Eastern Europe makes it only too clear that pyramid schemes exploit the absence of a fully-functioning market, adequate supervision, and/or an effective legal infrastructure. Second, you can report any suspect investment programs or potential pyramid schemes. Any information can help, and you may be able to provide valuable insight into who is operating a pyramid, how it works, and whom it victimizes. In the Cano case, it was the substantial assistance of financial fraud investigators at VISA that enabled the Commission to develop and bring its case. Third, help us and others foreign enforcers to identify and freeze defendants' assets located in your countries. Understandably, banks must observe their privacy laws, but to the extent it is legally possible for you to provide assistance in tracing and freezing the assets of pyramid operators, you will benefit all our citizens. This is often the only way to halt an illegal scheme and return money to victims. We hope that the Fortuna Alliance case signals the beginning of a trend in obtaining valuable help from foreign courts and banks.

Finally, you can encourage the relevant officials in your countries to combat pyramid schemes by educating consumers and businesses about how to recognize and avoid this type of fraud. This can be particularly important in emerging markets, where

experience with investment opportunities may be scarce.

Here are some tips that consumers and business might find helpful.

1. *Beware of any plan that makes exaggerated earnings claims, especially when there seems to be no real underlying product sales or investment profits. The plan could be a Ponzi scheme where money from later recruits pays off earlier ones. Eventually this program will collapse, causing substantial injury to most participants.*

2. *Beware of any plan that offers commissions for recruiting new distributors, particularly when there is no product involved or when there is a separate, up-front membership fee. At the same time, do not assume that the presence of a purported product or service removes all danger. The Commission has seen pyramids operating behind the apparent offer of investment opportunities, charity benefits, off-shore credit cards, jewelry, women's underwear, cosmetics, cleaning supplies, and even electricity.*

3. *If a plan purports to sell a product or service, check to see whether its price is inflated, whether new members must buy costly inventory, or whether members make most "sales" to other members rather than the general public. If any of these conditions exist, the purported "sale" of the product or service may just mask a pyramid scheme that promotes an endless chain of recruiting and inventory loading.*

4. *Beware of any program that claims to have a secret plan, overseas connection or special relationship that is difficult to verify. Charles Ponzi claimed that he had a secret method of trading and redeeming millions of postal reply coupons. The real secret was that he stopped redeeming them. Likewise, CDI allegedly represented that it had the backing of a special overseas bank when no such relationship existed.*

5. *Beware of any plan that delays meeting its commitments while asking members to "keep the faith." Many pyramid schemes advertise that they are in the "pre-launch" stage, yet they never can and never do launch. By definition pyramid schemes can never fulfill their obligations to a majority of their participants. To survive, pyramids need to keep and attract as many members as possible. Thus, promoters try to appeal to a sense of community or solidarity, while chastising outsiders or skeptics. Often the government is the target of the pyramid's collective wrath, particularly when the scheme is about to be dismantled. Commission attorneys now know to expect picketers and a packed courtroom when they file suit to halt a pyramid scheme. Half of the pyramid's recruits may see themselves as victims of a scam that we took too long to stop; the other half may view themselves as victims of government meddling that ruined their chance to make millions. Government officials in Albania have also experienced this reaction in the recent past.*

6. *Finally, beware of programs that attempt to capitalize on the public's interest in hi-tech or newly deregulated markets. Every investor fantasizes about becoming wealthy overnight, but in fact, most hi-tech ventures are risky and yield substantial profits only after years of hard work. Similarly, deregulated markets can offer substantial benefits to investors and*

consumers, but deregulation seldom means that "everything goes," that no rules apply, and that pyramid or Ponzi schemes are suddenly legitimate.

Conclusion

As we continue to pursue pyramid schemes, we would be delighted to coordinate our efforts with law enforcement in your countries. It is only too evident that the expansion of fraud across borders and on the World Wide Web means that no one agency or country can work effectively on its own. We must be collectively vigilant in order to protect the integrity of our marketplaces and the pocketbooks of our consumers.

References

- The views I give, of course, are my own and do not reflect the official views of the Commission or any particular Commissioner.
- Barbara Rudolph, Poof Go the Profits . . ., Time, Aug. 8, 1994 at 44.
- Assume a pyramid scheme in which each person recruits 10 new people. There would be one person at the top, 10 beneath her, 100 beneath them, 1,000 beneath them and so forth. The pyramid would involve everyone on earth in just 10 layers of people with one con artist on top. The bottom layer would have more than 4.5 billion people. The Skeptic's Dictionary at "http://wheel.vcdavis.edu/nbtcarroll/skeptic/pyramid.html"
- Some people also refer to multilevel marketing as direct selling or network selling.
- See Mark C. Knutson, "The Ponzi Scheme," published online at "http://www.usinternet.com/users/mcknutson/pscheme.htm".
- Id.
- See e.g., SEC v. Int'l Loan Network, Inc., 770 F. Supp. 678 (D.D.C 1991), aff'd, 968 F.2d 1304 (D.C. Cir. 1992)..
- See e.g. U.S. v. Crowe, 4:95CR-13-C (W.D. Ky. 1995) (charging an alleged pyramid promoters with mail fraud under 18 U.S.C. § 1341; securities fraud under 15 U.S.C. § § 78j(b), 78ff, 17 C.F.R. § 240.10b-5, and 18 U.S.C. § 2; and money laundering under 18 U.S.C. § § 2, 1957.)
- Cal. Penal Code § 327 (Deering 1996)
- 720 Ill. Compiled Stat. Ann. 5/17-7 (Michie 1997) (formerly Ill. Rev. Stat., ch. 38, para. 17/7 (1993))
- Ga. Code Ann. § 10-1-410 (1997)
- 15 U.S.C. § 45 (1997)
- See Thomas P. Rowan, Report, Confronting the Pyramid Hazard in the United States 15 (submitted to Prof. Robert Vaughn, Wash. College of Law, Am. U.) (1998) (citing Joseph N. Mariano & Mario Brossi, Multilevel Marketing: A Legal Primer 29 (2d ed. 1997)).
- 86 F.T.C. 1106 (1975), aff'd sub. nom. Turner v. FTC, 580 F.2d 701 (D.C. Cir. 1978).
- Id. at 1108-110 (complaint).
- See e.g., Webster v. Omnitrition Int'l, Inc., 79 F.3d 776, 781-82 (9th Cir. 1996), cert. denied, 117 S. Ct. 174, ___ U.S. ___ (1996).
- Koscot 86 F.T.C. at 1180.
- Id. at 1181.
- 93 F.T.C. 618 (1979)
- Id. at 710-14.
- Id. at 729-33.
- Id. at 715-17
- Id. See Rowan at 18-21 (analyzing the Amway decision).
- 79 F.3d 776, 781-82 (9th Cir. 1996), cert. denied, 117 S. Ct. 174, ___ U.S. ___ (1996).
- Id. at 783.
- Id. at 783-84.
- Tom Hundley, Always Poor, Albanians Go for Broke, Chicago Tribune, Feb. 11, 1997 at 18.
- Id. For an analysis of the effect of pyramid and Ponzi schemes on Eastern Europe's insurance market, see Int'l Chamber of Commerce, Pyramid sales of insurance policies condemned, Business World, July 9, 1997 at "http://www.iccwbo.org/html/pyramid.htm".
- Ram Avrahami, FTC Workshop on Consumer Information Privacy, Transcript of June 12, 1997 at 107.
- See FTC v. Affordable Media, LLC, Civil Action No. CV-S-98-00669-LDG) (D. Nev. filed April 23, 1998); FTC v FutureNet, Inc., No. 98-1113 FHK (AIJx) (C.D. Cal. filed Feb. 17, 1998); FTC v. Cano, No. (C.D. Cal. filed Oct. 29, 1997); FTC v. Jewelway Int'l Inc., No. CV-97-383 TUC JMR (D. Ariz. filed June 24, 1997); FTC v. World Class Network, Inc., No. SAV-97-162 AHS (Ebx) (C.D. Cal. filed Feb. 28, 1997); FTC v. Mentor Network, Inc., No. SACV 96-1104 LHM (Eex), (C.D. Cal. filed Nov. 5, 1996); FTC v. Global Assistance Network for Charities, No. CIV 96-2494 PHX RCB (D. Ariz. filed Nov. 5, 1996); FTC v. Fortuna Alliance, L.L.C., No. C96-799M (W.D. Wash. filed May 23, 1996).
- Based on complaints the FTC has filed, the Internet was a major recruiting tool used in FutureNet, Cano, World Class Network, Mentor Network, Global Assistance Network for Charities, and Fortuna Alliance.
- See, FTC, FutureNet Defendants Settle FTC Charges: \$ 1 Million in Consumer Redress for "Distributors", Apr. 8, 1998 at "/opa/9804/futurenet.htm" (press release).
- Int'l Loan Network, 770 F. Supp. at 678.
- Knutson, supra, note 5.
- Cano, supra, note 30.
- Exhibits in Support of Motion for TRO and Asset Freeze, Ex. 2, Attachments 2, 7, Cano, supra, note 30.
- Exhibits in Support of Motion for TRO and Asset Freeze, Ex. 2, Attachment 5 at 141, Cano, supra, note 30 (transcript of sales presentation) [hereafter "Transcript"].
- Id. at 86.
- Id. at 110.
- Fortuna Alliance, supra, note 30.
- International participants included Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Hungary, Ireland, Jamaica, Japan, Korea, Mexico, New Zealand, Norway, the Philippines, Poland, Portugal, South Africa, Spain, Sweden, Switzerland, and the United Kingdom.

Appendix 10E: Some Important MLM Cases

OFF-SHORE MLM – U.S. v. Fortuna⁴³⁹

In February, 1997, the FTC reached a settlement with Fortuna Alliance. This is how the FTC's formal press release described the FTC action:

INTERNET PYRAMID OPERATORS, FORTUNA ALLIANCE, COULD RETURN OVER \$5 MILLION TO CONSUMERS

"Consumers who lost money investing in an illegal pyramid scheme on the Internet will recover their funds, under a settlement obtained by the Federal Trade Commission and the scheme's promoters, and Fortuna Alliance. Under the settlement, every Fortuna member is entitled to receive a refund in full for their membership fees.

"In the complaint detailing the charges, the FTC charged that Fortuna Alliance, L.L.C., and four officers, marketed the pyramid scheme through a home page on the World Wide Web and with printed promotional materials. Using fabulous earnings claims, they induced tens of thousands of consumers in over 60 countries around the world to pay between \$250 and \$1750 to join their pyramid scheme, claiming that members would receive over \$5,000 per month in 'profits' as others were induced to 'enroll.' In addition, Fortuna and its officers provided advice and promotional materials for members to recruit others to join the pyramid, both through direct contact and by setting up their own web sites. The FTC's complaint asked the court to order a permanent halt to the alleged deceptive practices and to order redress for the people Fortuna signed up to the scheme.

"The redress program will offer consumers who invested in the scheme, including foreign nationals, full refunds for membership fees they paid. The money will come from a fund initially using money frozen in the U.S. and \$2.8 million

transferred from Antigua, W.I. If this is insufficient to meet refund requests, defendants will pay additional money to ensure full refunds for all who seek them. Consumers who receive refunds from the \$2 million already distributed will not receive further payments. The FTC expects refund notices to be sent out by the end of March."

For Release: November 17, 1997

FTC SETTLEMENT WITH JEWELWAY INTERNATIONAL DEFENDANTS NETS \$5 MILLION IN CONSUMER REDRESS

The Federal Trade Commission has settled charges against JewelWay International, Inc., and its corporate officers in an agreement requiring a \$5 million payment, which will be distributed to harmed consumers, and provisions halting the challenged conduct. In June of this year, the FTC charged JewelWay and six individual defendants with making deceptive earnings claims, and promising lucrative earnings and other benefits to induce almost 200,000 consumers to invest more than \$1000 per person in an illegal multi-level marketing plan, or pyramid scheme. The suit was filed as part of the FTC's "Project Field of Schemes" - a sweep targeted at investment-related fraud.

Legitimate multi-level marketing plans are a way of making retail sales of products or services to consumers through a network of representatives. However, in an illegal pyramid scheme the main focus is not on sales, but on recruiting new representatives into the program. Typically, each new representative must buy a certain amount of products and must recruit a specified number of new participants in order to earn money in the program. **In a pyramid scheme there is almost no emphasis on making retail sales of products to persons who are not participants in the program.** According to an FTC expert, earnings claims made in conjunction with promoting a pyramid scheme are false because pyramids inevitably collapse when no new participants can be recruited and approximately 90% (or possibly more) of the participants consequently lose their money.

⁴³⁹ Source: Jeffrey A. Babener, Babener & Associates 121 SW Morrison, Suite 1020, Portland, OR 97204 *Jeffrey A. Babener, the principal attorney in the Portland, Oregon law firm of Babener & Associates, represents many of the leading direct selling companies in the United States and abroad. Website URL for article – <http://www.mlmllegal.com/fortuna.html>*

On June 24, the FTC filed charges against JewelWay International, Inc., Bruce A. Caruth, Robert J. Charette, Jr., Donilyn A. Walden, Greg G. Stewart, Angela D. Charette, and Beverly Stewart. The JewelWay case was part of "Project Field of Schemes," a campaign comprised of nearly 61 law-enforcement actions with a major consumer education component.

In its complaint against JewelWay, the FTC alleged that the defendants were operating a pyramid scheme because their promotional efforts focused primarily on recruiting and not on retail sales to non-participants. The FTC further alleged that the defendants made deceptive earnings claims in order to induce consumers to make a token purchase of jewelry and become a JewelWay representative able to recruit additional participants for the company. A judge immediately issued a temporary restraining order freezing the defendants' assets and placing the company into receivership. On July 1, 1997, the defendants agreed to a preliminary injunction that corrected the allegedly illegal conduct.

The FTC's settlement has been submitted to the court and requires the court's approval to become binding. The settlement would require defendants Caruth, Robert and Angela Charette, and Walden to pay \$5 million in redress to the approximately 150,000 representatives who invested in JewelWay's program but earned no money. The monies would be due within five days from the date the court enters the order.

In addition, the settlement would prohibit all defendants and JewelWay representatives from operating any pyramid schemes, and:

- **prohibit them from misrepresenting the potential earnings, sales, discounts, benefits, or upgrades that a consumer can obtain, the value of any product or service offered by the company, or any other material fact;**
- prohibit them from representing that the defendants have received the approval or endorsement of the Federal Trade Commission for any product or service marketed or sold by any defendant;
- **prohibit the defendants from requiring a person to make a product purchase in order to become a participant in the program or to receive a particular level of compensation in the plan. In addition, statements suggesting that it would be beneficial to make a purchase in order to participate in the program are prohibited;**
- require the defendants to implement a refund program under which consumers will receive a 100 percent refund of the product purchase price for returns made within 60 days of the date of delivery and a 90 percent refund for returns made within 61 days to one year of the date of delivery if merchandise is returned in resalable condition. In addition, the defendants would be required to give consumers a 100 percent refund for defective products if a request is made within 60 days of delivery;
- **require the defendants and program participants to disclose the percentage of all representatives in the program who have received a particular reward (e.g., a specific income level, car or home allowance, vacation package) at the time a claim is made regarding income potential or likelihood of earning other types of rewards;**
- require the defendants to redeem any currently existing or prospectively issued gift or product certificate for products unless an expiration date is clearly stated on the certificate and the expiration date has passed;
- require the defendants to review all representatives' advertisements before allowing the ads to run;
- require the defendants to obtain from each new representative a signed verification form, which the defendants must review before depositing any of the representative's money, to ensure that none of the prohibited claims were made (if the defendants do not receive a completed verification form from a consumer, the purchase price must be refunded);
- require the defendants to institute a monitoring program to ensure that their representatives are complying with the settlement provisions, to investigate and resolve promptly all consumer complaints, and to submit to the FTC data concerning the total amount of retail sales made by representatives on an annual basis; and
- **require the defendants to implement a 90 day "cooling off" period, under which the purchaser of JewelWay's jewelry cannot join the company as a representative for 90 days (the FTC said this provision will allow purchasers time to become**

acquainted with the product before committing to the network and, in conjunction with the refund policy, will bar high pressure sales tactics).

Finally, the settlement would require the defendants to post the injunctive provisions of the settlement on the World Wide Web, distribute a copy of these provisions to all of their employees, and send a letter describing the misrepresentations and practices prohibited by the settlement agreement to all active representatives, which could total more than 40,000.

The FTC's Denver Regional Office handled this case.

The Commission vote to approve the settlement for filing in court was 4-0. The stipulated final judgment was filed on November 17, 1997, in the U.S. District Court for the District of Arizona, in Tucson.

NOTE: This consent judgment is for settlement purposes only and does not constitute an admission by the defendants of a law violation. Consent judgments have the force of law when signed by the judge.

Copies of the proposed settlement and other documents associated with Project "Field of Schemes," are available from the FTC's Public Reference Branch, Room 130, 6th Street and Pennsylvania Avenue, N.W., Washington, D.C. 20580; 202-326-2222; TTY for the hearing impaired 1-866-653-4261. To find out the latest FTC news as it is announced, call the FTC's NewsPhone recording at 202-326-2710. FTC news releases and other materials also are available on the Internet at the FTC's World Wide Web Site at: <http://www.ftc.gov> . . .

(Civil Action No. CV-97-383 TUC JMR)
(FTC Matter No. X970054)

WORLD CLASS NETWORK
For Release: November 26, 1997
DEFENDANTS IN FTC CASE
TARGETING MULTI-LEVEL
MARKETING OF TRAVEL
BUSINESS OPPORTUNITY AND
PYRAMID SCHEMES AGREES TO
SETTLE CHARGES

Jerome L. Goldberg has agreed to settle Federal Trade Commission charges stemming from his involvement with World Class Network, Inc., a multi-level marketer of travel agent credentials and a work-at-home travel agency business opportunity, which was **charged by the Federal Trade Commission as part of "Operation Trip-Up," a March 1997 crackdown on travel-related fraud.** Goldberg is the former owner of World Class Travel, L.L.C., which purportedly provided support and ticketing for World Class Network's distributor/travel agents.

The proposed settlement with Goldberg and World Class Travel would prohibit the defendants from participating in any pyramid marketing program, and would prohibit them from misrepresenting potential earnings, benefits or other material facts in connection with the sale of a travel agent business opportunity.

On Feb. 28, the FTC filed charges against World Class Network, Inc. (WCN), of Irvine, California; World Class Travel, L.L.C., of Calabasas, California; and the following officers: WCN Board Chairman Daniel R. Dimacale and Secretary Denise L. Dimacale, both of Newport Beach; WCN Executive Vice President and CFO Robert C.K. Lee, Mission Viejo; WCN President and CEO Howard K. Cooper, of Woodland Hills; and World Class Travel Chairman and CEO Jerome L. Goldberg, of Oxnard. In its court complaint in the WCN case, the FTC alleged that the defendants offered a travel tutorial kit that purportedly would allow purchasers to receive the professional courtesy discounts and upgrades traditionally available to travel agents on their own travel accommodations, and to operate and achieve specified earnings in an at-home travel business. Distributors also could receive commissions by recruiting new distributors and reselling the tutorial to these recruits. In fact, the FTC charged, purchasers could not obtain the promised discounts and upgrades for personal travel because many travel industry service providers did not recognize World Class Network's proprietary I.D. and the travel tutorials were inadequate to allow purchasers to open and operate a functioning business. A judge immediately issued a temporary restraining order halting the challenged practices, freezing the defendants' assets, and placing the companies into receivership. WCN, the Dimacales, Lee and Cooper have previously settled charges with the FTC, and have agreed to pay more than \$3 million into a consumer redress fund. The money will be used to provide refunds to many of the more than 51,000

consumers who purchased World Class Network's travel tutorial.

The proposed settlement with Goldberg and World Class Travel, which requires approval of the court, would prohibit the defendants from:

- **engaging in any pyramid schemes, which the settlement defines as a program where a distributor's income is derived from commissions for recruiting additional distributors;**
- **misrepresenting the potential earnings, sales, discounts, upgrades or benefits that a consumer can obtain, that the defendants have received the approval or endorsement of the Federal Trade Commission, or any other material fact; and**
- **failing to disclose, in connection with any earnings claims they make, the number of purchasers who make at least the amount claimed and the percentage of total purchasers who earn that amount.**

Finally, the proposed settlement contains a number of recordkeeping and reporting requirements designed to assist the FTC with monitoring compliance with its terms.

The FTC vote to approve the settlement for filing in court was 4-0. It was filed today in U.S. District Court for the Central District of California, in Los Angeles.

NOTE: The stipulated final judgment is for settlement purposes only and does not constitute an admission by the defendant of a law violation. The judgments have the force of law when signed by the judge.

For Release: April 8, 1998

FutureNet Defendants Settle FTC Charges; \$1 Million in Consumer Redress for Distributors

Operators of FutureNet, an alleged pyramid scheme, agreed to settle Federal Trade Commission charges that their scheme violated federal law. The settlement provides \$1 million for consumer redress, bans the defendants from participating in any pyramid, Ponzi or chain-marketing scheme, bars them from selling distributorships through multi-level marketing, and

requires that they obtain a bond that starts at \$100,000 and ratchets up to \$1,000,000 as sales increase, before operating any multi-level marketing program for goods or services in the future.

On February 17, the FTC filed charges against Valencia, California-based FutureNet, Inc., FutureNet Online, Inc., and five corporate officers seeking a permanent injunction against future violations and refunds for investors. On February 23, the court issued a temporary restraining order, freezing the defendants' assets and appointing a receiver for the corporate defendants. On March 3, 1998, the Court modified the order substituting a monitor for the receiver and **allowing the defendants to resume the sale of goods and services, but only to persons not participating in defendants' marketing program -- in effect maintaining the injunction against pyramiding included in the initial restraining order.** The stipulated final judgment announced today would settle charges with FutureNet, Inc., FutureNet Online, Inc., and two corporate officers: Alan J. Setlin and Chris Lobato. Three other defendants, Larry Huff, Robert Depew and David Soto, did not settle the FTC charges and the FTC's case against them will proceed to trial.

According to the FTC's complaint, FutureNet, Inc. claimed that its recruits could earn substantial income for the rest of their lives by joining a multi-level marketing program selling Internet access devices. Consumers paid fees ranging from \$195 to \$794 to become Future-Net distributors in the scheme, which was promoted on the Internet. But, according to the FTC, **a major portion of the income the defendants promised was not based on sales of the devices, which are easily available at other retail distributors, including Sears and Circuit City, at comparable or lower prices. Instead, the promised income came from fees paid by newly recruited distributors who would then bring on more recruits to provide a nonstop "downstream" of paying members.** FutureNet claimed that their recruits -- so called "Internet Consultants" -- would receive \$200 - \$400 when they personally recruited another consultant, and \$25 - \$50 when a person in their downline recruited a new member. **The agency charged that income from the FutureNet multilevel marketing plan did not depend on sales of the Internet devices they were purportedly selling, but rather on the recruitment of new distributors -- the typical profile of an illegal pyramid. Since almost 90 percent of investors in any pyramid program actually lose money, the defendants' earnings claims were false, and violated federal law, the**

FTC alleged. In addition to the pyramid based on Internet access devices, the defendants, prior to the initiation of the FTC action, also had started another, similar program to be based upon sales of deregulated electric power, even though no state had deregulated the sale of electric power at the time defendants began to offer this program.

The settlement announced today would:

- require \$1,000,000 for consumer redress;
- **prohibit the defendants from engaging in any pyramid scheme, which the settlement defines as a program where a distributor's income is primarily derived from commissions for recruiting additional distributors;**
- **prohibit the defendants from selling distributorships through multi-level marketing, which the settlement defines as a program whereby distributors' income is derived primarily from the sale of goods or services, rather than from commissions for recruitment;**
- require them to review all distributors' advertisements before allowing the ads to run;
- **prohibit misrepresentations about earnings or sales and require that if the defendants make specific earnings claims, they must disclose the number and percentage of distributors who achieved those earnings or the stated level of sales figures;**
- require the defendants to be registered with appropriate state utilities offices before engaging in the sale of electric power;
- require the defendants to implement a refund program for future investors under which they will refund 100 percent when requested within 60 days of payment, and 100 percent less a 10 percent restocking fee when requested from 61 days to a year;
- **require the defendants to obtain a completed written verification form from investors before they collect payment, to assure that no one in the marketing structure made any of the prohibited claims;**
- require the defendants to post a performance bond starting in the amount of \$100,000 in order to continue to operate FutureNet. Under the terms of the agreement, the amount of the bond will increase as new distributors sign up for FutureNet, to a maximum \$1,000,000.

This bond would be used for consumer redress in the event of future violations of the FTC order;

- prohibit the defendants from hiring any individual banned from multi-level marketing business by a court, at the request of the FTC. The FTC is currently seeking such a ban against the defendants who are not part of the settlement announced today.

In addition, the agreement contains recordkeeping provisions to allow the Commission to monitor compliance.

The proposed stipulated final judgment and order was submitted today to the Honorable George H. King, U. S. District Court Judge for the Central District of California, in Los Angeles. It is subject to court approval.

NOTE: This stipulated final judgment is for settlement purposes only and does not constitute an admission by the defendant of a law violation. Consent judgments have the force of law when signed by the judge.

Copies of the complaint and [stipulated final judgment](#) are available from the FTC's web site at <http://www.ftc.gov> and also from the FTC's Consumer Response Center, Room 130, 6th Street and Pennsylvania Avenue, N.W., Washington, D.C. 20580; 202-FTC-HELP (202-382-4357); TDD for the hearing impaired 1-866-653-4261. To find out the latest news as it is announced, call the FTC NewsPhone recording at 202-326-2710. . . (FTC File No. X98 0022)

Release: August 9, 1999

FTC, Six States Sue Equinox International; Law Enforcers Ask Court to Halt Illegal Pyramid Operation

The Federal Trade Commission and law enforcement authorities from Hawaii, Maryland, Nevada, North Carolina, Pennsylvania and South Carolina have asked a U.S. District Court in Las Vegas to halt the allegedly illegal operations of Equinox International Corporation; Advanced Marketing Seminars, Inc.; BG Enterprises, Inc.; and William Gould, their principal. In a suit filed jointly with the states, the FTC alleged that the defendants operated an illegal pyramid scheme, made deceptive earnings claims, and provided distributors with the means and instrumentalities to violate federal law. State law enforcers alleged violations of state securities laws, deceptive trade practices laws, false advertising laws, pyramid laws, and licensing requirements laws. At the request of the FTC and state enforcers, District Court Judge Johnnie B. Rawlinson has issued a Temporary Restraining Order, frozen the defendants' assets and

appointed a receiver, pending trial. The law enforcers have asked the court to enjoin the alleged illegal pyramid operations permanently and order consumer redress. Five states also have asked the court to award civil penalties for violations of state laws.

The companies and their principal are based in Las Vegas, Nevada.

According to allegations in the complaint filed with the Court, Equinox operated a multi-level marketing company which offered distributorships for products including water filters, vitamins, nutritional supplements, and skin care products. Equinox distributors ran classified ads in the "Help Wanted" sections of newspapers which implied that a salaried position was being offered. Persons who responded to the ads were instead given a sales presentation designed to recruit new distributors. The complaint further alleges that Equinox told the recruits that they could earn money by selling products or recruiting but emphasized that the real way that Equinox distributors make money is through recruiting, not through sales. New recruits were encouraged to purchase \$5,000 worth of products so they could enter the program at the manager level, to rent desk space for \$300 to \$500 a month, to subscribe to a phone line so they could begin recruiting others, and to attend seminars designed to train them. The seminars cost between \$300 and \$1000 and stressed that distributors could make substantial amounts of money. **The complaint alleges that a very small percentage of distributors who became participants in the Equinox program actually made more money than they expended for front-end expenses, and that a vast majority of distributors discontinued their participation in the program with little or no earnings. The complaint also alleges that while Equinox purported to link compensation to retail sales, it did not enforce the policies and requirements ostensibly designed to assure such sales. "The result of the structure and operation of the program is that financial gains to Equinox participants are primarily dependent upon the continued, successive recruitment of other participants, and retail sales are not required as a condition precedent to realization of such financial gains," the complaint says.**

The FTC alleged that the deceptive earnings claims made by Equinox are false and misleading and violate federal law. By furnishing distributors with promotional materials that contain false and misleading information, including the deceptive earnings claims, Equinox has supplied the means for the distributors, themselves, to violate federal law. The defendants represented that everyone who participates in the program will receive substantial income, instead of disclosing that many participants will not. That material misrepresentation violates federal law, according to the complaint. Finally, the FTC and states alleged that the program is actually a pyramid scheme and violates the FTC Act.

The FTC and state enforcers have asked the court to permanently enjoin the defendants' operation and order consumer redress. The states of Hawaii,

Maryland, Nevada, and North Carolina, and the Commonwealth of Pennsylvania also have asked the court to order civil penalties.

The complaint was filed in U.S. District Court for the District of Nevada, in Las Vegas, on August 3, under seal. The seal was lifted August 6.

<http://www.ftc.gov/opa/1999/08/equinox1.shtml>

For Release: April 25, 2000

Equinox International Settles Case with FTC, Eight States – Nearly \$40 Million in Restitution for Alleged Pyramid Victims

Consumers who lost money investing in a pyramid scheme they thought was a legitimate multi-level marketing business, will share in as much as \$40 million dollars under the terms of a settlement between the Federal Trade Commission and law enforcement authorities from eight states, and William Gould and Equinox International of Las Vegas, Nevada. The settlement also will bar Gould from any future involvement in any multi-level marketing scheme, for life, and requires dissolution of Equinox, Advanced Marketing Seminars, Inc. and BG Management, Inc. **Gould and Equinox faced charges by the FTC and law enforcement authorities from Hawaii, Maryland, Michigan, Nevada, North Carolina, Pennsylvania, Tennessee, and Virginia.**

In a suit filed jointly with the states on August 3, 1999 **the FTC alleged that the defendants operated an illegal pyramid scheme, made deceptive earnings claims, and provided distributors with the means and instrumentalities to violate federal law. State law enforcers alleged violations of state securities laws, deceptive trade practices laws, false advertising laws, pyramid laws, and licensing requirements laws.** Private class action plaintiffs' lawyers also joined the suit. At the request of the FTC and state law enforcers, a U.S. District Court in Las Vegas halted the allegedly illegal operations of Equinox International Corporation; Advanced Marketing Seminars, Inc.; BG Management, Inc.; and William Gould, their principal, froze the defendants' assets, and appointed a receiver, pending trial. The trial began April 3, 2000. The settlement announced today will end the trial process.

The terms of the settlement bar Gould, for life, from engaging in any multi-level marketing operations. It also provides that cash and corporate and individual assets will be placed in the hands of the court-appointed receiver for liquidation. The assets have an estimated book value of nearly \$50 million, and once liquidated are expected to yield approximately \$40 million. Proceeds from the sale of assets will be used for consumer redress and payment of certain court-approved expenses, including the payment of states plaintiffs' fees and costs and fees and costs to defendants' and private class action plaintiffs' lawyers.

Redress will be paid by the court-appointed receiver following what likely will be months of accounting and liquidation proceedings. Consumers who believe that they are eligible to participate in the redress distribution may check on the status of these proceedings by visiting the Federal Trade Commission's website, www.ftc.gov, or calling the FTC's Equinox hotline, 202-326-2103.

The provisional stipulated final judgment and order was filed on April 20, 2000 by Judge Johnnie B. Rawlinson, and the full text of the order and the consent agreement is available on the FTC's website (www.ftc.gov). The court will hold a fairness hearing before entering a final order.

<http://www.ftc.gov/opa/2000/04/equinox.shtm>

For Release: March 27, 2001

Bigsmart Pyramid Promoters Settle FTC Charges \$5 Million for Consumer Redress

Operators of an Internet-based business opportunity that promised easy income for investors in an Internet shopping mall network have agreed to settle Federal Trade Commission charges that their scheme was an illegal pyramid operation. Under the terms of the settlement, Bigsmart.Com L.L.C. and principals Mark and Harry Tahilian will provide up to \$5 million in consumer redress and post a \$500,000 performance bond before engaging in any new multi-level marketing activity. The defendants also are prohibited from engaging in any illegal pyramid schemes.

Bigsmart is based in Mesa, Arizona.

According to the FTC complaint detailing the charges, Bigsmart marketed Internet theme "malls" that it claimed would enable investors to earn substantial income from commissions on products purchased through the Internet. The malls were a collection of links to retail sites maintained by independent third-party merchants, such as MarthaStewart.com, and to a "Superstore" maintained by Bigsmart, itself. Traffic was directed to the malls through the personalized Bigsmart "welcome pages" that members bought access to for a \$10 application fee and a \$99.95 "hosting" fee. Although Bigsmart claimed that members would make substantial amounts of money, **the scheme was structured in such way that to realize continued financial gains, would depend on ". . . the continued, successive recruitment of other participants," not on retail sales of products and services to the public. The FTC charged that the claims that consumers who invested in Bigsmart**

would make substantial income were false; that promotional materials that made the false and misleading claims provided the means and instrumentalities for others to deceive consumers; and that Bigsmart was actually a pyramid scheme. All three were violations of the FTC Act.

To settle the FTC charges, Bigsmart and the Tahilianis will provide up to \$5 million in consumer redress. They also will be required to post a \$500,000 performance bond before engaging in any new multi-level marketing activity.

Consumers who believe they may qualify to receive consumer redress should call 202-326-3294.

This case was brought with the invaluable assistance of the Offices of the Attorney General of Texas and the Wisconsin Department of Agriculture, Trade, & Consumer Protection, Division of Trade & Consumer Protection. It was filed in U.S. District Court for the District of Arizona, March 12, 2001.

NOTE: A Stipulated Final Judgment and Order is for settlement purposes only and does not constitute an admission by the defendant of a law violation. Consent judgments have the force of law when signed by the judge.

Copies of the Stipulated Final Judgment and Order are available from the FTC's web site at <http://www.ftc.gov> and also from the FTC's Consumer Response Center, Room 130, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. The FTC works for the consumer to prevent fraudulent, deceptive and unfair business practices in the marketplace and to provide information to help consumers spot, stop and avoid them. To file a complaint, or to get free information on any of 150 consumer topics, call toll-free, 1-877-FTC-HELP (1-877-382-4357). The FTC enters Internet, telemarketing and other fraud-related complaints into Consumer Sentinel, a secure, online database available to hundreds of civil and criminal law enforcement agencies worldwide.

Skybiz - For Release: June 18, 2001 **Court Appoints Temporary Receiver over International Pyramid Operation**

**Illegal Scheme Claims It Is Operating in 200
Countries World Wide**

The Federal Trade Commission has asked a U. S. District Court Judge to halt the unlawful operations of SkyBiz.com, **charging that the operation that purports to sell online tutorials on Web-based products is actually a massive illegal pyramid scheme which may have conned consumers around the world out of approximately \$175,000,000.** At the request of the FTC, Chief Judge Terry C. Kern has temporarily halted all unlawful activities of the SkyBiz operation, frozen the defendants' assets to preserve them for consumer redress, and appointed a receiver, pending the preliminary injunction hearing scheduled for June 26, 2001.

The FTC suit was filed in U. S. District Court in the Northern District of Oklahoma. The corporate and individual defendants are based in Tulsa. The corporate entities named in the suit include: SkyBiz.com, Inc; World Service Corporation; Nanci Corporation International; and WorldWide Service Corporation. Several individual defendants were also named, including: James S. Brown; Stephen D. McCullough; Elias F. Masso; Nanci H. Masso; Kier E. Masso; and Ronald E. Blanton.

In papers filed with the court, the FTC alleges that since late 1998, the defendants have promoted a work-at-home business opportunity with claims of quick riches. One SkyBiz presentation claimed, *"This system was put together by a gentleman named Eric Rasmussen who basically joined SkyBiz and six months later was able to retire with an income of about 400,000 a month. Currently, [he] lives in the Gold Coast of Australia and he's making 76,000 a week and growing."* **In in-person sales presentations, seminars, teleconferences, Web site presentations and in other marketing material, the defendants touted the opportunity to earn thousands of dollars a week by recruiting new "Associates" into the program. They provided CD-Roms, computer disks, videos and books promoting the SkyBiz programs and they provide a PowerPoint presentation on their website that can be downloaded to aid in recruiting new members. The cost to join the SkyBiz Program is \$125, ostensibly used to buy an "e-Commerce Web Pak," but in reality was to purchase the right to receive compensation for recruiting additional participants. Participants were urged to invest in more than one "Web Pak," to maximize their earning potential.**

The FTC charged that the claims that consumers who invested in SkyBiz would make substantial income were false; that failure to disclose that most people in pyramid schemes lose money is deceptive; that defendant provided the means and instrumentalities for others to deceive consumers by providing speakers and promotional materials that made the false and misleading claims; and that SkyBiz was actually an illegal pyramid scheme. All four violate the FTC Act.

The complaint was filed by the FTC in U.S. District Court for the Northern District of Oklahoma on May

30, 2001, under seal. The seal was lifted June 8, 2001.⁴⁴⁰

<http://www.ftc.gov/opa/2001/06/sky.shtm>

For Release: August 4, 2003

Court Halts Trek Alliance Pyramid Scheme

A federal district court judge has issued a preliminary injunction halting the alleged illegal activities of Trek Alliance, freezing its assets and those of its principals pending trial, and appointing a receiver to oversee the business assets. **In his order, Judge J. Spencer Letts barred the defendants from making misrepresentations about the potential earnings, financial gain, or benefits of any multi-level marketing program, business investment opportunity, or pyramid marketing scheme. In addition, the order prohibits the defendants from participating in any illegal pyramid schemes. The order also prohibits the defendants from failing to disclose all information material to a consumer's decision to participate in such programs.**

Defendants also are prohibited from falsely representing that salaries or permanent employment opportunities are available. **Finally, the defendants are prohibited from making any false or misleading representation of material fact in connection with the advertising, promotion, marketing, distribution, offering for sale or sale of any good or service.**

Judge Letts, of the United States District Court for the Central District of California in Los Angeles, found that there is good cause to believe that defendants have violated Section 5(a) of the FTC Act, and that the FTC is likely to prevail on the merits of this action. The parties will continue to conduct discovery, after which a trial will be scheduled.

In December 2002, **the Federal Trade Commission sued the California-based operation for using deceptive earnings claims to lure recruits into investing hundreds or thousands of dollars in their illegal scheme.** The FTC charged that Trek Alliance was patterned after Equinox International, an

⁴⁴⁰ *F.T.C. v. Skybiz.Com, Inc., et al.* (Dist. Ct., N.D. Oklahoma)

operation that in April 2000 agreed to liquidate assets worth roughly \$40 million to settle charges by the FTC and eight state attorneys general that it was operating an illegal pyramid scheme. Two of the four individual defendants associated with Trek were top distributors with Equinox.

According to the FTC, Trek Alliance operated a multilevel marketing company that offered distributorships for products including water filters, cleaning products, and nutritional supplements. The FTC alleged that Trek distributors ran classified ads in the "Help Wanted" sections of newspapers that implied that they were offering salaried positions. According to the FTC, **people who responded to the ads were instead given a sales presentation designed to recruit new distributors. The FTC alleged that Trek told recruits that they could earn money by selling products or recruiting, but emphasized that more money could be made through recruiting.** The recruits were expected to attend training seminars around the country, **purchase hundreds of dollars worth of products so they could enter the program at a higher level,** rent desk space in regional offices, and subscribe to phone lines so they could begin recruiting others, all at their own expense. **While the company promised monthly incomes ranging from \$2,000 to \$20,000, the FTC complaint alleged that the vast majority of consumers made less money than they had paid for front-end expenses, and that many made little or nothing. The complaint also alleged that compensation was not sufficiently linked to retail sales, and that Trek did not adequately enforce policies and requirements that were ostensibly designed to assure such a link.**

The FTC charged that Trek's earnings claims, as well as its claims implying that employment opportunities were available, were false. The FTC also charged that the defendants deceptively failed to disclose that most investors would not make substantial income. Finally, the FTC alleged that the program is a pyramid scheme and most participants lose money. The practices violate federal law, the complaint says. The FTC has asked the court to permanently enjoin the defendants' deceptive practices and to order consumer redress as final relief in the matter.

The FTC's complaint names as defendants Trek Alliance Inc., Trek Education Corporation, VonFlagg Corporation, and individual defendants J. Kale Flagg, Harry Flagg, and Richard and Tiffani Von Alvensleben.

BurnLounge, Inc.:

For Release: June 12, 2007

FTC Asks Court to Shut Down Illegal Pyramid Operation

On June 6, 2007, the FTC filed a complaint in the U.S. District Court for the Central District of California against BurnLounge, Inc. **The complaint charges that BurnLounge sold opportunities to operate on-line digital music stores that was, in fact, an illegal pyramid scheme.** The agency is seeking a permanent halt to the illegal pyramid practices as well as other illegal practices alleged in the complaint.

According to the FTC, BurnLounge recruited consumers through the Internet, telephone calls, and in-person meetings. The sales pitch represented that participants in BurnLounge were likely to make substantial income. BurnLounge recruited participants by selling them so-called "product packages," ranging from \$29.95 to \$429.95 per year. More expensive packages purportedly provided participants with an increased ability to earn rewards through the BurnLounge compensation program.

The BurnLounge compensation program primarily provided payments to participants for recruiting of new participants, not on the retail sale of products or services, which the FTC alleges would result in a substantial percentage of participants losing money.

The FTC specifically alleges that the defendants operate an illegal pyramid scheme, make deceptive earnings claims, and fail to disclose that most consumers who invest in pyramid schemes don't receive substantial income, but lose money, instead. These practices violate the FTC Act, the agency alleges.

The FTC has asked the court to halt the deceptive practices and misrepresentations and to freeze the defendants assets, pending a trial, to preserve them for consumer redress. At a hearing on the FTC's request for a temporary restraining order, on June 8, 2007, BurnLounge's attorneys asked for more time to respond fully, and U. S. District Court Judge George Wu ordered that a full hearing on the FTC's request for a preliminary injunction and asset freeze be held

on June 19, 2007, after which he will rule on the FTC's requests.

In addition to naming BurnLounge, Inc., a Delaware corporation based in New York City, the Commission's complaint also names: Juan Alexander Arnold, of Studio City, California; John Taylor, of Houston, Texas; Rob DeBoer of Irmo, South Carolina; and Scott Elliott of Forney, Texas.

This case was brought with the invaluable assistance of the Office of the Attorney General of South Carolina.

Over the last 10 years, the Commission has halted 17 pyramid schemes and has collected almost \$90 million in consumer redress and tens of millions of additional dollars in suspended judgments.

Copies of the legal documents associated with this case are available from the FTC's Web site at <http://www.ftc.gov> and also from the FTC's Consumer Response Center, Room 130, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. **The FTC works for the consumer to prevent fraudulent, deceptive, and unfair business practices in the marketplace and to provide information to help consumers spot, stop, and avoid them.** To file a complaint in English or Spanish or to get free information on any of 150 consumer topics, call toll-free, 1-877-FTC-HELP (1-877-382-4357), or use the complaint form at <http://www.ftc.gov/ftc/complaint.shtm>. The FTC enters Internet, telemarketing, identity theft, and other fraud-related complaints into Consumer Sentinel, a secure, online database available to more than 1,600 civil and criminal law enforcement agencies in the U.S. and abroad.

More on BurnLounge:

For Release: 03/14/2012

FTC Action Leads to Court Order Shutting Down Pyramid Scam. Thousands of Consumers Burned by BurnLounge

At the request of the Federal Trade Commission, a U.S. district court judge has ordered the operators and top promoters of a deceptive pyramid scheme to pay a total of \$17 million to refund consumers who were burned by the scam. [The court order permanently halts marketing methods used by the operation known as BurnLounge](#), which lured more than 56,000 consumers from around the country by masquerading as a legitimate multi-level marketing program and making misleading claims about earnings to be made.

The FTC [filed a complaint against BurnLounge](#) in 2007 as part of its [ongoing efforts to protect consumers from fraud and deception](#).

BurnLounge had touted itself as a cutting-edge way to sell digital music through multi-level marketing, but music sales accounted for only a small percentage of its sales. The agency charged that BurnLounge recruited consumers from across the country by telling them that participants earned huge incomes. Investors could buy into the BurnLounge organization for prices ranging from \$29.95 to \$429.95, plus monthly fees. While participants were compensated for music and album sales, most compensation came from recruiting others into the plan.

The FTC [charged the defendants with operating an illegal pyramid scheme](#), with making deceptive earnings claims, and with failing to disclose that most consumers who participated in pyramid schemes wouldn't receive substantial income, but instead would lose money. The agency charged that the practices violate federal law.

The court's final judgment and order bars the defendants from engaging in pyramid, Ponzi, or chain letter schemes or any schemes in which compensation for recruitment is unrelated to the sale of product to customers who are not participants. The order bars misrepresentations about multi-level marketing operations or business ventures, including misrepresentations about sales, income, profitability, or legality of the operations. If the defendants make claims about earnings, sales, or profits, the order requires them to disclose the number and percentage of participants in the business venture who have earned, sold or profited that much.

Finally, the court ordered the defendants to pay, collectively, close to \$17 million for consumer redress. BurnLounge, Inc., and Juan Alexander Arnold were ordered to pay \$16,245,799. John Taylor was ordered to pay \$620,138 and Rob DeBoer was ordered to pay \$150,000. Standard bookkeeping and record keeping requirements in the order will allow the FTC to monitor compliance.

In June 2007, another defendant in the pyramid scheme, Scott Elliott, settled the FTC's charges against him. The settlement barred him from participating in any pyramid scheme or other prohibited marketing scheme, barred false earning claims, and required him to give up \$20,000 in ill-gotten gains.

This case was filed in U.S. District Court for the Central District of California, Western Division.

History of BurnLounge case:

**Federal Trade Commission, Plaintiff,
v. BurnLounge, Inc., a corporation,
Juan Alexander Arnold, an individual,
John Taylor, an individual, Rob
DeBoer, an individual, and Scott
Elliott, an individual, Defendants
(United States District Court for the Central
District of California, Western Division)**

**Chapter 2 Case No. 2:07-cv-03654-GW-FMO
FTC File No. 062 3201**

Chapter 3 July 2, 2012

- [Notice](#) of Plaintiff Federal Trade Commission's Cross-Appeal

Chapter 4 March 14, 2012

- [Amended Final Judgment and Order](#) for Permanent Injunction and Other Equitable Relief Against Defendants Burnlounge, Inc., Juan Alexander Arnold, John Taylor and Rob Deboer
- [News Release](#)

Chapter 5 August 4, 2011

- [Order](#) Granting Defendants' Ex Parte Application Vacating Entry of Judgment and Setting Briefing Schedule on Objections

Chapter 6 July 25, 2011

- [Final Judgment and Order](#) for Permanent Injunction and Other Equitable Relief Against Defendants Burnlounge, Inc., Juan

Alexander Arnold, John Taylor and Rob Deboer

Chapter 7 July 1, 2011

- [United States District Court Statement of Decision](#)

Chapter 8 July 1, 2008

- [Stipulated Final Order](#) for Permanent Injunction and Other Equitable Relief Against Defendant Scott Elliott

Chapter 9 August 8, 2007

- Stipulated Preliminary Injunction as to [Defendant Rob DeBoer](#)
- Stipulated Preliminary Injunction Order with Asset Freeze, Required Accounting and Other Equitable Relief as to [Defendant John Taylor](#)

Chapter 10 July 9, 2007

- [Stipulated Preliminary Injunction](#)
- [Stipulated Preliminary Injunction Order](#) with Asset Freeze, Required Accounting, and Other Equitable Relief as to Defendant Scott Elliott

Chapter 11 June 12, 2007

- [Complaint](#) for Injunctive and Other Equitable Relief
- [Memorandum](#) of Points and Authorities In Support of Plaintiff's Application for Temporary Restraining Order With Conduct Prohibitions and Asset Freeze, Order to Preserve Records and Provide Business and Financial Information, and Order to Show Cause Why A Preliminary Injunction Should Not Issue
- [News Release](#)

YTB – "YourTravelBiz.com

Brown Sues To Topple Online Pyramid Scheme, Aug. 2008

(News Release August 05, 2008, Office of the Attorney General – Edmond G. Brown, Jr.) California Attorney General Edmund G. Brown Jr. today announced a lawsuit against ourTravelBiz.com for operating a "gigantic pyramid scheme" that recruited tens of thousands of members with deceptive claims that members could earn huge sums of money through its online travel agencies.

"YourTravelBiz.com operates a gigantic pyramid

scheme that is immensely profitable to a few individuals on top and a complete rip-off for most everyone else," Attorney General Brown said. "Today's lawsuit seeks to shut down the company's unlawful operation before more people are exploited by the scam."

YourTravelBiz.com and its affiliates operate an illegal pyramid scheme that only benefits members if and when they find enough new members to join the scam. Once enrolled, members who join the pyramid scheme earn compensation for each new person they enlist, regardless of whether they sell any travel. The company lures new members by offering huge income opportunities through online travel agencies yet the typical person actually makes nothing selling travel.

According to company records there were over 200,000 members in 2007 who typically pay more than \$1,000 per year--\$449.95 to set up an "online travel agency" with a monthly fee of \$49.95. In 2007, only 38 percent of the company's members made any travel commissions. For the minority of members who made any travel commission in 2007, the median income was \$39.00--less than one month's cost to keep the Website. There are at least 139,000 of the company's travel Websites, all virtually identical, on the Internet.

YourTravelBiz's extensive marketing materials include videos of people driving Porsches and other luxury cars, holding ten-thousand dollar checks, and claiming to be raking in millions of dollars in profits. The company advertises through its Website www.ytb.com, and at conventions, workshops and nationwide sales meetings which have been held in California locations such as Los Angeles, Sacramento, San Francisco and San Diego.

Brown charges the company, its affiliates, and the company's founders J. Lloyd Tomer, J. Scott Tomer, J. Kim Sorensen and Andrew Cauthen with operating an "endless chain scheme," an unlawful pyramid in which a person pays money for the chance to receive money by recruiting new members to join the pyramid. Brown also charges the company with unfair business practices and false advertising practices including:

- * Deceptive claims that members can earn millions of dollars with the company
- * Operating without filing legally mandated documents with the attorney general and the Department of Corporations
- * Selling an illegal travel discount program

Under California's unfair business practices statute, the company is liable for \$2,500 per violation of law. Attorney General Brown is suing YourTravelBiz.com to get a court order that:

- * Bars the company from making false or misleading statements
- * Assesses a civil penalty of at least \$15,000,000 and at least \$10,000,000 in restitution for Californians who were ripped off by the company.

From August 6 through 10, thousands of members are preparing to travel to St. Louis for a national convention to learn new techniques to recruit more victims into the illegal pyramid scheme. Last year at least 10,000 people attended a similar national conference. For more details on the company's plan to perpetuate its scheme visit:

http://www.yourtravelbiz.com/bizRep/BizReports/BIZREPORT_07-18-08.htm

For more information on pyramid schemes visit: http://ag.ca.gov/consumers/general/pyramid_schemes.php

Consumers who believe they have been bilked by YTB should send a written complaint with copies of any supporting documentation to:

Office of the Attorney General
Public Inquiry Unit, P.O. Box 944255
Sacramento, CA 94244-2550

Or through an on-line complaint form: http://ag.ca.gov/contact/complaint_form.php?cmplt=CL.

Today's lawsuit against YourTravelBiz.com, filed yesterday in Los Angeles Superior Court, also names affiliates which include YTB Travel Network, Inc., YTB Travel Network of Illinois, Inc., as well as the company's founders J. Lloyd Tomer, J. Scott Tomer, J. Kim Sorensen and Andrew Cauthen.

FHTM – Fortune Hi-Tech Marketing

For Release: 01/28/2013

FTC Action Leads Court to Halt Alleged Pyramid Scheme

FHTM Promoted Itself as a Path to Financial Independence, but Most People Made Little or No Money

At the request of the Federal Trade Commission and the states of Illinois, Kentucky, and North Carolina, a federal court has halted an allegedly illegal pyramid scheme pending trial. The FTC and the state attorneys general seek to stop the allegedly illegal practices of the Fortune Hi-Tech Marketing (FHTM) operation, which claimed consumers would make substantial income by joining the scheme. The operation affected more than 100,000 consumers throughout the United States, including Puerto Rico, and Canada. In some areas, including Chicago, the scheme targeted Spanish-speaking consumers.

"Pyramid schemes are more like icebergs," said C. Steven Baker, Director of the FTC's Midwest Region. "At any point most people must and will be underwater financially. These defendants were promising people that if they worked hard they could make lots of money. But it was a rigged game, and the vast majority of people lost money."

According to the complaint filed by the FTC and the state attorneys general, the defendants falsely claimed consumers would earn significant income for selling the products and services of companies such as Dish Network, Frontpoint Home Security, and various cell phone providers, and for selling FHTM's line of health and beauty products. Despite FHTM's claims, nearly all consumers who signed up with the scheme lost more money than they ever made. To the extent that consumers could make any income, however, it was mainly for recruiting other consumers, and FHTM's compensation plan ensured that most consumers made **little or no money, the complaint alleged.**

“This is the beginning of the end for one of the most prolific pyramid schemes operating in North America,” Kentucky Attorney General Jack Conway said. “This is a classic pyramid scheme in every sense of the word. The vast majority of people, more than 90 percent, who bought in to FHTM lost their money.”

As alleged in the complaint, FHTM promoted itself as a way for average people to achieve financial independence. Some FHTM representatives claimed they earned more than 10 times as much as their previous earnings in their second and subsequent years with FHTM. One person claimed that another representative earned more than \$50,000 in his sixth month and millions of dollars in subsequent years. Another person promoted a recruitment meeting on her Twitter account, stating, “Bring ur friends & learn how 2 make \$120K aYR.” At its 2012 national convention in Dallas, FHTM called its top 30 earners to the stage to present them with a mock-up of a \$64 million check, which several of them shared as a photo on social networking websites.

To participate in the scheme, consumers paid annual fees ranging from \$100 to \$300. To qualify for sales commissions and recruiting bonuses, they had to pay an extra \$130 to \$400 per month and agree to a continuity plan that billed them monthly for products unless they canceled the plan. Those who signed up more consumers and maintained certain sales levels could earn promotions and greater compensation, but contrary to FHTM's claims, the complaint alleged, its compensation plan ensured that, at any given time, most participants would spend more money than they would earn.

According to the complaint, recruits were told they could earn high commissions by selling products to people outside the operation, but instead only minimal compensation was paid for sales to non-participants, and few products were ever sold to anyone other than participants. The scheme provided much larger rewards for recruiting people than for selling products, and more than 85 percent of the money consumers made was for recruitment.

In addition to charging the defendants with operating an illegal pyramid scheme and making false earnings claims, the FTC charged them with furnishing consumers with false and misleading

materials for recruiting more participants. The attorneys general offices of Illinois, Kentucky and North Carolina joined the FTC complaint, as well as alleging violations of their respective state laws.

The defendants are Paul C. Orberson, Thomas A. Mills, Fortune Hi-Tech Marketing Inc., FHTM Inc., Alan Clark Holdings LLC, FHTM Canada Inc., and Fortune Network Marketing (UK) Limited. On January 24, 2013, the court halted the deceptive practices, froze the defendants' assets, and appointed a temporary receiver over the corporations pending a trial.

The Commission vote, including Commissioner J. Thomas Rosch, authorizing the staff to file the complaint was 5-0. The complaint was filed in the U.S. District Court for the Northern District of Illinois, Eastern Division.

For more information about the case, in English and Spanish, consumers can call 202-326-2643.

For release August 20,2015

Vemma Agrees to Ban on Pyramid Scheme Practices to Settle FTC Charges

Health drinks marketer touted unlimited income potential, but most people lost money

TAGS: deceptive/misleading conduct Bureau of Consumer Protection Southwest Region Consumer Protection Going into Business

Under a settlement with the Federal Trade Commission, Arizona-based Vemma Nutrition Company will end the business practices that the FTC alleged created a pyramid scheme.

The multi-level marketing (MLM) company, which sells health and wellness drinks through a network of distributors called “affiliates,” will be prohibited under a federal court order from paying an affiliate unless a majority of that affiliate’s revenue comes from sales to real customers rather than other distributors. The order also bars Vemma from making deceptive income claims and unsubstantiated health claims.

“Unfortunately, extravagant income claims and compensation plans that reward recruiting over sales continue to plague the MLM industry,” said Jessica Rich, Director of the FTC’s Bureau of Consumer Protection. “MLM companies must ensure that their promotional materials aren’t misleading, and that their compensation programs focus on selling goods or services to customers who really want them, not on recruiting more distributors.”

In August 2015, the FTC brought a federal court action against Vemma Nutrition Company, Vemma International Holdings, Inc., CEO Benson K. Boreyko and top affiliate Tom Alkazin. The companies’ “Young People Revolution” campaign targeted college students

and other young adults with materials that presented Vemma as a profitable alternative to traditional employment and depicted young affiliates surrounded by conspicuous displays of wealth, such as luxury automobiles and yachts. Vemma allegedly failed to disclose that the program's structure ensured that most participants would not earn substantial income, and provided affiliates with false and misleading materials for recruiting others.

According to the complaint, the defendants encouraged participants to buy products to qualify for bonuses and to recruit others to do the same. The result, the agency alleged, was a pyramid scheme that compensated participants mainly for recruiting others rather than for retail sales based on legitimate consumer demand for the products.

Vemma expanded throughout the U.S and several foreign countries and took in more than \$200 million a year in revenue in 2013 and 2014.

Under the stipulated order announced today, the Vemma companies and Boreyko are banned from any business venture that:

pays any compensation for recruiting new participants;

ties a participant's compensation or an ability to be compensated to that participant's purchases; or

pays a participant compensation related to sales in a pay period unless the majority of the revenue generated during that period, by the participant and others the participant has recruited, comes from sales to non-participants.

The order also bars these defendants from involvement in any pyramid, Ponzi, or chain marketing schemes and prohibits them from making misrepresentations about the profitability of business ventures or the health benefits of products. The order imposes a \$238 million judgment that will be partially suspended upon payment of \$470,136 and the surrender of certain real estate and business assets. It also requires Vemma to provide compliance reports from an independent auditor for 20 years.

A separate order provides similar conduct provisions against Vemma affiliate Tom Alkazin and his wife, Bethany Alkazin and imposes a judgment of more than \$6.7 million, which will be partially suspended upon payment of more than \$1.2 million and the surrender of certain real estate and business assets.

The Commission vote approving the stipulated final orders was 3-0. The orders were filed in the U.S. District Court for the District of Arizona on December 15, 2016.

To learn more about multilevel marketing, read *Multi-level Marketing and Business Opportunity Scams*. For other recent enforcement actions by the FTC regarding multilevel marketing, see *Herbalife and FHTM*.

For release July 15, 2016

Herbalife Will Restructure Its Multi-level Marketing Operations and Pay \$200 Million For Consumer Redress to Settle FTC Charges

Company must tie distributor rewards to verifiable retail product sales and stop misleading consumers about potential earnings

Herbalife International of America, Inc., Herbalife International, Inc., and Herbalife, Ltd. have agreed to fully restructure their U.S. business operations and pay \$200 million to compensate consumers to settle Federal Trade Commission charges that the companies deceived consumers into believing they could earn substantial money selling diet, nutritional supplement, and personal care products.

In its complaint against Herbalife, the FTC also charged that the multi-level marketing company's compensation structure was unfair because it rewards distributors for recruiting others to join and purchase products in order to advance in the marketing program, rather than in response to actual retail demand for the product, causing substantial economic injury to many of its distributors.

"This settlement will require Herbalife to fundamentally restructure its business so that participants are rewarded for what they sell, not how many people they recruit," FTC Chairwoman Ramirez said. "Herbalife is going to have to start operating legitimately, making only truthful claims about how much money its members are likely to make, and it will have to compensate consumers for the losses they have suffered as a result of what we charge are unfair and deceptive practices."

According to the FTC's complaint, Herbalife claims that people who participate can expect to quit their jobs, earn thousands of dollars a month, make a career-level income, or even get rich. But the truth, as alleged in the FTC complaint, is that the overwhelming majority of distributors who pursue the business opportunity earn little or no money.

For example, as stated in the complaint, the average amount that more than half the distributors known as "sales leaders" received as reward payments from Herbalife was under \$300 for 2014. According to a survey Herbalife itself conducted, which is described in the complaint, Nutrition Club owners spent an average of about \$8,500 to open a club, and 57 percent of club owners reported making no profit or losing money.

The small minority of distributors who do make a lot of money, according to the complaint, are compensated for recruiting new distributors, regardless of whether those recruits can sell the products they are encouraged to buy from Herbalife.

Finding themselves unable to make money, the FTC's complaint alleges, Herbalife distributors abandon Herbalife in large numbers. The majority of them stop ordering

products within their first year, and nearly half of the entire Herbalife distributor base quits in any given year.

The settlement announced today requires Herbalife to revamp its compensation system so that it rewards retail sales to customers and eliminates the incentives in its current system that reward distributors primarily for recruiting. It mandates a new compensation structure in which success depends on whether participants sell Herbalife products, not on whether they buy products.

For example:

- The company will now differentiate between participants who join simply to buy products at a discount and those who join the business opportunity. “Discount buyers” will not be eligible to sell product or earn rewards.
- Multi-level compensation that business opportunity participants earn will be driven by retail sales. At least two-thirds of rewards paid by Herbalife to distributors must be based on retail sales of Herbalife products that are tracked and verified. No more than one-third of rewards can be based on other distributors’ limited personal consumption.
- Companywide, in order to pay compensation to distributors at current levels, at least 80 percent of Herbalife’s product sales must be comprised of sales to legitimate end-users. Otherwise, rewards to distributors must be reduced.
- Herbalife is prohibited from allowing participants to incur the expenses associated with leasing or purchasing premises for “Nutrition Clubs” or other business locations before completing their first year as a distributor and completing a business training program.

Under the order, Herbalife will pay for an Independent Compliance Auditor (ICA) who will monitor the company’s adherence to the order provisions requiring restructuring of the compensation plan. The ICA will be in place for seven years and will report to the Commission, which shall have authority to replace the ICA if necessary.

The settlement also prohibits Herbalife from misrepresenting distributors’ potential or likely earnings. The order specifically prohibits Herbalife from claiming that members can “quit their job” or otherwise enjoy a lavish lifestyle.

In addition, the order imposes a \$200 million judgment against Herbalife to provide consumer redress, including money for consumers who purchased large quantities of Herbalife products (such as many Nutrition Club owners, among others) and lost money. Information on the FTC’s redress program will be announced at a later date.

The Commission votes authorizing the staff to file the complaint and stipulated final order, and to issue a Statement of the Commission, were 3-0. The complaint and the stipulated final order will be filed shortly in the U.S. District Court for the Central District of California.

NOTE: Stipulated final orders or injunctions, etc. have the force of law when approved and signed by the District Court judge.

NOTES FROM JON TAYLOR:

It is quite clear from analysis of the complaints against the above MLM companies – as compared with standard industry practices – that the violations listed are prevalent throughout the MLM industry. In fact, these same complaints could be levied against literally hundreds of MLMs that use the same endless chain “income opportunity” recruitment model with a pay-to-play, top-weighted compensation plan.

The reasons for such selective enforcement of existing statutes and rules are as follows:

Failure to address the inherent flaws in MLM as a business model; i.e., unlimited recruitment of a whole network of endless chains of participants as primary customers, the assumption of an infinite market and a virgin market, etc. (See Chapter 2.)

FTC officials have been led to believe that there are “good MLMs” and “bad MLMs,” based on certain behavioral characteristics. What should be considered are (1) focus on recruitment over sales to non-participating consumers, (2) misrepresentations regarding income potential, (3) requiring purchases of products and services as conditions to qualify for commissions and/or rank advancement, (4) extraordinary rewards of those at the top of the pyramid of participants that are unrelated to sales of products. etc.

The FTC has been “captured” by the very type of industry it was established to protect against – unfair and deceptive acts or practices in the marketplace. It has capitulated to the DSA/MLM (pyramid) lobby to the point that it is to some extent controlled by it. This was most evident when the FTC bowed to pressure from the DSA/MLM lobby to exempt MLMs from having to provide transparency to protect consumers in its Business Opportunity Rule, which went into effect in 2012.⁴⁴¹

⁴⁴¹ A complete history and analysis of rulemaking for this rule is found in my book REGULATORY CAPTURE: The FTC’s Flawed Business Opportunity Rule, published in 2015. Available for free download from the author’s web site at mlm-thetruth.com.

The Koscot model remains the best, clearest method for distinguishing between legitimate MLM programs and pyramid schemes. The Amway model has proven to be a failure.

Appendix 10F: The Pyramid Scheme Industry: Examining Some Legal and Economic Aspects of Multi-Level Marketing *[excerpts]*

Excerpts from a “white paper” released March 13, 2014, by plaintiff attorney Douglas M. Brooks, who has represented distributors in major class actions against MLM companies; Bruce Craig, who served as Assistant Attorney General for Wisconsin and who prosecuted landmark landmark pyramid cases; and Robert L. FitzPatrick, president of Pyramid Scheme Alert

NOTE: A lengthy analysis of the profitability (or lack thereof) of three of the largest MLMs – Amway, NuSkin, and Herbalife – in the original report is not included here because a much more extensive analysis is given in Chapter 7 of this book, using data from 50 MLMs, and the conclusions is the same: MLM is profitable only for those at the top of their respective pyramids.

Summary

- The so-called "Amway rules" are inadequate, ambiguous and ineffective in ensuring that MLM compensation is based on actual retail sales to consumers and protecting participants from losses.
- The FTC should follow its earlier Koscot decision, which prohibits payment of MLM compensation unless based on actually consummated retail sales to persons who are not participating in the plan.
- The FTC's current practice of prosecuting MLM pyramid schemes on a case by case basis permits substantial losses to occur before the scheme is shut down; pre-sale disclosures are essential.

The announcement on March 12, 2014, that Herbalife Ltd. ([HLF](#)) had received a Civil Investigative Demand from the Federal Trade Commission caps a twenty-two month period during which persistent questions have been raised concerning the purported business opportunity known as multi-level marketing (MLM). While much of the financial media has recently been focused on the Herbalife story, the problems with MLM are not new, and they are not limited to Herbalife. As we explain in this paper, there are fundamental problems at the core of the MLM business model, and with the efforts of the FTC to regulate the MLM "industry." The authors of this paper are all members of an international coalition of consumer advocates which, on October 24, 2013, filed a formal petition with the FTC requesting that it investigate the MLM industry

and promulgate regulations to protect consumers from unfair and deceptive MLM business opportunities.^[1] This paper is intended to build on the Petition and to assist legislators, regulators and interested persons to understand the MLM industry and the need for further action.

Why all the fuss over MLM? Why are Wall Street billionaires fighting very public battles over MLM? Is MLM merely a form of direct, person-to-person selling in which independent distributors can earn money both by selling products directly to consumers or by recruiting additional distributors, who can in turn recruit additional distributors and so on? Or is MLM the modern incarnation of the age-old pyramid scheme, masquerading as direct selling? Why is it so difficult to assess whether an MLM firm is operating as a pyramid scheme? Why should we care? . . .

Controversies concerning MLM have intensified over the past several years, as illustrated by the following series of events:

- On May 1, 2012, Herbalife, one of the largest publicly traded MLM firms, held an investor conference call during which David Einhorn of the hedge fund Greenlight Capital, asked several questions concerning the percentage of Herbalife's sales "outside the distributor network," i.e., to consumers.⁴⁴² While Einhorn made no accusations of impropriety and did not reveal any investment thesis, short or long, Herbalife shares plunged

⁴⁴² See <http://www.businessinsider.com/david-einhorn-herbalife-2012-5> (accessed 2/7/14).

20%, apparently in the belief that Mr. Einhorn was shorting Herbalife shares and would publish a detailed analysis supporting his views. Greenlight never did publish any report concerning Herbalife. To date Herbalife has failed to provide any actual data in response to Mr. Einhorn's questions.

- In August of 2012, an independent financial analyst firm, Citron Research, released a report accusing Nu Skin Enterprises ([NUS](#)), another large, publicly traded MLM firm, of operating an illegal pyramid scheme in China.⁴⁴³
- In November of 2012, the U.S. District Court in San Francisco approved a \$55 million class action settlement on behalf of distributors of Quixtar, also known as Amway, the largest and one of the oldest MLM firms.⁴⁴⁴ The plaintiffs had alleged that Quixtar/Amway was an illegal endless chain scheme and that high level Quixtar/Amway distributors made deceptive earnings claims and sold overpriced products and business support materials to lower level distributors.
- In December of 2012, William Ackman and his hedge fund, Pershing Square Capital, made a detailed presentation supporting their thesis that Herbalife, one of the largest MLM firms and a publicly traded company, is a pyramid scheme.⁴⁴⁵ Mr. Ackman stated that Pershing Square had sold short approximately \$1 Billion worth of Herbalife stock. Other investors have come out in support of Herbalife, including Carl Icahn, George Soros, Daniel Loeb and Bill Stiritz.⁴⁴⁶
- In January of 2013, the Federal Trade Commission (FTC), working with regulators in the states of Kentucky, North Carolina and Illinois, shut down an MLM firm called Fortune Hi-Tech Marketing, alleging that it was a

pyramid scheme and that promoters made deceptive earnings claims.⁴⁴⁷

- In April of 2013 Herbalife distributor Dana Bostick filed a class action in the U.S. District Court for the Central District of California (Los Angeles), alleging that Herbalife was violating the California Endless Chain Scheme Law and other claims. The court denied Herbalife's motion to dismiss in October.⁴⁴⁸
- In May of 2013, the CEO of Amway India was arrested for fraud in the Indian state of Kerala.⁴⁴⁹ This was only the latest in a series of legal proceedings involving Amway's subsidiary in India.
- In June of 2013, Representative Linda Sanchez (D.Calif.) sent a letter to the FTC requesting that it investigate allegations that Herbalife is a pyramid scheme that is harming consumers, including low-income Hispanics and African Americans.⁴⁵⁰
- In July of 2013, a group of Hispanic and consumer organizations met with the FTC to request an investigation of Herbalife, arguing that Herbalife was targeting deceptive earnings claims at poor, Hispanic would-be entrepreneurs.⁴⁵¹
- In October of 2013 an international coalition of consumer advocates filed a formal petition with the Federal Trade Commission, urging that the FTC investigate the entire MLM industry and promulgate a trade regulation rule to protect consumers.⁴⁵²
- On January 16, 2014, Chinese regulators announced that they were investigating allegations in the Chinese People's Daily that Nu Skin

⁴⁴³ See http://www.citronresearch.com/page/2/?search-class=DB_CustomSearch_Widget-db_customsearch_widget&widget_number=preset-default&cs-stock_ticker-0=NUS&cs-all-1&search=Search (accessed 2/4/14)

⁴⁴⁴ See <https://quixtarclass.com/Home.aspx> (accessed 2/14/14).

⁴⁴⁵ See <http://factsaboutherbalife.com/> (accessed 2/4/2014).

⁴⁴⁶ See <http://www.businessinsider.com/bill-ackman-herbalife-short-anniversary-2013-12> (providing time line) (accessed 2/4/14).

⁴⁴⁷ See <http://www.ftc.gov/news-events/press-releases/2013/01/ftc-action-leads-court-halt-alleged-pyramid-scheme> (accessed 2/7/14).

⁴⁴⁸ See <http://ftalphaville.ft.com/files/2013/10/Bostick-Order-Denying-Motion-to-Dismiss.pdf> (accessed 2/14/14).

⁴⁴⁹ See <http://www.theverge.com/2013/6/28/4472608/the-indian-express-pyramid-scheme-investigations-amway-herbalife> (accessed 2/7/14).

⁴⁵⁰ See nypost.com/2013/06/13/congresswoman-asks-.../ (accessed 2/14/14).

⁴⁵¹ See <http://articles.latimes.com/2013/jul/19/business/la-fi-herbalife-latino-20130719> (accessed 2/7/14).

⁴⁵² See <http://ftalphaville.ft.com/2013/10/24/1676802/the-ftc-is-standing-in-a-shrinking-circle-of-grey/> (accessed 2/7/14). The authors of this white paper are among the signatories to this petition.

was operating an illegal pyramid scheme in China.⁴⁵³ Shares in Nu Skin dropped 40% over several days; shares in Herbalife and Usana ([USNA](#)), another publicly traded MLM with operations in China, also dropped sharply, despite the absence of any evidence that Chinese regulators were investigating them.

- On January 22, 2014, Senator Edward J. Markey (D. Mass.) requested the FTC and the Securities and Exchange Commission to investigate the business practices of Herbalife.⁴⁵⁴
- On January 28, 2014, the New York Post reported that the Canadian Competition Bureau was investigating allegations that Herbalife was operating a pyramid scheme in Canada.⁴⁵⁵
- On January 29, 2014, Representative Linda Sanchez (D. Calif.) held a briefing for other lawmakers concerning pyramid schemes.⁴⁵⁶
- On February 5, 2014, Hispanic consumer groups met with Edith Ramirez, chair of the FTC, concerning Herbalife.
- On February 18, 2014, the government of India announced that an Inter-Ministerial Group was investigating the functioning of MLM and evaluating the regulatory framework for MLM companies.⁴⁵⁷
- On March 12, 2014, Herbalife announced that it had received a Civil Investigative Demand (CID) from the FTC.⁴⁵⁸ On March 12, 2014, Herbalife announced that it had received a Civil Investigative Demand (CID) from the FTC.⁴⁵⁹ Later, on July 15, 2016, the FTC announced a settlement with Herbalife, requiring a fine of \$200

million in consumer redress and procedures to assure that 80% of its products are being sold to legitimate end users (which can include distributors). Herbalife is also barred from misleading distributors about their earnings potential.

We can answer some of the questions concerning MLM by examining two critical issues:

1. What are the economic consequences for participants in MLM programs? Does MLM actually offer a viable business opportunity to millions of participants? Why do so many MLM participants lose their investments and drop out, while a tiny few gain tremendous rewards? [See Chapter 7]

2. Is the basic business proposition of MLM, as it is generally practiced, legal in America? Should an endless entrepreneurial chain ever be legal, whether presented as a financial investment or as a "business opportunity," where the promise of lucrative returns is funded primarily by contributions from future investors? What is the significance of retail sales to the legal analysis?

. . . [We] examine the legality of MLM, primarily through a series of Federal Trade Commission cases beginning in the 1970's. We conclude that the two seminal FTC cases from the 1970's, Koscot and Amway, present two fundamentally different regulatory approaches to MLM. Both cases assert that for an MLM to be legal the rewards to participants must be based on retail sales. In the Koscot approach the retail sales determination is based on two "bright line" requirements: First, the rewards must be based on "actually consummated" retail sales. Second, retail sales are rigorously defined as sales to persons who are not participants in the MLM plan and who are not purchasing in order to participate. In contrast, the Amway approach permits rewards to be based on distributor *purchases*, with the understanding that those purchases should theoretically result in retail sales *in the future* due to the action of various rules originally adopted by Amway (the 10 customer rule, the 70% rule and the buyback rule, collectively referred to as the "Amway rules") that are supposed to encourage retail sales by distributors. In addition, the Amway model has permitted MLM firms to argue that rewards may be paid on purchases by participants so long as they

⁴⁵³ See <http://online.wsj.com/news/articles/SB1000142405270230373080457935303342418222?mod=djemalertMARKET> (accessed 2/7/14).

⁴⁵⁴ See <http://nypost.com/2014/01/23/senator-delves-deeper-into-herbalifes-business-practices/> (accessed 2/7/14).

⁴⁵⁵ See <http://nypost.com/2014/01/23/senator-delves-deeper-into-herbalifes-business-practices/> (accessed 2/7/14).

⁴⁵⁶ See <http://nypost.com/2014/01/30/pyramid-scheme-tal.../> (accessed 2/14/14).

⁴⁵⁷ See http://www.business-standard.com/article/pti-stories/high-level-img-looking-into-functioning-of-mlm-nbfc-cis-114021800886_1.html (accessed 2/24/14).

⁴⁵⁸ See <http://online.wsj.com/news/articles/SB1000142405270230373080457935303342418222?mod=djemalertMARKET>

⁴⁵⁹ See <http://online.wsj.com/news/articles/SB1000142405270230373080457935303342418222?mod=djemalertMARKET>

are purchasing for their own use, thus obscuring the distinction between MLM participant and retail purchaser.

The Amway decision purported to follow Koscot, and the FTC has cited Koscot in every one of its pyramid scheme prosecutions to this day. However, the practical effect of Amway was to provide MLM firms with an alternative model for compliance that completely undercuts the rationale of Koscot. Under the Koscot model, the bright line rules would enable regulators, MLM firms, investors and prospective distributors to determine whether a particular MLM plan is legal, based solely on examining the MLM compensation plan itself. Under the Amway model, however, the legality of an MLM plan can only be determined by an after-the-fact analysis of whether retail sales are actually taking place. Such an analysis requires a complex, factually intensive investigation that can only be done after the MLM program has been up and running for a time, during which substantial, unrecoverable losses to participants will inevitably occur.

MLM firms have overwhelmingly adopted the Amway model and have incorporated the Amway rules into their distributor contracts. We are not aware of any modern MLM that limits the payment of compensation to consummated retail sales. Moreover, most MLM firms have taken the position that compensation may be paid based on purchases by distributors who are buying for their own use ("internal consumption"), despite substantial FTC and federal court case law to the contrary. Compounding the problem is the fact that MLM firms generally do not collect retail sales data from their distributors. For example, Herbalife, one of the MLM firms discussed in this paper, requires its distributors to maintain retail sales records for two years, and to produce those records to Herbalife on request. But despite repeated questions concerning the extent of retail sales in its network, Herbalife maintains that it does not have "visibility" into this data, which indicates that it has chosen not to collect it.

Based on the tremendous loss rates experienced by MLM distributors, we conclude that the Amway model is a failure. Simply put, the Amway rules do not effectively ensure that compensation to MLM participants is based primarily on retail sales, and have not prevented the substantial losses incurred by

99% of MLM participants. Effective consumer protection can be achieved by returning to a rigorous enforcement of the Koscot approach. Koscot properly recognizes the *inherent* fraudulence of the "endless chain" and permits MLM firms to operate only if their compensation plan does not require any purchase to participate and does not permit the payment of compensation other than on consummated retail sales. Alternatively, if the Amway approach is to be permitted, MLM firms must be required to provide evidence, in the form of distributor retail sales records, that their products are profitably sold on a retail basis to *bona fide* consumers who are not participants in the sales chain.

In addition to ensuring that they are not operating as pyramid schemes, MLM companies must be prevented from making, or allowing their distributors to make, deceptive earnings claims. In the short term this can be accomplished by enforcement actions by the FTC and state regulators, utilizing established precedents for assessing deceptive claims. But enforcement actions are costly and inefficient in protecting consumers from loss. There is no reason why MLM business opportunities should not be subject to pre-sale disclosures similar to those applicable to franchises and other types of business opportunities under the FTC's Franchise Rule and Business Opportunity Rule.

After a brief description of the MLM industry we will address the economics of MLM distributorships, and then examine the legal issues raised by the MLM controversy, and, finally, propose a way out of the morass.

What is Multi-Level Marketing?

The subject of this paper is a form of direct selling known as "multi-level marketing," popularly known as "MLM."¹⁹ The Direct Selling Association ("DSA"), which is the primary MLM industry trade association and lobbying group, states that "[d]irect selling is the sale of a consumer product or service, person-to-person, away from a fixed retail location, marketed through independent sales representatives who are sometimes also referred to as consultants, distributors or other titles."⁴⁶⁰

⁴⁶⁰ See <http://www.directselling411.com/> (accessed 2/4/2014).

While the origins of MLM can be traced back to the 1950's or before, most of the modern MLM "industry" has developed since 1979, when the Amway decision discussed below provided a template for would-be MLM entrepreneurs to follow and, at least facially, distinguish themselves from pyramid schemes.⁴⁶¹ Today, MLM enterprises are soliciting investments from virtually every household in America.

Reliable data concerning the MLM industry is hard to come by, but it is undeniably a large industry affecting tens of millions of consumers who are induced to purchase billions of dollars worth of products and services, ostensibly to resell as MLM distributors. The DSA estimates that in 2012, total sales of the industry were \$31.63 billion, and the total number of MLM distributors was 15.9 million.⁴⁶² The DSA currently has 167 member companies.⁴⁶³ In 2001 an industry expert estimated that there were over 1,000 MLM firms in the United States.⁴⁶⁴ About a dozen MLM firms are publicly traded in the United States, with a combined market capitalization of over \$30 billion.⁴⁶⁵

⁴⁶¹ See generally Keep, William and Peter Vander Nat, "Multilevel Marketing and Pyramid Schemes in the United States: An Historical Analysis" *Journal of Historical Research in Marketing*, Vol 6, Issue 4 (November), 2014 (forthcoming), available at http://business.pages.tcnj.edu/files/2014/02/Keep-and-Vander-Nat_MLM-and-Pyramid-Schemes_Final.pdf

⁴⁶² See <http://www.dsa.org/research/industry-statistics/> (accessed 2/22/14). The term "direct selling" refers to the sale of a consumer product or service, person-to-person, away from a fixed retail location. All MLM programs involve direct selling; however, not all direct selling companies utilize MLM compensation plans. The DSA reports that approximately 95% of its members utilize an MLM type of compensation plan. See <http://www.dsa.org/research/industry-statistics/11gofactsheet.pdf> (accessed 2/22/14).

⁴⁶³ See <http://www.dsa.org/forms/CompanyFormPublicMembers/search?action=find> (accessed 2/22/14).

⁴⁶⁴ See Zig Zigar, John P Hayes, PhD (2001), *Network Marketing for Dummies*. Another source lists over three thousand MLM firms, many of which are apparently defunct.

See <http://www.financialindustryscam.com/mlm.htm>

⁴⁶⁵ Publicly traded MLM firms, and their approximate market capitalizations include Avon ([AVP](#)) (\$6.6 billion); Herbalife (\$6.8 billion); Nu Skin (\$5.1 billion); Tupperware ([TUP](#)) (\$3.9 billion); Primerica ([PRI](#)) (\$2.4 billion); Oriflame ([OTCPK:ORFLY](#)) (\$1.4 billion); Usana (\$1 billion); Medifast ([MED](#)) (\$371.1 million); Nature's Sunshine ([NATR](#)) (\$254 million); Lifevantage

Does MLM Offer a Viable Business Opportunity?

Underlying the legal questions that this paper addresses is the fundamental issue of the *economic viability* of the MLM "business opportunity." The court cases that have been brought against various MLM companies by the FTC, SEC, state Attorneys General and by consumers in class action lawsuits are all founded on the premise that those MLM companies gained their revenues by means of an *inherently unfair and deceptive practice* which caused financial harm to 90-99% of all who invested.⁴⁶⁶ [See Chapter 7] . . .

What does the law say about MLM?

There is no definition of "pyramid scheme" in any federal statute. Both the Federal Trade Commission and the Securities and Exchange Commission have, through prosecutions and case law, developed their concepts of what constitutes a pyramid scheme. The FTC, following its statutory mandate to protect consumers from "unfair or deceptive acts or practices in trade or commerce," has developed a definition applicable to MLM programs through a series of cases beginning in the 1970's. In *Koscot* the Commission stated that:

Such schemes are characterized by the payment by participants of money to the company in return for which they receive (1) the

Corp. ([LFVN](#)) (\$140.3 million); Blyth, Inc. ([BTH](#)) (\$150.2 million); Mannatech ([MTX](#)) (\$52.5 million); Natural Health Trends Corp. ([OTCQB:NHTC](#)) (\$49.3 million); Reliv' Int'l ([RELV](#)) (\$28.1 million); and Forever Green ([OTCQB:FVRG](#)) (\$27 million). Of the companies on this list, at least two, Medifast and Blyth, distribute through multiple channels including MLM, and one, Oriflame, does not distribute in the U.S. Prominent, privately held MLM firms include Amway, Mary Kay, Melaleuca, Monavie, ACN, Shaklee, Sunrider, Pre-Paid Legal, Neways, Market America, Advocare, Arbonne, Xango, Nikken, and Vemma Nutrition Company.

⁴⁶⁶ In a prosecution of Amway by the State of Wisconsin, analysis of the tax returns of Amway distributors indicated that during the two year period 1979-80, **the average Amway "Direct Distributorship" (which collectively comprised the top 1% of all Amway distributors in Wisconsin) had adjusted gross annual income of \$14,389 but after deduction of business expenses incurred a net loss of \$918.** See Complaint in State of Wisconsin v. Amway Corp., et al, No. 589806 (Milwaukee Circuit Court, July 28, 1982). A copy of the Complaint is reproduced in Kerns, Phil, *Fake it Til You Make It!* (Victory Press 1982), pp. 134-46.

right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users. In general such recruitment is facilitated by promising all participants the same 'lucrative' rights to recruit.

In re Koscot Interplanetary, Inc., 86 F.T.C. 1106, 1180 (1975), *aff'd mem. sub nom., Turner v. FTC*, 580 F.2d 701 (D.C. Cir. 1978). The Commission continues to cite the Koscot rule in all of its pyramid scheme prosecutions. See, e.g. *FTC v. Trudeau*, No. 03-C-3904 (N.D.Ill.) (Affidavit of Peter Vander Nat filed Dec. 20, 2013); *FTC v. Burnlounge, Inc.*, No 12-55926 (9th Cir.) (Brief of FTC filed April 1, 2013). The Koscot rule has been followed by the federal courts. *U.S. v. Gold Unlimited*, 177 F.3d 472, 480-81 (6th Cir. 1999); *Webster v. Omnitrition International, Inc.*, 79 F.3d 776, 781-82 (9th Cir. 1996).

The Koscot definition contains three key elements: (1) the participant has the right not only to sell products but to recruit other participants into the program, who in turn have the right to recruit still more participants (the "endless chain" element); (2) the right to participate requires a payment of money (the "payment" element); and (3) the recruitment of new participants results in compensation paid to participants which is unrelated to the sale of product to ultimate users (the "retail sales" element).

Most of the current controversy over MLM operations concerns the retail sales element. Before addressing that element, it is worth discussing the first two elements.

The Endless Chain Element

In all of the recent discussions concerning MLM, the "endless chain" aspect has received very little attention. In part this is because with all of the MLM programs at issue, including those addressed here, it is undisputed that the compensation plans contemplate an endless chain of recruitment, in which each new recruit can only achieve success by recruiting more distributors who will themselves recruit still more distributors. In Koscot the FTC expressed in straightforward terms the fundamental deception at the heart of entrepreneurial chains:

Respondents' marketing plan contemplates upon the payment of consideration, participants would thereby acquire the right to engage in two income-producing activities, one of which contemplated the sale of similar rights to others

for which substantial compensation would be paid, while the other contemplated the sale of products or services. Since implicit in the holding out of such rights is the representation that substantial rewards would be gained therefrom, and since the operation of such plan due to its very structure precludes the realization of such rewards to most of those who invest therein, such plan is inherently deceptive. Furthermore, such plan is contrary to established public policy in that it is generally considered to be unfair and unlawful and is by its very nature immoral, unethical, oppressive, unscrupulous, and exploitative. Therefore, such plan was and is inherently unfair and the operation of the Koscot marketing plan by respondents, having caused substantial injury to the participants therein as well as to other members of the public, constitutes an unfair and deceptive act and practice and an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act.

In re Koscot, 86 F.T.C. at 1180.

The fundamental deception of such a plan seems obvious, yet the FTC seems to have tacitly decided to permit such plans, provided that they do not require a payment to participate and do not pay compensation except on retail sales, as discussed below. In Koscot the FTC noted that even if commissions were based on retail sales, this type of plan would inevitably lead to losses when the newest rank of distributors finally ran out of retail customers:

Indeed, even where rewards are based upon sales to consumers, a scheme which represents indiscriminately to all comers that they can recoup their investments by virtue of the product sales of their recruits must end up disappointing those at the bottom who can find no recruits capable of making retail sales.

In re Koscot, 86 F.T.C. at 1180. The Commission continued:

At the very least we would conclude that a company which offers its distributors substantial rewards for recruiting other distributors, and charges them substantial amounts for this right, creates overwhelming barriers to the development of a sound retail distribution network and resultant meaningful retail sales opportunities for participants. What compels the categorical condemnation of entrepreneurial chains under Section 5 is, however, the inevitably deceptive representation (conveyed by their mere existence)

that any individual can recoup his or her investment by means of inducing others to invest. That these schemes so often do not allow recovery of investments by means of retail sales either merely points up that there is very little positive value to be lost by not allowing such schemes to get started in the first place.

In re Koscot, 86 F.T.C. at 1180-1181.

It may be too late in the regulatory game to simply prohibit endless entrepreneurial chains regardless of how they are structured. But making the legality of such schemes depend on whether participants are paying for the right to earn compensation on ever expanding waves of recruits, or whether the compensation is being paid on retail sales, is putting lipstick on a pig. Moreover, as discussed below, it invites gamesmanship among MLM firms in designing compensation plans which disguise or obscure the fact that participants must pay up in order to "make real money," and which distort the meaning of "retail sales" in order to pay compensation based on inventory investments of participants.

The Payment Element

In Koscot the payment element was defined in Section I.3. of the final order, which prohibited the defendants from:

Requiring or suggesting that a prospective participant or a participant in any merchandising, marketing, or sales promotion program purchase any product or services or pay any other consideration, either to respondents or to any person, in order to participate in said program, *other than payment for the actual cost to respondents*, as determined by generally accepted accounting principles, of those items respondents deem to be reasonably necessary sales materials in order to participate in any manner therein; *Provided, That necessary sales material shall not include any product inventory.*

86 F.T.C. at 1186. Under this definition, a "starter kit" containing, for example, promotional and sales material and perhaps some product samples, purchased by the MLM distributor from the company at cost, would not be considered a "payment." However, this exemption expressly did not apply to "product inventory." Accordingly, any requirement that a distributor purchase inventory should be deemed to be a "payment."

In Koscot, the marketing plan explicitly required participants to make payments for inventory to advance to various levels in the scheme. 86 F.T.C. at 1179. Accordingly, proof of the "payment" element was easily obtained. In contrast, the FTC found that Amway did not impose such requirements. In re Amway, 93 F.T.C. 618, 715-717 (1979). The MLM industry learned this lesson. Most MLM firms require the purchase of a starter kit of some sort (Herbalife calls it an "International Business Pack"; Nu Skin calls it a "Business Portfolio"; Amway has a "Business Services and Support package"), but the cost is usually nominal, less than \$100 and most MLM companies undoubtedly would be prepared to establish that these items are sold "at cost." Moreover, at least in sophisticated MLMs like Herbalife, Nu Skin and Amway, the purchase of a starter kit or its equivalent does not result in the payment of a commission to any upline distributor.

Similarly, most modern MLM firms do not have any explicit inventory purchase requirements; in fact most MLM firms state repeatedly that distributors are not "required" to purchase any inventory. A careful examination of how their compensation plans actually operate, however, demonstrates that as a practical matter there most certainly are inventory purchase requirements. The FTC recognized this phenomenon in a Staff Advisory Opinion dated January 14, 2004, signed by James A. Kohm, Acting Director of Marketing Practices (the "Kohm Letter"), which states in relevant part that:

*"The Commission's recent cases, however, demonstrate that the sale of goods and services alone does not necessarily render a multi-level system legitimate. Modern pyramid schemes generally do not blatantly base commissions on the outright payment of fees, but instead try to disguise those payments to appear as if they are based on the sale of goods or services. The most common means employed to achieve this goal is to require a certain level of monthly purchases to qualify for commissions."*⁴⁶⁷

As discussed above, Herbalife, Nu Skin and Amway all employ variations of the subterfuge identified in the Kohm letter; they all effectively impose product purchase requirements as qualifications for earning commissions based on downline purchases. Accordingly, each of these companies can point to the fact that there are no

⁴⁶⁷ See http://www.mlmmwatchdog.com/files/FTC_Letter.pdf (accessed 2/28/14). As of the date of this paper the Kohm Letter was not available on the FTC's web site, but has been widely circulated.

required purchases to become a distributor. However, in each of these MLM systems, distributors cannot reap the promised benefits unless they purchase a certain volume of products as well as maintain a "group volume." Does the elimination of purchase requirements at the entry level of distributorship rescue them from satisfying the Koscot "purchase element?" Should an MLM firm be able to evade the purchase element by the simple expedient of creating an entry level distributorship whose only purchase requirement is a starter kit? The only Circuit level appeals court which has considered this issue has answered "no:"

Omnitrition argues that because it does not charge for the right to sell its products at the "distributor" level, as a matter of law the first *Koscot* element is not met. We disagree.

Omnitrition's argument improperly focuses only on the "distributor" level of Omnitrition's program. The program is unquestionably *not* a pyramid scheme if only the distributor level is taken into account; the participant pays no money to Omnitrition, has the right to sell products and has no right to receive compensation for recruiting others into the program. The distributor level, however, is only a small part of the entire program. Taking into account the "supervisor" levels, a reasonable jury could conclude the *Koscot* factors are met here.

Webster v. Omnitrition Intern., Inc. 79 F.3d 776, 780-82 (9th Cir. 1996).

The Retail Sales Element

As discussed above, the element of the *Koscot* test which has received the most attention is the payment of compensation unrelated to retail sales. Critically, the final injunction in *Koscot* provided that (A) compensation could only be paid on "actually consummated" sales, and (B) compensation could only be paid on sales to persons who were not participants in the MLM plan.

The key language from the *Koscot* injunction prohibited the defendants from:

2. Offering, operating, or participating in, any marketing or sales plan or program wherein a participant is given or promised compensation (1) for inducing another person to become a participant in the plan or program, or (2) when a person induced by the participant induces another person to become a participant in the plan or program; Provided, That the term

'compensation,' as used in this paragraph only, does not mean any payment based on actually consummated sales of goods or services to persons who are not participants in the plan or program and who do not purchase such goods or services in order to resell them.

86 F.T.C. at 1186. The previously decided *Holiday Magic* case made a similar distinction:

Paragraph II(1) will not prohibit payment of compensation to distributors for recruiting other distributors based on actually consummated sales of such recruits to consumers. We recognize that some incentive is necessary in a direct selling system in which a company lacks resources to hire distributional personnel, to induce distributors to recruit other distributors. Overrides based on actually consummated retail sales of recruits appear to us to be the least potentially pernicious of such incentives, and not subject to the same abuse in which respondents engaged with respect to flat payments or overrides related to inventory purchases. The order would not forbid such payments to compensate distributors for recruiting efforts, but such an incentive structure should help impress upon all participants that their concern must be with retailing or building a retail organization, and not merely with recruiting.

In re *Holiday Magic*, 84 F.T.C. 748, 1043 (1974).

Neither the FTC nor any federal court has explicitly abandoned these two elements of the retail sales requirement. However, the FTC failed to apply them in the infamous *Amway* case.

The Amway Decision

The FTC brought a case similar to *Koscot* against the *Amway* Corporation in 1975. The *Amway* case consumed four years of litigation, thirty contested pretrial orders, a lengthy trial before an administrative law judge with over 150 witnesses and over 1,000 exhibits, and a subsequent appeal to the Commission. In re *Amway*, 93 F.T.C. 618, 630-31 (1979). The Commission ultimately ruled that although *Amway* was using a pyramid structure, it would not be considered an illegal pyramid because it had adopted, and enforced, certain internal rules which were believed to prevent the problems recited in *Koscot*.

The Commission's decision cited the *Koscot* definition, as well as two other pyramid/MLM

cases, *In re Ger-Ro-Mar*, 84 F.T.C. 95 (1974), *aff'd in part, rev'd in part sub nom, Ger-Ro-Mar v. F.T.C.*, 518 F.2d 33 (2d Cir. 1975) and *In re Holiday Magic, Inc.*, 84 F.T.C. 748 (1974). The Commission then distinguished the "Amway Plan" from these cases:

The *Koscot*, *Ger-Ro-Mar*, and *Holiday Magic* cases all involved 'marketing' plans which required a person seeking to become a distributor to pay a large sum of money, either as an entry fee (usually called a 'headhunting' fee) or for the purchase of a large amount of nonreturnable inventory (a practice known as 'inventory loading'). In exchange, the new distributor obtained the right to recruit others who would themselves have to pay a large sum of money--some of which would go to the recruiting distributor--to join the organization. By contrast, a person is not required to pay a headhunting fee or buy a large amount of inventory to become an Amway distributor. The only purchase a new distributor is required to make is a \$15.60 Sales Kit, which contains Amway literature and sales aids; no profit is made in the sale of this Kit, and the purchase price may be refunded if the distributor decides to leave the business. Initial Decision, p. 12, Findings 34-37. Thus a sponsoring distributor receives nothing from the mere act of sponsoring. It is only when the newly recruited distributor begins to make wholesale purchases from his sponsor and sales to consumers, that the sponsor begins to earn money from his recruit's efforts.

93 F.T.C. at 715-16. We are not privy to the evidence which was presented to the Administrative Law Judge and the Commission in Amway over thirty-five years ago, but we note that the findings concerning the initial "Sales Kit" and subsequent wholesale purchases generating commission to the "sponsor" do not justify distinguishing the Amway plan from *Koscot* and the other pyramid cases. As discussed above in the section on the "purchase element," it appears that Amway simply employed a more sophisticated structure, which involved an initial, nominal fee to become a distributor and disguised the subsequent payments as inventory purchases. This error, if it was the only one, would not have had any lasting impact on MLM law, but the Commission then took a serious departure from *Koscot* in dealing with the "retail sales" element:

And Amway has prevented inventory loading at this point with its 'buy-back rule,' which states

that a sponsoring distributor shall '[p]urchase back from any of his personally sponsored distributors leaving the business, upon his request, any unused, currently marketable products. . . .' By this rule, a sponsoring distributor is inhibited from pushing unrealistically large amounts of inventory onto his sponsored distributors in order to increase his Point Value and Business Volume, and thereby increase his Bonus.

Two other Amway rules serve to prevent inventory loading and encourage the sale of Amway products to consumers. The '70 percent rule' provides that '[e]very distributor must sell at wholesale and/or retail at least 70% of the total amount of products he bought during a given month in order to receive the Performance Bonus due on all products bought . . .' This rule prevents the accumulation of inventory at any level. The '10 customer' rule states that '[i]n order to obtain the right to earn Performance Bonuses on the volume of products sold by him to his sponsored distributors during a given month, a sponsoring distributor must make not less than one sale at retail to each of ten different customers that month and produce proof of such sales to his sponsor and Direct Distributor.' This rule makes retail selling an essential part of being a distributor.

93 F.T.C. at 716. Here is the crux of the problem with the Amway decision: In endorsing these "Amway rules" the Commission failed to enforce the requirement in *Koscot* that the compensation paid to distributors be based solely on consummated retail sales. Moreover, the Commission did not even seem to recognize that it was changing the rules of the game.

Perhaps the Commission was led astray by the factual finding of the Administrative Law Judge that the Amway rules were effective in ensuring that retail sales were actually being made. It noted that:

The ALJ found that the buy-back rule, the 70 percent rule, and the ten customer rule are enforced, and that they serve to prevent inventory loading and encourage retailing. Initial Decision, p. 26, Findings 72-75, and p. 58, Findings 145-47. Given these facts, the Amway plan is significantly different from the pyramid plans condemned in *Koscot*, *Ger-Ro-Mar*, and *Holiday Magic*. Specifically, the Amway Plan is not a plan where participants purchase the right to earn profits by recruiting other participants,

who themselves are interested in recruitment fees rather than the sale of products.

93 F.T.C. at 716-17. Here again we have to question the adequacy of the fact finding process. There is no indication in the decisions of either the Administrative Law Judge or the Commission that Amway produced actual evidence of retail sales. All that appears in support of this finding is the conclusory testimony of Amway officers and some of its high level distributors. For example, here is finding 75:

75. The buy-back rule, the 70% rule, and the ten-customer rule encourage retail sales to consumers. (Van Andel, Tr. 1999-2000, 2010; Halliday, Tr. 6231-33; Lemier, Tr. 176; Cady, Tr. 5795-97) (27)

93 F.T.C. at 646. And here are findings 145, 146 and 147:

145. Amway's buy-back rule deters inventory loading by sponsoring distributors. (Van Andel, Tr. 1999-2000; Halliday, Tr. 6231-32; S.Bryant, Tr. 4062-63)

146. Amway's 70% rule deters inventory loading by sponsoring distributors. (Cady, Tr. 5795-97; Halliday, Tr. 6231; Lemier, Tr. 176)

147. Amway's ten customer rule deters inventory loading by sponsoring distributors. (Max, Tr. 5996-97)

93 F.T.C. at 668. These are rather thin factual findings on which to premise the critical judgment that Amway was only paying compensation based on actual retail sales. Significantly, however, it was Amway that bore the burden of proof on this issue. Amway, sued as a pyramid, had the burden of proof not only that it had these "retail sales rules" but that they effectively prevented the abuses listed in Koscot and resulted in actual retail sales. See *Omnitrition*, 79 F.3d at 783; *SEC v. International Heritage, Inc.*, 4 F.Supp.2d 1378, 1384 (N.D.Ga.1998) ("[T]he critical determination of the legality of [defendant's] operations will not be based on the written plan but on the actual practices of the company."). As the Sixth Circuit has held:

We find it more appropriate, however, that a defendant carry the burden of establishing that it has effective anti-saturation programs. Given the

grave risks imposed on investors in illegal schemes, the government should have to do no more than prove that the program satisfies the definition of Koscot.

U.S. v. Gold Unlimited, Inc., 177 F.3d 472, 482 (6th Cir.,1999).

Notwithstanding that the MLM firm has the burden of demonstrating compliance, in over 30 years of pyramid prosecutions the FTC has taken upon itself the burden of proving, over and over again, the consumer injury inflicted by these schemes. This proof has normally been in the form of expert testimony of FTC economist Peter Vander Nat. For instance, in the recent joint FTC and state attorney general action against Fortune High Tech Marketing, commenced in January 2013, Dr. Vander Nat stated:

In its decade of operation, FHTM has defrauded hundreds of thousands of consumers out of hundreds of millions of dollars. FHTM's victims, including at least 100,000 current participants, live throughout the United States and Canada. The founders of this enterprise, Paul Orberson and Thomas Mills, along with a handful of others, have reaped millions while the overwhelming majority of recruits have lost nearly all of the money they invested in the scheme.

The FTC also stated in its memorandum in support of a temporary restraining order:

FHTM targets its recruitment efforts at consumers who are struggling to make ends meet but have an entrepreneurial bent. Increasingly, FHTM has been recruiting non-native English speaking recruits. In fact, several of the presentations at FHTM's annual convention are conducted in Spanish, particular Spanish-speakers as are many local recruiting meetings. FHTM's promises of significant earnings are patently false: more than 90% of consumers who join FHTM earn nothing at all and at least 96% should expect to lose money.⁷¹ The company's own data bears this out.

F.T.C. v. Fortune Hi Tech Marketing, Inc., No. 13cv578 (N.D.Ill., Eastern Div.).[\[37\]](#)

Given the explicit ruling in the Amway case, it is the defendant who has the burden of proving that its otherwise illegal pyramid scheme is legal, not the burden of the FTC to wait until evidence of victim losses is gathered and documented. This critical legal requirement has been ignored for over 30 years. The prescient

language of the Koscot case predicted this unfortunate development.

It is regrettably clear that responsible authorities, including this Commission, have acted far too slowly to protect consumers from the manipulations of respondents and others like them.

86 F.T.C. at 1181.

The Amway decision immediately and dramatically changed the legal landscape of the MLM world. MLM firms were provided with an attractive alternative to complying with the onerous definition of "retail sales" in the Koscot injunction. Instead of limiting compensation to consummated retail sales, MLM firms could pay compensation on *purchases* by downline participants, provided that they followed the "Amway rules." Every sophisticated MLM firm promptly adopted some variant of the Amway rules. The decision also made billionaires of the Amway owners and funded a highly effective lobby which has successfully insulated endless entrepreneurial chain schemes from effective regulation and meaningful enforcement.

Are the Amway Rules Sufficient to Prevent MLM Pyramid Schemes?

The Amway rules which supposedly encourage retail sales are impotent when faced with the overwhelming incentives of MLM plans to encourage recruiting profits in return for required inventory purchases. Aside from the conflict inherent between the incentives of the MLM compensation plan and the encouragement of retail sales, there is a notable absence of data to support the proposition that substantial retail sales are actually taking place. MLM firms have data only as to sales made to their distributors. Any proof of actual retail sales would have to be collected from their "independent" distributors. Because the distributor's status is dependent on the proof of compliance, the potential for inaccurate responses is virtually assured. This is particularly relevant in light of the fact that all available evidence, in the form of Dr. VanderNat's affidavits, is that actual, profitable retail sales are minimal. As stated in Koscot:

"That these schemes so often do not allow recovery of investments by means of retail sales either merely points up that there is very little positive value to be lost by not allowing such schemes to get started in the first place."

86 F.T.C. at 1181. The Omnitrition court also noted the questionable value of a 'retail sales' rule:

On its face, Omnitrition's program appears to be a pyramid scheme. Omnitrition cannot save itself simply by pointing to the fact that it makes some retail sales. See *In re Ger-Ro-Mar, Inc.*, 84 F.T.C. 95, 148-49 (1974) (that some retail sales occur does not mitigate the unlawful nature of pyramid schemes), *rev'd on other grounds*, 518 F.2d 33 (2d Cir.1975). The promise of lucrative rewards for recruiting others tends to induce participants to focus on the recruitment side of the business at the expense of their retail marketing efforts, making it unlikely that meaningful opportunities for retail sales will occur. Koscot, 86 F.T.C. at 1181.

The final element to this analysis is the question, what are in fact retail sales? Even though Koscot is explicit that commissions may only be paid on 'consummated' sales, and that sales must be to persons who are not participating in the plan, many MLM firms, as well as the DSA, argue that sales to participants should be considered to be 'retail sales' because they are buying for their own use. [38] That is, a purchase of inventory by a participant, in order to qualify for benefits through recruiting, can be considered a retail sale because the products might be personally used by the participant. Considering the extensive evidence of victim losses approaching 99%, the questionable corporate verifiability of the entire retail sales issue, and the inherent conflict between this legal stance and the documented realities of pyramid recruiting, this expansive view is not consistent with responsible enforcement and would essentially negate the critical requirement for 'retail sales' as an element of a pyramid scheme.

In *BurnLounge*, which is currently on appeal, the injunction explicitly dealt with this issue in a manner entirely consistent with Koscot:

"Prohibited Marketing Scheme" means an illegal pyramid sales scheme (see e.g., *Webster v. Omnitrition Int'l*, 79 F.3d 776, 781 (9th Cir. 1996), Ponzi scheme, chain marketing scheme, or other marketing plan or program in which participants pay money or valuable consideration in return for which they obtain the right to receive rewards for recruiting other participants into the program, and those rewards are unrelated to the sale of products or services to ultimate users. For purposes of this definition, "sale of products or services to ultimate users"

does not include sales to other participants or recruits or to the participants' own accounts.

F.T.C. v. Burnlounge, Case No. CV 07-3654 GW (C.D.Cal., Western Div.) (Amended Final Judgment and Order for Permanent Injunction and Other Equitable Relief Against Defendants Burnlounge, Inc., Juan Alexander Arnold, John Taylor and Rob DeBoer) (emphasis supplied).⁴⁶⁸

CONCLUSION

The Amway decision has enabled modern MLM firms to escape the rigors of the Koscot definition by adopting the so-called Amway rules. The complexities of determining whether the retail sales rules of a given MLM firm are actually effective in ensuring that compensation is only paid based on retail sales pose a significant barrier to effective enforcement. Ambiguities concerning whether internal consumption constitutes retailing, and how much product must be retailed, and whether or not the distributor should be earning a retail profit, worsen the problem. The need for case-by-case analysis has resulted in limited enforcement and oversight on the part of the Federal Trade Commission, with only two significant MLM prosecutions in the past seven years (Burnlounge in 2007; Fortune Hi Tech Marketing in 2013). The lack of enforcement has caused substantial consumer injury now in the many billions of dollars.

The perceived legitimacy of MLM has enabled US based companies to promote their offerings in other countries. At present it is estimated that 80% of the MLM industry's revenues come from outside the United States. Worldwide annual revenues now total over \$150 billion.

The Koscot model remains the best, clearest method for distinguishing between legitimate MLM programs and pyramid schemes. The Amway model has proven to be a failure.

The victim losses, here and abroad, make it imperative that the Federal Trade Commission take a vigorous pro-active stance in respect to pyramid offerings. This must include an enforcement position which enables detection and litigation prior to the delays currently encountered in recent cases such as Fortune Hi Tech Marketing and Burnlounge. Such a position would include formal investigatory efforts to determine the scope

and extent of consumer injury and the verifiability of the Amway rules ostensibly in place. If the Amway rules continue to be used by MLM firms as a means for complying with Koscot, then the MLM firm should be required to meet its burden of proof to collect and produce evidence of actual retail sales supporting the payment of compensation to its distributors. An absence of critical verifiable data indicating that profitable retail sales are occurring should be grounds for prosecution of an MLM as a pyramid scheme. As in Amway, the defendant will be afforded the opportunity to prove the effectiveness of its procedures designed to protect its victims from the abuses fully documented in Koscot, the cases belatedly brought by the Commission, and the extensive affidavits filed in support of these actions by Dr. Vander Nat.

Ultimately, a formal regulation prohibiting pyramid schemes should be enacted, as stated in Koscot:

A discussion of 'inherent' illegality and capacity to deceive may seem pointless given the more than 4000 pages of transcript detailing the actual deception and injury in which the Koscot plan resulted. Nothing could be further from the truth. It is regrettably clear that responsible authorities, including this Commission, have acted far too slowly to protect consumers from the manipulations of respondents and others like them. ...

The viability of a Federal remedy, however, will depend, if not upon congressional enactment, then upon the willingness of courts to recognize the serious potential hazards of entrepreneurial chains and to permit summary excision of their inherently deceptive elements, without the time-consuming necessity to show occurrence of the very injury which justice should prevent. To require too large an evidentiary burden to condemn these schemes can only ensure that future generations of self-made commercial messiahs will dare to be great and dare anyone to stop them.

86 F.T.C. at 1181-82. The fact that many current victims of these US based countries are members of minority groups, particularly Latino and African-American, or are in other countries where losses in the billions of dollars are essentially shielded from the public and political forums is an even greater reason to proceed, since these victims have few to speak on their behalf. This is precisely the enforcement role of the Federal Trade Commission, to protect those who cannot protect themselves.

⁴⁶⁸ Available at <http://www.ftc.gov/sites/default/files/documents/cases/2012/03/120314burnloungeorder.pdf>

Appendix 10G

STATE STATUTES RELATED TO MULTI-LEVEL MARKETING

This collection of state statutes, each followed by the commentary of author Jon M. Taylor, shows the wide range of statutory prohibitions applicable to MLM. In some states, the DSA (Direct Selling Association), the chief lobbying group for the MLM industry, has been successful in introducing bills revising the statutes to favor MLMs, but almost always to the detriment of consumers. Even still, the case can be made that all MLMs, with their inherent flaws as endless chain recruitment schemes, are violating some federal and state laws. (See Chapters 2, 7, 8, and 10.) At the very least, all are violating statutes against unfair and deceptive practices, which are declared unlawful by the FTC (Section 5) and in applicable statutes in most of the states.

Emphases in the statutes themselves were provided by the author. The author's commentary for each state follows his initials (JMT) and are in bold type.

Statutes forbidding pyramid schemes are problematic because definitions of pyramid schemes vary so widely from state to state, and because the DSA is continually introducing bills to amend existing statutes to redefine what is or is not an illegal pyramid scheme – so as to exempt MLMs. However, in Chapter 2, an objective set of causative and defining characteristics (“red flags”) has been identified which enables consumers to clearly distinguish between legitimate sales or business opportunities and recruitment-driven MLMs, or product-based pyramid schemes. And in Chapter 7, the author shows that product-based pyramid schemes are far more harmful than are no-product pyramid schemes, by any measure – loss rate, aggregate losses, and number of victims.

Unfair and/or deceptive trade practices.

Federal legislation and statutes in every state prohibit employment of unfair or deceptive trade practices and unfair competition in business.

The Federal Trade Commission regulates federal laws designed to prohibit a series of specific practices prohibited in interstate commerce. Several states have established consumer protection offices as part of the state attorney general offices.

The Federal Trade Commission Act (FTCA), originally passed in 1914 and amended several times thereafter, was the original statute in the United States prohibiting "unfair or deceptive trade acts or practices." Development

of the federal law was related to federal antitrust and trade-mark infringement legislation. Prior to the enactment in the 1960s of state statutes prohibiting deceptive trade practices, the main focus of state law in this area was "unfair competition," which refers to the tort action for practices employed by businesses to confuse consumers as to the source of a product. The tort action for a business "passing off" its goods as those of another was based largely on the common law tort action for trademark infringement.

Because the law governing deceptive trade practices was undefined and unclear, the National Conference of Commissioners on Uniform State Laws in 1964 drafted the Uniform Deceptive Trade Practices Act. The NCCUSL revised this uniform law in 1966. The law was originally "designed to bring state law up to date by removing undue restrictions on the common law action for deceptive trade practices." Only eleven states have adopted this act, but it has had a significant effect on other states. Most state deceptive or unfair trade practices statutes were originally enacted between the mid-1960s and mid-1970s.

Based on the information in prior chapters, especially Chapter 7, although approximately 99% of MLM participants lose money, MLMs are promoted as business or income opportunities – a huge deception. Misrepresentations are also common in MLM (See Chapter 8). Therefore, MLMs can generally be considered unfair and deceptive practices.

NOTE: While effort has been made to be as current as possible, the DSA/MLM lobby is continually looking for opportunities to weaken anti-pyramid laws, as they did in Utah. So some may have been altered since this Appendix was prepared.

ALABAMA

Section 8-19-5

Unlawful trade practices.

The following deceptive acts or practices in the conduct of any trade or commerce are hereby declared to be unlawful:

(1) Passing off goods or services as those of another, provided that this section shall not prohibit the private labeling of goods or services

.....
(18) Using or employing a chain referral sales plan in connection with the sale or offering for sale of

goods, merchandise, or anything of value, involving a sales technique, plan, arrangement, or agreement in which the buyer or prospective buyer is offered the opportunity to purchase merchandise or goods and in connection with the purchase receives the seller's promise or representation that the buyer shall have the right to receive compensation or consideration in any form for furnishing to the seller the names of other prospective buyers, if the receipt of the compensation or consideration is contingent upon the occurrence of an event subsequent to the time the buyer purchased the goods, merchandise, or anything of value.

(19) Selling or offering to sell, either directly or associated with the sale of goods or services, a right to participation in a pyramid sales structure. As used herein, "pyramid sales structure" includes any plan or operation for the sale or distribution of goods, services, or other property wherein a person for consideration acquires the opportunity to receive a pecuniary benefit, which is based primarily upon the inducement of additional persons by that person, and others, regardless of number, to participate in the same plan or operation, and is not primarily contingent on the volume or quantity of goods, services, or other property sold or distributed. For purposes of this subdivision, "consideration" shall not include payments made for sales demonstration equipment and materials furnished on a nonprofit basis for use in making sales and not for resale wherein such payments amount to less than \$100 annually.

(20) In connection with any seller-assisted marketing plan, either misrepresenting the amount or extent of earnings to result therefrom, or misrepresenting the extent or nature of the market for the goods or services, or both, sold or delivered in connection with the plan, or misrepresenting that the seller of the plan will repurchase all or part of the goods or services, or both, sold or delivered in connection with the plan, or failing to deliver goods or services, or both, within the time represented. As used herein, "seller-assisted marketing plan" includes any plan, scheme, or system in which for a consideration a buyer acquires goods or services, or both, together with a plan, scheme, or system for the resale of said goods or services, or both.⁴⁶⁹

[JMT: An MLM's "endless chain" structure or "chain referral sales plan," is a key red flag for any product-based pyramid scheme.⁴⁷⁰ All MLMs are built on endless chains of recruitment. Also, the "pyramid sales structure" (19) would have to include MLMs.

Misrepresenting earnings or markets (20): In every case where average income figures have been released by MLM companies, 99% of

⁴⁶⁹ Acts 1981, No. 81-355, p. 510, §5; Acts 1993, No. 93-203, §1.

⁴⁷⁰ See Chapter 2.

participants lost money. So to present MLM as a business or income opportunity is misleading. In addition, Alabama has a statute that prohibits deceptions and unconscionable acts or practices.]

ALASKA

Chapter 50. Competitive Practices and Regulation of Competition.

AS 45.50.561. Definitions.

In AS 45.50.471 - 45.50.561

(1) "advertising" includes the attempt directly or indirectly by publication, dissemination, solicitation, endorsement, or circulation, display in any manner, including solicitation or dissemination by mail, telephone or door-to-door contacts, or in any other way, to induce directly or indirectly a person to enter or not enter into an obligation or acquire title or interest in any merchandise or to increase the consumption of it or to make a loan; . . .

(3) "chain distributor scheme" means a sales device whereby a person, upon condition that the person make an investment, is granted a license or right to solicit or recruit for profit one or more additional persons who are also granted a license or right upon condition of making an investment and may further perpetuate the chain of persons who are granted a license or right upon the condition of investment; a limitation as to the number of persons who may participate, or the presence of additional conditions affecting eligibility for the license or right to solicit or recruit or the receipt of profit from these does not change the identity of the scheme as a chain distributor scheme; as used in this paragraph, "investment" means acquisition, for a consideration other than personal services, of tangible or intangible property, and includes but is not limited to franchises, business opportunities and services; "investment" does not include sales demonstration equipment and materials furnished at cost for use in making sales and not for resale;

AS 45.50.471. Unlawful Acts and Practices.

(a) Unfair methods of competition and unfair or deceptive acts or practices in the conduct of trade or commerce are declared to be unlawful.

(b) The terms "unfair methods of competition" and "unfair or deceptive acts or practices" include, but are not limited to, the following acts: . . .

(19) using a chain referral sales plan by inducing or attempting to induce a consumer to enter into a contract by offering a rebate, discount, commission, or other consideration, contingent upon the happening of a future event, on the condition that the consumer either sells, or gives information or assistance for the purpose of leading to a sale by the seller of the same or related goods;

(20) selling or offering to sell a right of participation in a chain distributor scheme;

[JMT: An MLM's "endless chain" structure - or "chain distributor scheme" is a key red flag for any product-based pyramid scheme.⁴⁷¹ All MLMs are built on endless chains of recruitment.

MLM defenders may object to equating the word "investment"(3) to what a person pays to join an MLM. However, the word is used frequently in MLM opportunity and training meetings to encourage prospects to pay more than the initial signup fee. Participants are given monthly quotas to qualify for commissions and advancement in the scheme – and are in addition, often urged and incentivized to buy additional quantities of products in order to "maximize" their opportunity.

The statute also prohibits "unfair or deceptive acts or practices" (b). In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."]

ARIZONA

44-1731 Definitions

In this article, unless the context otherwise requires:

1. "Compensation" includes a payment based on a sale or distribution made to a person who either is a participant in a pyramid promotional scheme or has the right to become a participant upon payment.
2. "Consideration" means the payment of cash or the purchase of goods, services or intangible property but does not include: (a) The purchase of goods or services furnished at cost to be used in making sales and not for resale. (b) Time and effort spent in pursuit of sales or recruiting activities.
3. "Pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from any person's introduction of other persons into participation in the plan or operation rather than from the sale of goods, services or intangible property by the participant or other persons introduced into the plan or operation.

44-1732 . Violation; classification

A. Any person who violates any of the provisions of this article is guilty of a class 6 felony.

B. The attorney general or county attorney, or both, shall institute the criminal actions to enforce the provisions of this article.

C. An act or practice in violation of this article constitutes an unlawful practice under section 44-1522. The attorney general may investigate and take appropriate action as prescribed by Chapter 10, article 7 of this title.

44-1733 . Sale or contract for sale of interest in pyramid promotional scheme voidable

Any purchaser in a pyramid promotional scheme may, notwithstanding any agreement to the contrary, declare the related sale or contract for sale void, and he may bring an action in a court of competent jurisdiction to recover the consideration he paid to participate in the scheme. In such action the court shall, in addition to any judgment awarded to the plaintiff, require the defendant to pay interest, reasonable attorneys' fees and the costs of the action, less any money paid to the plaintiff as profit in the transaction.

44-1735. Pyramid promotional scheme; prohibition; defenses excluded

A. A person shall not establish, operate, advertise or promote a pyramid promotional scheme.

B. A limitation as to the number of persons who may participate or the presence of additional conditions affecting eligibility for the opportunity to receive compensation under the plan or operation does not change the identity of the scheme as a pyramid promotional scheme nor is it a defense under this article that a participant, on giving consideration, obtains any goods, services or intangible property in addition to the right to receive compensation.

[JMT: The Arizona statute forbidding a "pyramid promotional scheme" allows compensation to be based on personal consumption; i.e., "by the participant or other persons introduced into the plan or operation" (3). The "other person" could be a person above the participant in the hierarchy of participants who is selling to the participant. This allowance for compensation based on personal consumption of downline participants is something for which the DSA lobbies aggressively – and that works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.]

ARKANSAS

Title 4. Business and Commercial Law.

Subtitle 7. Consumer Protection.

Chapter 88. Deceptive Trade Practices.

Subchapter 1. General Provisions.

§ 4-88-109. Pyramiding devices.

(a) Every person who contrives, prepares, sets up, proposes, or operates any pyramiding device shall be guilty of an unlawful practice.

⁴⁷¹ See Chapter 2.

(b)(1) As used in this section, a pyramiding device shall mean any scheme whereby a participant pays valuable consideration for the chance to receive compensation primarily from introducing one (1) 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.

(2) "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

[JMT: In Arkansas, to avoid being a "pyramiding device," compensation must not be based on personal consumption of participants.

Arkansas also has a statute prohibiting 10 specific practices, plus any other deceptive or unconscionable acts or practices.⁴⁷² In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading (deceptive). It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

CALIFORNIA
CALIFORNIA CODES
PENAL CODE – SECTION 319-329

....
327. 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.

[JMT: An MLM's "endless chain" structure is a key red flag for any product-based pyramid scheme.⁴⁷³ All MLMs are built on an endless chain of recruitment. In fact, a case could be made that all MLMs are violating CA's law (as well as several other states) against endless

chains, since all MLMs are built up through an endless chain of recruitment.

Also, the stipulation that requires compensation based on sales to non-participants prevents the establishment of a money transfer scheme, in which commissions from purchases from those at the bottom enriches those at the top of a pyramid of participants.

Finally, California's Unfair Competition Law ("UCL"), Business & Professions Code Sec. 17200, was designed to protect competitors and consumers from illegal, fraudulent, and "unfair" business practices, and Business & Professions Code Sec. 17500 prohibits false advertising. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to advertise MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."]

COLORADO

6-1-102 - Definitions.

As used in this article, unless the context otherwise requires:

(1) "Advertisement" includes the attempt by publication, dissemination, solicitation, or circulation, visual, oral, or written, to induce directly or indirectly any person to enter into any obligation or to acquire any title or interest in any property.

(7) "Promoting a pyramid promotional scheme" means inducing one or more other persons to become participants, or attempting to so induce, or assisting another in promoting a pyramid promotional scheme by means of references or otherwise.

(8) "Property" means any real or personal property, or both real and personal property, intangible property, or services.

(9) "Pyramid promotional scheme" means any program utilizing a pyramid or chain process by which a participant in the program gives a valuable consideration in excess of fifty dollars for the opportunity or right to receive compensation or other things of value in return for inducing other persons to become participants for the purpose of gaining new participants in the program. Ordinary sales of goods or services to persons who are not purchasing in order to participate in such a scheme are not within this definition.

6-1-105 - Deceptive trade practices.

(1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person:

(a) Knowingly passes off goods, services, or property as those of another;

⁴⁷² § 4-88-101 to 4-88-115

⁴⁷³ See Chapter 2.

(b) *Knowingly makes a false representation as to the source, sponsorship, approval, or certification of goods, services, or property;*

(p) Solicits door-to-door as a seller, unless the seller, within thirty seconds after beginning the conversation, identifies himself or herself, whom he or she represents, and the purpose of the call;

(p.3) (I) Solicits a consumer residing in Colorado by telephone as a seller, unless the seller, within one minute after beginning the conversation, identifies himself or herself, whom he or she represents, and the purpose of the call or repeatedly causes any telephone to ring or engages any person in a telephone conversation repeatedly or continuously with the intent to annoy, abuse, or harass any person at the telephone number called.

(II) The provisions of this paragraph (p.3) shall not apply to a telephone solicitation between a seller and a consumer if there is an existing business relationship between the seller and the consumer at the time of the telephone solicitation or if the call is initiated by the consumer.

(q) *Contrives, prepares, sets up, operates, publicizes by means of advertisements, or promotes any pyramid promotional scheme;*

[JMT: An MLM's "endless chain" structure – or "chain process" is a key red flag for any product-based pyramid scheme.⁴⁷⁴ All MLMs are built on an endless chain of recruitment. Note that sales to non-participants are not within the definition of a "pyramid promotional scheme."

The statute also prohibits "false representations." In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

CONNECTICUT

General Statutes of Connecticut, Revised to 1997
Title-42 - Business, Selling, Trading and Collection Practices

Sec. 42-144. Definitions.

Sec. 42-145. Contingent consideration void.

CHAPTER 741 CONTINGENT TRANSACTIONS

Sec. 42-144. Definitions.

As used in this chapter:

(a) "Advertisement" includes the attempt by publication, dissemination, solicitation or circulation, written or oral, to induce directly or indirectly, any person to enter into any obligation or acquire any title or interest in any merchandise;

(b) "Merchandise" includes any objects, wares, goods, commodities, intangibles, securities, bonds, debentures, stocks, real estate or services;

(c) "Services" includes any supply of accommodations, work, repair or other needs, instruction or education, including any type of training course in any field such as personality improvement, self motivation, salesmanship and similar fields;

(d) "Rights or privileges" includes the right or privilege to market, distribute, wholesale or retail, merchandise or services or to procure others to do so;

(e) "Procure" includes obtaining, providing, inducing, suggesting, soliciting, recruiting, training, supervising, advancing in position, or aiding or abetting any of the activities specified in this subsection;

(f) "Person" includes any natural person, or his legal representative, partnership, limited liability company, corporation, whether domestic or foreign, company, trust, business entity or association, and any agent, employee, salesman, partner, officer, director, member, stockholder, associate, trustee or cestui que trust thereof;

(g) "Sale" includes any sale, offer of sale or attempt to sell any merchandise, services, or rights or privileges for any consideration, or aiding or abetting any of the activities specified in this section;

(h) "Trade and commerce" means the advertising, offering for sale, sale or distribution of services and property, tangible or intangible, and any other article, commodity or thing of value wherever situate, and shall include any trade or commerce directly or indirectly affecting the people of this state;

(i) "Commissioner" means the Commissioner of Consumer Protection.

Sec. 42-145. Contingent consideration void.

The advertisement for sale, lease or rent, or the actual sale, lease or rental of any merchandise, service or rights or privileges at a price or with a rebate or payment or other consideration to the purchaser which is contingent upon the procurement of prospective customers procured by the purchaser, or the procurement of sales, leases or rentals of merchandise, services, rights or privileges, to other persons procured by the purchaser, is declared to be an unlawful practice rendering any obligation incurred by the buyer in connection therewith, completely void and a nullity.

The rights and obligations of any contract relating to such contingent price, rebate or payment shall be interdependent and inseparable from the rights and obligations relating to the sale, lease or rental.

[JMT: "Contingent consideration" could include any MLM's characteristic "endless chain" of recruitment, which is a key red flag for any product-based pyramid scheme.⁴⁷⁵ All MLMs are built on an endless chain of recruitment.

⁴⁷⁴ See Chapter 2.

⁴⁷⁵ See Chapter 2.

Also, according to Connecticut's Unfair Trade Practices Act, "no person is allowed to engage in any unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce."⁴⁷⁶ In every case where average income figures have been publicly released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading; i.e., an unfair and deceptive act. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."]

DELAWARE

§ 2561. Definitions.

As used in this subchapter:

(1) "Pyramid or chain distribution scheme" means a sales device whereby a person, upon a condition that he part with money, property or any other thing of value, is granted a franchise license, distributorship or other right which person may further perpetuate the pyramid or chain of persons who are granted such franchise, license, distributorship or right upon such condition. A limitation as to the number of persons who may participate, or the presence of additional conditions upon the eligibility for such a franchise, license, distributorship or other right recruit or upon the receipt of profits therefrom, does not change the identity of the scheme as a pyramid or chain distribution scheme.

(2) "Person" includes an individual, corporation, trust, estate, partnership, unincorporated association, or any other legal or commercial entity.

§ 2562. Unlawful practice.

The use of a pyramid or chain sales distribution scheme in connection with the solicitation of investments in the form of money, property or any other thing of value is hereby declared to be an unlawful practice under § 2513 of this title.

§ 2563. Prohibition.

(a) No person, either directly or through the use of agents or other intermediaries, shall promote, sell, attempt to sell, offer or grant participation in a pyramid or chain distribution scheme.

(b) Whoever, directly or through the use of agents or intermediaries, violates subsection (a) of this section shall be fined not more than \$5,000, or imprisoned not more than 3 years, or both.

(c) The Superior Court shall have exclusive jurisdiction of offenses under this section.

§ 2564. Contracts void; civil liability.

(a) Any contract made in violation of § 2563 of this title shall be void and any person who, directly or

through the use of agents or intermediaries, induces or causes another person to participate in a pyramid or chain distribution scheme shall be liable to that person in an amount equal to the sum of: (1) Twice the amount of any consideration paid; and (2) In the case of any successful action to enforce such liability, the costs of the action together with a reasonable attorney's fee, as determined by the court.

(b) An action under this section may be brought in any court in this State otherwise having jurisdiction over the dollar amount being sought by way of recovery within one year from the date on which the consideration was paid.

[JMT: An MLM's "endless chain" structure - or "chain distribution scheme" is a key red flag for any product-based pyramid scheme.⁴⁷⁷ All MLMs are built on an endless chain of recruitment.

Also, MLM defenders may object to equating the word "investment" to what a person pays to join an MLM. However, the word is used frequently in MLM opportunity and training meetings to encourage prospects to pay more than the initial signup fee. Participants are given monthly quotas to qualify for commissions and advancement in the scheme – and are in addition, often urged and incentivized to buy additional quantities of products in order to "maximize" their opportunity.

Also, the state legislature adopted the Uniform Deceptive Trade Practices Act, which prohibits 12 specific practices, plus other conduct that creates the likelihood of a misunderstanding on the part of a consumer. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, such as those selling "pills, potions, and lotions."]

FLORIDA

849.091 Chain letters, pyramid clubs, etc., declared a lottery; prohibited; penalties

(1) The organization of any chain letter club, pyramid club, or other group organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by members thereof are to be paid or given to any other member thereof, which plan or device includes any provision for the increase in such membership through a chain process of new members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues, or things of

⁴⁷⁶ Title 42, Chapter 735a, Section 42-110b

⁴⁷⁷ See Chapter 2.

material value from other members, is hereby declared to be a lottery, and whoever shall participate in any such lottery by becoming a member of, or affiliating with, any such group or organization or who shall solicit any person for membership or affiliation in any such group or organization commits a misdemeanor of the first degree, punishable as provided in sec. 775.082 or sec. 775.083.

(2) A "pyramid sales scheme," which is any sales or marketing plan or operation whereby a person pays a consideration of any kind, or makes an investment of any kind, in excess of \$100 and acquires the opportunity to receive a benefit or thing of value which is not primarily contingent on the volume or quantity of goods, services, or other property sold in bona fide sales to consumers, and which is related to the inducement of additional persons, by himself or herself or others, regardless of number, to participate in the same sales or marketing plan or operation, is hereby declared to be a lottery, and whoever shall participate in any such lottery by becoming a member of or affiliating with, any such group or organization or who shall solicit any person for membership or affiliation in any such group or organization commits a misdemeanor of the first degree, punishable as provided in sec. 775.082 or sec. 775.083. For purposes of this subsection, the term "consideration" and the term "investment" do not include the purchase of goods or services furnished at cost for use in making sales, but not for resale, or time and effort spent in the pursuit of sales or recruiting activities

[JMT: An MLM's "endless chain" structure – or "chain process" is a key red flag for any product-based pyramid scheme.⁴⁷⁸ All MLMs are built on an endless chain of recruitment. It is also interesting that Florida equates such a chain scheme or "pyramid promotional scheme" as a lottery because it involves a strong element of chance. Participation in such schemes – which could include MLMs – is a misdemeanor in Florida.

MLM defenders may object to equating the word "investment" (2) to what a person pays to join an MLM. However, the word is used frequently in MLM opportunity and training meetings to encourage prospects to pay more than the initial signup fee. Participants are given monthly quotas to qualify for commissions and advancement in the scheme – and are in addition, often urged and incentivized to buy additional quantities of products in order to "maximize" their opportunity.

Also, while the words "bona fide sales to consumers" may be interpreted by MLM

defenders to include personal consumption of participants, it seems clear that the intent of the wording was to mean sales to actual bona fide customers not in the network.

And finally, a Florida statute prohibits "unfair methods of competition, or unconscionable, deceptive, or unfair acts or practices in the conduct of any trade or commerce."⁴⁷⁹ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

GEORGIA

10-1-410.

As used in this part, the term:

(1) "Agreement" means any agreement relating to a business opportunity or multilevel distribution company, including, but not limited to, the contract.

(6) "Multilevel distribution company" means any person, firm, corporation, or other business entity which sells, distributes, or supplies for a valuable consideration goods or services through independent agents, contractors, or distributors at different levels wherein such participants may recruit other participants and wherein commissions, cross-commissions, bonuses, refunds, discounts, dividends, or other considerations in the program are or may be paid as a result of the sale of such goods or services or the recruitment, actions, or performances of additional participants. The term shall not include licensed insurance agents, insurance agencies, licensed real estate brokers, licensed real estate agents, licensed real estate agencies, licensed securities dealers, licensed limited securities dealers, licensed securities salesmen, or licensed limited securities salesmen. Any multilevel distribution company which operates in any of the forms precluded by paragraphs (1) through (4) of subsection (a) of Code Section 10-1-411 shall be considered an unlawful pyramid club under Code Section 16-12-38.

(7) "Participant" means anyone who participates at any level in a multilevel distribution company.

(8) "Person" means any individual, corporation, partnership, joint venture, association, trust, unincorporated organization, or other entity and shall include any other person that has a substantive interest in or effectively controls such person as well as the individual officers, directors, general partners, trustees, or other individuals in control of the activities of such person.

(9) "Purchaser" means any person who is solicited to become obligated, or does become obligated, under any agreement.

⁴⁷⁸ Title 42, Chapter 735a Section 42-110b

⁴⁷⁹ [§501.207(1)(c)]

(10) "Seller" means any multilevel distribution company or it means any person who offers to sell to individuals any business opportunity, either directly or through any agent.

10-1-411.

(a) No multilevel distribution company or participant in its marketing program shall:

(1) Operate or, directly or indirectly, participate in the operation of any multilevel marketing program wherein the financial gains to the participants are primarily dependent upon the continued, successive recruitment of other participants and where sales to nonparticipants are not required as a condition precedent to realization of such financial gains;

(2) Offer to pay, pay, or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend, or other consideration to any participant in a multilevel marketing program solely for the solicitation or recruitment of other participants therein;

(3) Offer to pay, pay, or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend, or other consideration to any participant in a multilevel marketing program in connection with the sale of any product or service unless the participant performs a bona fide supervisory, distributive, selling, or soliciting function in the sale or delivery of such product or services to the ultimate consumer;

(4) Offer to pay, pay, or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend, or other consideration to any participant:

(A) Where payment thereof is or would be dependent on the element of chance dominating over the skill or judgment of such participant;

(B) Where no amount of judgment or skill exercised by the participant has any appreciable effect upon any finder's fee, bonus, refund, override,

commission, cross-commission, dividend, or other consideration which the participant may receive; or

(C) Where the participant is without that degree of control over the operation of such plan as to enable him substantially to affect the amount of finder's fee, bonus, refund, override, commission, cross-commission, dividend, or other consideration which he may receive or be entitled to receive; or

(5) Represent, directly or by implication, that participants in a multilevel marketing program will earn or receive any stated gross or net amount or represent in any manner the past earnings of participants except as may be permitted under this part; provided, however, that a written or verbal description of the manner in which the marketing plan operates shall not, standing alone, constitute a representation of earnings, past or future.

Multilevel distribution companies shall not represent, directly or by implication, that it is relatively easy to secure or retain additional

distributors or sales personnel or that most participants will succeed.

10-1-412.

(a) Any business opportunity seller or company which represents, in conjunction with any agreement which requires a total initial payment of an amount exceeding \$500.00, that the seller or company will refund all or part of the price paid for the business opportunity or will repurchase any of the products, equipment, supplies, or chattels supplied by the seller or company if the purchaser is dissatisfied with the business opportunity and any multilevel distribution company must either have obtained a bond issued by a surety company authorized to do business in this state or have established a trust account with a licensed and insured bank or savings institution located in this state. For purposes of this subsection, deposits shall not be considered part of the price paid for the business opportunity. The amount of the bond or trust account shall be an amount not less than \$75,000.00. . . . A multilevel distribution company which requires an initial payment of less than \$500.00 from each participant shall be exempt from the requirements of this Code section.

10-1-413.

(a) Every multilevel distribution company intending to have participants in this state, with an agreement made in this state, or with its principal place of business in this state shall have readily available to any potential participants, prior to obtaining any participants in this state or elsewhere, a copy of the contract and of any material incorporated by reference into the contract to be used with participants. In every instance in which a multilevel distribution company solicits any initial payment in excess of \$500.00, the multilevel distribution company shall also have readily available to the particular potential participant or participants, prior to signing the contract, a disclosure statement containing the following:

(1) The name and principal business address of the company; whether the company is doing business as a proprietorship, partnership, or corporation; the names under which the company has done, is doing, or intends to do business; and the name of any parent or affiliated company that will engage in business transactions with participants;

(2) The names, addresses, and titles of the company's officers, directors, and trustees;

(3) The length of time the company has:

(A) Been engaged in multilevel distribution; and

(B) Been engaged in multilevel distributions involving the types of products, equipment, supplies, or services currently offered to the purchaser; and

(4) A detailed description of the levels of distribution in the multilevel program, the manner in

which participants will be compensated, and the extent or amount of any compensation.

(b) Every seller shall update the disclosures required by subsection (b) of Code Section 10-1-411 and by subsection (a) of Code Section 10-1-413 as often as any material change in the required information occurs, but not less than annually.

(c) Whenever a multilevel distribution company must provide the disclosure statement required by subsection (a) of this Code section, the multilevel distribution company, prior to obtaining any participant, shall provide that participant with an 8 1/2 inch by 11 inch document in at least ten-point type, which reads as follows:

NOTICE REQUIRED BY STATE LAW REGARDING DISCLOSURES

State law requires that a multilevel distribution company shall make available certain disclosures regarding the company prior to obtaining participants. This is your official notice that you have a right to request to see these disclosures prior to entering into any agreement with a multilevel distribution company. This will be the only notice you receive regarding your rights to see these disclosures. If you waive these rights, you are giving up an important consumer protection that the State of Georgia has found you should be provided. If you wish to exercise these rights, please indicate below that you want to see the disclosures before agreeing to be a participant, then do not agree to become a participant until the disclosures have been made available to you.

SIGN ONLY ONE OF THE FOLLOWING STATEMENTS:

I wish to see the disclosures required by law before I agree to become a participant.

_____ Date:

I do not wish to see the disclosures required by law; I understand that I will not be seeing important information which might affect my decision to participate in this multilevel distribution company.

_____ Date:

(d) Every multilevel distribution company shall maintain on file all of the statements as described in subsection (c) of this Code section for a period of two years from the date such statements are signed.

(e) Every seller shall include the following regarding each officer, director, principal, and owner in the disclosures required by subsection (b) of Code Section 10-1-411 and by subsection (a) of Code Section 10-1-413:

(1) Whether he or she has at any time during the previous seven fiscal years been convicted of a felony or pleaded nolo contendere to a felony

charge if the felony involved fraud, including violation of any franchise law, unfair or deceptive acts or practices law, business opportunity law, multilevel distributing law, or pyramid law; embezzlement; fraudulent conversion;

(2) Whether he or she has at any time during the previous seven fiscal years been held liable in a civil action resulting in a final judgment or has settled out of court any civil action or is a party to any civil action involving fraud, including violation of any franchise law, unfair or deceptive acts or practices law, business opportunity law, multilevel distributing law, or pyramid law; embezzlement; fraudulent conversion; misappropriation of property; or restraint of trade;

(3) Whether he or she is currently subject to any state or federal agency or court injunctive or restrictive order or is a party to a proceeding currently pending in which such an order is sought relating to fraud, including violation of any franchise law, unfair or deceptive acts or practices law, business opportunity law, multilevel distributing law, or pyramid law; embezzlement; fraudulent conversion; misappropriation of property; or restraint of trade; and

(4) Whether he or she has at any time during the previous seven fiscal years filed in bankruptcy, been adjudged bankrupt, or been reorganized due to insolvency or has been a principal, director, executive officer, or partner of any other person that has so filed or was so adjudged or reorganized during or within one year after the period that such person held such position in such other person.

(f) The disclosures required under subsection (e) of this Code section shall include any of the following which are applicable:

(1) The identity and location of the court or agency;

(2) The date of conviction, judgment, or decision;

(3) The penalty imposed;

(4) The damages assessed;

(5) The terms of settlement or the terms of the order and the date, nature, and issuer of each such order or ruling; and

(6) The name and principal business address of any other person which filed, was adjudged, or was reorganized in bankruptcy.

10-1-414.

Sellers shall not:

(1) Represent that a business opportunity or multilevel program provides income or earning potential of any kind unless the seller has documented data to substantiate the claims of income or earning potential, which data shall be furnished to the administrator or his representatives upon request;

.....

10-1-415.

(a) Every business opportunity or multilevel distribution contract shall be in writing, and a copy

shall be given to the purchaser or participant at the time he or she signs the contract.

(b) Every contract or any material incorporated therein by reference shall include the following:

(1) The terms and conditions of payment, including but not limited to compensation paid to a participant by the company and any payments to be made by the participant to the company within the first six months of the agreement;

(2) A full and detailed description of the acts or services that the seller undertakes to perform for the purchaser or participant, including a specific description of the product or service being marketed;

(3) The seller's principal business address. For purposes of this paragraph, a post office box shall not be considered a principal place of business; and

(4) The approximate delivery date of any products, equipment, supplies, or services that the seller is to deliver to the purchaser or participant

(c) In addition to the information required in subsection (b) of this Code section, every multilevel distribution contract, or an addendum thereto, shall contain the following:

(1) If training of any type is promised by the seller or company, a complete description of the training and the length of the training;

(2) If a bond is required under Code Section 10-1-412, the following statement, with all blanks properly filled:

<p>"As required by Georgia law, the company has secured a bond or established a trust account for your protection. This bond or trust account can be identified as # _____ in the name of _____, provided by the following bonding company or trust company: _____, which is located at the following address: _____ in the City of _____, State of _____."</p>

(3) A participant in a multilevel marketing plan has a right to cancel at any time, regardless of reason. If a participant will be under an obligation to make any payment after the agreement has been entered into, a statement in ten-point boldface type as follows must appear in the contract or an addendum thereto:

"A participant in this multilevel marketing plan has a right to cancel at any time, regardless of reason. Cancellation must be submitted in writing to the company at its principal business address."; and

(4) A description of any cancellation rights.

(d) Cancellation rights pursuant to paragraph (4) of subsection (c) of this Code section must, at a minimum, provide the following:

(1) If the participant has purchased products or paid for administrative services while the contract of participation was in effect, the seller shall repurchase all unencumbered products, sales aids, literature, and promotional items which are in a reasonably resalable or reusable condition and which were acquired by the participant from the seller; such repurchase shall be at a price not less than 90 percent of the original net cost to the participant of the goods being returned. For purposes of this paragraph, "original net cost" means the amount actually paid by the participant for the goods, less any consideration received by the participant for purchase of the goods which is attributable to the specific goods now being returned. Goods shall be deemed "resalable or reusable" if the goods are in an unused, commercially resalable condition at the time the goods are returned to the seller. Goods which are no longer marketed by a company shall be deemed "resalable or reusable" if the goods are in an unused, commercially resalable condition and are returned to the seller within one year from the date the company discontinued marketing the goods; provided, however, that goods which are no longer marketed by a multilevel distribution company shall not be deemed "resalable or reusable" if the goods are sold to participants as nonreturnable, discontinued, or seasonal items and the nonreturnable, discontinued, or seasonal nature of the goods was clearly disclosed to the participant seeking to return the goods prior to the purchase of the goods by the participant. Notwithstanding anything to the contrary contained in this paragraph, a multilevel distribution company may not assert that any more than 15 percent of its total yearly sales per calendar year to participants in dollars are from nonreturnable, discontinued, or seasonal items;

(2) The repayment of all administrative fees or consideration paid for other services shall be at not less than 90 percent of the costs to the participant of such fees or services and shall reflect all other administrative services that have not, at the time of termination, been provided to the participant; and

(3) The participant may be held responsible for all shipping expenses incurred in returning sales aids or products to the company but only if such responsibility of a canceling participant is disclosed in the written description of the cancellation rights.

.....
10-1-417.

(a) *If a business opportunity seller or multilevel distribution company uses any untrue or misleading statements; or fails to comply with Code Section 10-1-411; or fails to deliver the equipment, supplies, or products necessary to begin substantial operation within 45 days of the delivery date stated in the contract; or if the business opportunity seller or multilevel distribution company does not comply with the requirements of Code Sections 10-1-410 through 10-1-416, then, within*

one year of the date of the contract, upon written notice to the seller, the purchaser or participant may void the contract and shall be entitled to receive from the seller all sums paid to the seller. Upon receipt of such sums, the purchaser or participant shall make available to the seller at the purchaser's or participant's address or at the places at which they are located at the time notice is given, all products, equipment, or supplies received by the purchaser or participant. However, the purchaser or participant shall not be entitled to unjust enrichment by exercising the remedies provided for in this subsection.

(b) The violation of any provision of this part shall constitute an unfair or deceptive act or practice in the conduct of a consumer act or practice or consumer transactions under Part 2 of this article, the "Fair Business Practices Act of 1975," and shall authorize an affected participant or purchaser to seek the remedies provided for in Code Section 10-1-399 and in subsection (a) of Code Section 10-1-417.

(c) Nothing contained in this part shall be construed to limit, modify, or repeal any provisions of Chapter 5 of this title, the "Georgia Securities Act of 1973," including, but not limited to, the definition of the term "security" as contained in paragraph (26) of subsection (a) of Code Section 10-5-2.

(d) Any person who fails to comply with this part shall be guilty of a misdemeanor of a high and aggravated nature. In addition thereto, if the violator is a corporation, each of its officers and directors may be subjected to a like penalty; and, if the violator is a sole proprietorship, the owner thereof may be subjected to a like penalty; and, if the violator is a partnership, each of the partners may be subjected to a like penalty, provided that no person shall be subjected to a like penalty if the person did not have actual knowledge of the acts violating this part.

[JMT: The Georgia statute includes a great consumer protection if enforced; i.e., overrides from downline sales would not be legal" unless the participant performs a bona fide supervisory, distributive, selling, or soliciting function in the sale or delivery of such product or services to the ultimate consumer."⁴⁸⁰ This means that the promise of time freedom or residual or absentee income from building a downline – needing little or no tending – that would allow one to live a life of ease would be encouraging violation of this statute.

Undocumented earnings claims⁴⁸¹ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as

a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

The "repurchase agreement" may sound good, and the DSA has been successful in convincing legislatures that such repurchase provision prevents stockpiling. However, statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.]

GUAM

§32201. Deceptive Trade Practices Unlawful.

(a) False, misleading, or deceptive acts or practices, including, but not limited to those listed in this chapter, are hereby declared unlawful and are subject to action by the Attorney General or any person as permitted pursuant to this chapter or other provisions of Guam law. A violation consisting of any act prohibited by this title is in itself actionable, and may be the basis for damages, rescission, or equitable relief. The provisions of this chapter are to be liberally construed in favor of the consumer, balanced with substantial justice, and violation of such provisions may be raised as a claim, defense, crossclaim or counterclaim.

(b) The term false, misleading, or deceptive acts or practices includes, but is not limited to, the following acts by any person or merchant, which acts are hereby prohibited and declared illegal and contrary to public policy if committed by any person or merchant:

(15) Selling or offering to sell, either directly or associated with the sale of goods or services, a right of participation in a multi-level distributorship. As used herein, multi-level distributorship means a sales plan for the distribution of goods or services in which promises of rebate or payment are made to individuals, conditioned upon those individuals recommending or securing additional individuals to assume positions in the sales operation, and where the rebate or payment is not exclusively conditioned on or in relation to proceeds from the retail sales of goods, provided that nothing herein shall prohibit the sale of a sales or presentation kit to prospective salespersons for Five Hundred Dollars (\$500) or less; provided, that the kit is sold at not more than the actual cost to the seller, that no commission is paid on the sale of the kit, and that a full refund (less any demonstration products used) is offered to the buyer for thirty (30) days after the delivery of the kit if the buyer returns the kit to the seller, whether or not the kit is used; and

⁴⁸⁰ §10-1-411 (a) (3)

⁴⁸¹ §10-1-415 (d) (1)

provided further that if the kit was purchased on Guam the kit can be returned to a location in Guam and the refund immediately collected thereat and if purchased off-island can be returned to the place of purchase for the refund.⁴⁸²

[JMT: “False, misleading, or deceptive acts or practices”: In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

HAWAII

[§480-3.3] Endless chain schemes. A person engages in an unfair method of competition and an unfair or deceptive act or practice within the meaning of section 480-2 when, in the conduct of any trade or commerce, the person contrives, prepares, sets up, proposes, or operates any endless chain scheme. As used in this section, an endless chain scheme 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 payments 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. [L 1970, c 28, §1; gen ch 1985]

[JMT: An MLM’s “endless chain scheme” is a key red flag for any product-based pyramid scheme.⁴⁸³ All MLMs are built on an endless chain of recruitment.

Hawaii also has a statute called the “Uniform Deceptive Trade Practices Act”⁴⁸⁴ which prohibits 12 specific practices, plus any other conduct that creates a misunderstanding on the part of a consumer. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

IDAHO

Idaho Unlawful Sales Referral Practices: The State of Idaho Legislative Code contains a prohibition

against unfair methods of competition and unfair or deceptive acts or practices in the conduct of trade or business. One such “unlawful practice” listed in the Idaho Consumer Protection Act is the practice of “referral selling.” Idaho law defines this unlawful practice as follows:

48-603. UNFAIR METHODS AND PRACTICES

(15) Promising or offering to pay, ... any compensation or reward in consideration of his giving to the seller or lessor the names of prospective purchasers or lessees, or otherwise aiding the seller or lessor in making a sale or lease to another person, if the earning of the rebate, discount or other value is contingent upon the occurrence of an event subsequent to the time the buyer or lessee agrees to buy or lease...

Idaho Pyramid Statute

TITLE 18– CRIMES AND PUNISHMENTS
CHAPTER 31 – FALSE PRETENSES, CHEATS
AND MISREPRESENTATIONS

18-3101. PYRAMID PROMOTIONAL SCHEMES
PROHIBITED -- PENALTIES -- SALE OF
INTEREST VOIDABLE -- SCOPE OF REMEDY.

(1) It is illegal and prohibited for any person, or any agent or employee thereof, to establish, promote, offer, operate, advertise or grant participation in any pyramid promotional scheme.

(2) As used in this section:

(a) "Appropriate inventory repurchase program" means a program by which a plan or operation repurchases, upon request at the termination of a participant's business relationship with the plan or operation and based upon commercially reasonable terms, current and marketable inventory purchased and maintained by the participant for resale, use or consumption, provided such plan or operation clearly describes the program in its recruiting literature, sales manual, or contracts with participants, including the manner in which the repurchase is exercised and disclosure of any inventory that is not eligible for repurchase under the program.

(b) "Commercially reasonable terms" means the repurchase of current and marketable inventory within twelve (12) months from the date of original purchase at not less than ninety percent (90%) of the original net cost to the participant, less appropriate set-offs and legal claims, if any. In the case of service products, the repurchase of such service products shall be on a pro rata basis, unless clearly disclosed otherwise to the participant, in order to qualify as "commercially reasonable terms."

(c) "Compensation" means a payment of any money, thing of value, or financial benefit.

(d) "Consideration" means a payment of any money, or the purchase of goods, services, or intangible property but shall not include:

1. The purchase of goods or services furnished at cost to be used in making sales and not for resale.
2. Time and effort spent in pursuit of sales or recruiting activities.

⁴⁸² Subsection (c)(21) added by P.L. 22-34:1 (9/27/93).

⁴⁸³ See Chapter 2.

⁴⁸⁴ §481A

(e) "Current and marketable" includes inventory that, in the case of consumable or durable goods, is unopened, unused and within its commercially reasonable use of shelf-life period. In the case of services and intangible property, including internet sites, "current and marketable" means the unexpired portion of any contract or agreement. The term "current and marketable" does not include inventory that has been clearly described to the participant prior to purchase as a seasonal, discontinued, or special promotion product not subject to the plan or operation's inventory repurchase program.

(f) "Inventory" includes both goods and services, including company-produced promotional materials, sales aids and sales kits that the plan or operation requires independent salespersons to purchase.

(g) "Inventory loading" means that the plan or operation requires or encourages its independent salespersons to purchase inventory in an amount that unreasonably exceeds that which the salesperson can expect to resell for ultimate consumption, or to use or consume, in a reasonable time period.

(h) "Participant" means a natural person who joins a plan or operation.

(i) "Person" means a natural person, partnership, corporation, trust, estate, business trust, joint venture, unincorporated association, or any other legal or commercial entity.

(j) "Promote" means to contrive, prepare, establish, plan, operate, advertise or otherwise induce or attempt to induce another person to be a participant.

(k) "Pyramid promotional scheme" means any plan or operation in which a participant gives consideration for the right to receive compensation that is derived primarily from the recruitment of other persons as participants in the plan or operation rather than from the sales of goods, services or intangible property to participants or by participants to others.

(3) A limitation as to the number of persons who may participate, or the presence of additional conditions affecting eligibility, or upon payment of anything of value by a person whereby the person obtains any other property in addition to the right to receive consideration, does not change the identity of the scheme as a pyramid promotional scheme.

(4) Any person, or any agent or employee thereof who willfully and knowingly promotes, offers, advertises, or grants participation in a pyramid promotional scheme shall be guilty of a felony.

(5) All pyramid promotional schemes offered by the same person, or agents or employees thereof, or any person controlled by or affiliated with such person, for the same type of consideration, at substantially the same period of time and for the same general purpose, shall be deemed to be one

(1) integrated pyramid promotional scheme, even

though such pyramid promotional schemes may be given different names or other designations.

(6) *Nothing in this section or in any rule promulgated pursuant to this section shall be construed to prohibit a plan or operation, or to define such plan or operation as a pyramid promotional scheme, based upon the fact that participants in the plan or operation give consideration in return for the right to receive compensation based upon purchases of goods, services or intangible property by participants for personal use, consumption or resale, provided the plan or operation implements an appropriate inventory repurchase program and does not promote inventory loading.*

(7) Any violation of this section shall also be deemed an unfair and deceptive practice in violation of the Idaho consumer protection act. Any person aggrieved by a violation of this section can recover monetary damages pursuant to the Idaho consumer protection act.

(8) The rights and remedies that are granted under the provisions of this section to purchasers in pyramid promotional schemes are independent of and in addition to any other right or remedy available to them in law or equity, and nothing contained herein shall be construed to diminish or abrogate any such right or remedy.

[JMT: The "personal use" exemption in the Idaho statute⁴⁸⁵ was recently introduced as a result of deceptive DSA lobbying. This works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

The "inventory repurchase program"⁴⁸⁶ may sound good, and the DSA has been successful in convincing legislatures that such repurchase provision prevents stockpiling. However, statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.]

However, another Idaho statute prohibits any misleading consumer practices or unconscionable practices. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent

⁴⁸⁵ §18-3101 (2) (k)

⁴⁸⁶ §18-3101 (2) (a)

products, especially those selling “pills, potions, and lotions.”]

ILLINOIS

Illinois consumer protection law defines a "pyramid sales scheme" as: "any plan or operation whereby a person, in exchange for money or other thing of value, acquires the opportunity to receive a benefit or thing of value, which is primarily based upon the inducement of additional persons, by himself or others, regardless of number, to participate in the same plan or operation and is not primarily contingent on the volume or quantity of goods, services, or other property sold or distributed or to be sold or distributed to persons for purposes of resale to consumers." Illinois Compiled Statutes Ch. 121 ½, Par. 262A.

[JMT: Pyramid schemes (which can include MLMs) also violate the Illinois Consumer Fraud and Deceptive Business Practices Act which is enforced by the Consumer Fraud Bureau of the Office of the Illinois Attorney General. The law allows the Attorney General to ask the court to impose a civil penalty in the amount of \$50,000 per violation.

In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading; i.e., a deceptive business practice. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

INDIANA

Indiana Code

IC 24-5-0.5-2. As used in this chapter:

(3) "Supplier" means: . . .

(B) a person who contrives, prepares, sets up, operates, publicizes by means of advertisements, or promotes a pyramid promotional scheme.

(8) "Pyramid promotional scheme" means any program utilizing a pyramid or chain process by which a participant in the program gives a valuable consideration exceeding one hundred dollars (\$100) for the opportunity or right to receive compensation or other things of value in return for inducing other persons to become participants for the purpose of gaining new participants in the program. The term does not include ordinary sales of goods or services to persons who are not purchasing in order to participate in such a scheme.

(9) "Promoting a pyramid promotional scheme" means: (A) inducing or attempting to induce one (1) or more other persons to become participants in a pyramid promotional scheme; or (B) assisting another in promoting a pyramid promotional scheme.

IC 24-5-0.5-3. (a) The following acts or representations as to the subject matter of a consumer transaction, made either orally or in writing by a supplier, are deceptive acts:

. . . .

(9) That the consumer will receive a rebate, discount, or other benefit as an inducement for entering into a sale or lease in return for giving the supplier the names of prospective consumers or otherwise helping the supplier to enter into other consumer transactions, if earning the benefit, rebate, or discount is contingent upon the occurrence of an event subsequent to the time the consumer agrees to the purchase or lease.

[JMT: An MLM’s “endless chain” structure - or “chain process”⁴⁸⁷ is a key red flag for any product-based pyramid scheme.⁴⁸⁸ All MLMs are built on an endless chain of recruitment.

Also, the provision that the term “pyramid promotional scheme . . . does not include ordinary sales of goods or services to persons who are not purchasing in order to participate in such a scheme” is good wording for encouraging a retail focus, although MLMs typically do not incentivize retail sales to nonparticipants.]

IOWA

714.16 Consumer frauds.

1. Definitions:

a. The term "advertisement" includes the attempt by publication, dissemination, solicitation or circulation to induce directly or indirectly any person to enter into any obligation or acquire any title or interest in any merchandise;

. . . .

2. a. The act, use or employment by a person of an unfair practice, deception, fraud, false pretense, false promise, or misrepresentation, or the concealment, suppression, or omission of a material fact with intent that others rely upon the concealment, suppression, or omission, in connection with the lease, sale, or advertisement of any merchandise or the solicitation of contributions for charitable purposes, whether or not a person has in fact been misled, deceived, or damaged, is an unlawful practice.

It is deceptive advertising within the meaning of this section for a person to represent in connection with the lease, sale, or advertisement of any merchandise that the advertised merchandise has certain performance characteristics, accessories, uses, or benefits or that certain services are performed on behalf of clients or customers of that person if, at the time of the representation, no reasonable basis for the claim existed. The burden is on the person making the representation to

⁴⁸⁷ IC 24-5-0.5-2, §(B)(8)

⁴⁸⁸ See Chapter 2.

demonstrate that a reasonable basis for the claim existed.

....

b. The advertisement for sale, lease or rent, or the actual sale, lease, or rental of any merchandise at a price or with a rebate or payment or other consideration to the purchaser which is contingent upon the procurement of prospective customers provided by the purchaser, or the procurement of sales, leases, or rentals to persons suggested by the purchaser, is declared to be an unlawful practice rendering any obligation incurred by the buyer in connection therewith, completely void and a nullity. The rights and obligations of any contract relating to such contingent price, rebate, or payment shall be interdependent and inseverable from the rights and obligations relating to the sale, lease, or rental.

[JMT: Note the following: “The act, use or employment by a person of an unfair practice, deception, fraud, false pretense, false promise, or misrepresentation, or the concealment, suppression, or omission of a material fact with intent that others rely upon the concealment, suppression, or omission,” In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”

Also, §b could suggest a product-based pyramid scheme, or MLM.]

KANSAS

Chapter 21.

CRIMES AND PUNISHMENTS

PART II

PROHIBITED CONDUCT

Part 2.--Prohibited Conduct

Article 37.--CRIMES AGAINST PROPERTY

21-3762. Establishing, operating, advertising or promoting a pyramid promotional scheme.

(a) As used in this section, “pyramid promotional scheme” means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from any person’s introduction of other persons into participation in the plan or operation rather than from the sale of goods, services or intangible property by the participant or other persons introduced into the plan or operation.

(b) Establishing, operating, advertising or promoting a pyramid promotional scheme shall be a severity level 9, nonperson felony.

(c) A limitation as to the number of persons who may participate or the presence of additional conditions affecting eligibility for the opportunity to

receive compensation under the plan or operation does not change the identity of the scheme as a pyramid promotional scheme nor is it a defense under this section that a participant, on giving consideration, obtains any goods, services or intangible property in addition to the right to receive compensation.

(d) The attorney general, or county attorney or district attorney, or both, may institute criminal action to prosecute this offense.

(e) This section shall be part of and supplemental to the Kansas criminal code.

Chapter 50.--UNFAIR TRADE AND CONSUMER PROTECTION

Article 6.--CONSUMER PROTECTION

50-626. Deceptive acts and practices.

(a) No supplier shall engage in any deceptive act or practice in connection with a consumer transaction.

(b) Deceptive acts and practices include, but are not limited to, the following, each of which is hereby declared to be a violation of this act, whether or not any consumer has in fact been misled:

(1) Representations made knowingly or with reason to know that:

....

(E) the consumer will receive a rebate, discount or other benefit as an inducement for entering into a consumer transaction in return for giving the supplier the names of prospective consumers or otherwise helping the supplier to enter into other consumer transactions, if receipt of benefit is contingent on an event occurring after the consumer enters into the transaction;

[JMT: Note the following: “No supplier shall engage in any deceptive act or practice in connection with a consumer transaction.” In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”

The Kansas statute allows compensation to be based on personal consumption; e.g. “by the participant or other persons introduced into the plan or operation.”⁴⁸⁹ The “other person” could be a person above the participant in the hierarchy of participants. This allowance for compensation based on personal consumption of downline participants is something for which the DSA lobbies aggressively – and that works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.]

⁴⁸⁹ §21-3762 (a)

KENTUCKY

CHAPTER 367

CONSUMER PROTECTION

PYRAMID SALES

367.830 DEFINITIONS

Unless the context otherwise requires:

- (1) "Participant" shall include, but is not limited to, those who give consideration in order to participate in the pyramid distribution plan;
- (2) "Person" means natural persons, corporations, trusts, partnerships, incorporated or unincorporated associations, or any other legal entity;
- (3) "Promotes" means inducing one (1) or more other persons to become a participant;
- (4) "Pyramid distribution plan" means any plan, program, device, scheme, or other process by which a participant gives consideration for the opportunity to receive compensation or things of value in return for inducing other persons to become participants in the program;
- (5) "Compensation" means payment of any money, thing of value, or financial benefit conferred in return for inducing others to become participants in the pyramid distribution plan. Compensation does not include payment based on sales of goods or services by the person or by other participants in the plan to anyone, including a participant in the plan, who is purchasing the goods or services for actual use or consumption; and
- (6) "Consideration" means the payment of cash or the purchase of goods, services, or intangible property but does not include the purchase of goods or services furnished at cost to be used in making sales and not for resale, nor does it include time and effort spent in pursuit of sales or recruiting activities.

HISTORY: 1986 c 184, § 1, eff. 7 15 86

367.832 PYRAMID DISTRIBUTION PLAN

PROHIBITED

(1) *It is hereby declared unlawful for any person to establish, promote, operate, or participate in any pyramid distribution plan.*

(2) A limitation as to the number of persons who may participate or the presence of additional conditions affecting eligibility for the opportunity to receive compensation under the plan does not change the identity of the plan as a pyramid distribution plan nor is it a defense under this section that a participant, on giving consideration, obtains goods, services or intangible property in addition to the right to receive compensation.

HISTORY: 1986 c 184, § 2, eff. 7 15 86

PENALTY

Penalty: 367.990(20)(a)

[JMT: From § (5) we read: “Compensation does not include payment based on sales of goods or services by the person or by other participants in the plan to anyone, including a participant in the plan, who is purchasing the goods or services for actual use or consumption.” This allowance for

compensation based on personal consumption of downline participants is something for which the DSA has lobbied aggressively – and that works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

However, it should be noted that Kentucky also has a statute that prohibits unfair or deceptive acts or practices in the conduct of any trade or commerce⁴⁹⁰. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading; i.e., an unfair or deceptive act or practice. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

LOUISIANA

§361. Definitions

As used in this Subpart:

- (1) "Compensation" means the payment of money, a thing of value, or any financial benefit. Compensation does not include:
 - (a) Payment to participants based upon sales of products purchased for actual use or consumption, including products used or consumed by participants in the plan.
 - (b) Payment to participants under reasonable commercial terms.
- (2) "Consideration" means the payment of cash or purchase of goods, services, or intangible property. Consideration does not include:
 - (a) Purchase of products furnished at cost to be used in making sales and not for resale.
 - (b) Purchase of products where the seller offers to repurchase the participant's products under reasonable commercial terms.
 - (c) Participant's time and effort in pursuit of sales or recruiting activities.
- (3) "Participant" means a person who contributes money into a pyramid promotional scheme.
- (4) "Person" means an individual, a corporation, a partnership, or any association, or unincorporated organization.
- (5) "Promote" means to contrive, direct, establish, or operate a pyramid promotional scheme.
- (6) "Pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from the person's introduction of other persons into a plan or operation rather than from the sale of goods, services, or intangible property by the participant or other persons introduced into the plan or operation.
- (7) "Reasonable commercial terms" includes repurchase by the seller, at the participant's request,

⁴⁹⁰ § 367.170

and upon termination of the business relationship or contract with the seller, of all unencumbered products purchased by the participant from the seller within the previous twelve months which are unused and in commercially resalable condition, provided that repurchase by the seller shall be for not less than ninety percent of the actual amount paid by the participant to the seller of the products, less any consideration received by the participant for purchase of the products which are being returned. A product shall not be deemed nonresalable solely because the product is no longer marketed by the seller, unless it is clearly disclosed to the participant at the time of the sale that the product is a seasonal, discontinued, or special promotional product, and not subject to the repurchase obligation.

Acts 1997, No. 379, § 1; Acts 2001, No. 837, § 1.

§362. Promoting pyramid promotional scheme unlawful

No person shall promote a pyramid promotional scheme in Louisiana or cause a pyramid promotional scheme to be promoted in Louisiana. Acts 1997, No. 379, § 1; Acts 2001, No. 837, § 1.

§363. Violations; penalties

Whoever promotes a pyramid promotional scheme in Louisiana or causes a pyramid promotional scheme to be promoted in Louisiana shall be fined not more than ten thousand dollars or imprisoned, with or without hard labor, for not more than ten years, or both.

Acts 1997, No. 379, § 1; Acts 2001, No. 837, § 1.

[JMT: The Louisiana statute allows compensation to be based on personal consumption of participants⁴⁹¹, something for which the DSA has lobbied aggressively – and that works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

“Repurchase by the seller”⁴⁹² within 12 months may sound good to regulators, but statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.

However, Louisiana also has a statute prohibiting “unfair or deceptive acts or practices.”⁴⁹³ In every case where average income figures have been released by MLM

companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

MAINE

§ 2305. *Multi-level distributorships, pyramid clubs, etc., declared a lottery; prohibited; penalties*
The organization of any multi-level distributorship arrangement, pyramid club or other group, organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by members thereof are to be paid or given to any other member thereof who has been required to pay or give anything of material value for the right to receive such sums, with the exception of payments based exclusively on sales of goods or services to persons who are not participants in the plan and who are not purchasing in order to participate in the plan, which plan or device includes any provision for the increase in such membership through a chain process of new members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues or things of material value from other members, is declared to be a lottery, and whoever shall organize or participate in any such lottery by organizing or inducing membership in any such group or organization shall be guilty of a misdemeanor, and upon conviction thereof shall be punished by a fine of not more than \$5,000 or by imprisonment for not more than 11 months, or by both. [1971, c. 312 (new).]

A violation of this section shall constitute a violation of Title 5, Chapter 10, Unfair Trade Practices Act. [1971, c. 312 (new).]

[JMT: An MLM’s “endless chain” structure - or “chain process” is a key red flag for any product-based pyramid scheme.⁴⁹⁴ All MLMs are built on an endless chain of recruitment.

The labeling of an MLM or pyramid scheme as a lottery is a reflection of the fact that the income resulting from building a downline of participants is quite unpredictable and depends on many factors not under the control of the participant, such as time or sequence of entry in the chain of recruitment, performance of downline members, and decisions by company executives.

In addition, the state legislature in Maine adopted the Uniform Deceptive Trade Practices Act. The statute prohibits 12 specific practices, plus “conduct likely to create confusion or misunderstanding to a consumer, unfair

⁴⁹¹ §361 (1) (a)

⁴⁹² §361 (7)

⁴⁹³ §RS 22:574

⁴⁹⁴ See Chapter 2.

methods of competition, and unfair or deceptive acts or practices.” In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”

NOTE: In my opinion, Maine is one of the best examples of consumer protective legislation against endless chain selling schemes. If it were strictly enforced, MLMs could not operate in Maine.]

MARYLAND

§ 14-301.

Business Regulation

In this subtitle, "multilevel distribution company" means a person who, for consideration, distributes goods or services through independent agents, contractors, or distributors at different levels of distribution with rates of pricing or discounting that differ from 1 level to another.

§ 14-302.

Business Regulation

(a) A multilevel distribution company may not require a participant in its marketing program to buy goods or services or pay any other consideration to participate in the marketing program unless the multilevel distribution company agrees to repurchase the goods:

- (1) that are in resalable condition; and
- (2) that the participant has been unable to sell 3 months after receipt of the goods first ordered.

(b) A multilevel distribution company shall state in writing in each contract of participation in its marketing program that:

- (1) a participant may cancel the contract for any reason within 3 months after the date of receipt of goods or services first ordered by written notice to the multilevel distribution company; and
 - (2) on cancellation, the multilevel distribution company shall repurchase the goods.
- (c) The repurchase price shall be at least 90% of the original price paid by the participant.

§ 14-303.

Business Regulation

A multilevel distribution company may not represent directly or indirectly that participants in its marketing program may or will earn a stated gross or net amount or represent in any way the past earnings of participants unless the stated gross amount, net amount, or past earnings:

- (1) are those of a substantial number of participants in the community or geographic area where the representation is made; and

(2) accurately reflect the average earnings of participants under circumstances similar to those of the participant or prospective participant to whom the representation is made.

§ 14-304.

Business Regulation

(a) The Attorney General or a State's Attorney may sue to enjoin, wholly or partly, the activities of a multilevel distribution company that violate this subtitle.

(b) At least 10 days before seeking injunctive relief, the Attorney General or State's Attorney shall send written notice of the alleged violation by certified mail to the principal place of business of the multilevel distribution company.

§ 14-305.

Commercial Law

Any person who willfully violates any provision of this subtitle is guilty of a misdemeanor and, in addition to the injunctive relief provided for in Title 13, Subtitle 4 of this article, on conviction is subject to a fine of not more than \$1,000 or imprisonment of not more than one year or both.

§ 13-304.

Commercial Law

A seller may not use any general referral sales technique, plan, arrangement, or agreement by which a buyer is induced to purchase merchandise, real property, or intangibles on the representation or promise of the seller that if the buyer furnishes to the seller the names of other prospective buyers of like or identical merchandise, real property, or intangibles, he will receive a reduction in purchase price by means of a cash rebate, commission, or credit toward balance due or any other consideration.

§ 233D.

Crimes and Punishments

(a) In this section, the following words have the meanings indicated.

(1) "Compensation" includes payment based on a sale or distribution made to a person who is either a participant in a plan or operation or who, upon making payment, then has the right to become a participant.

(2) "Consideration" does not include:

- (i) Payment for purchase of goods or services furnished at cost for use in making sales to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme;
- (ii) Time or effort spent in pursuit of sales or recruiting activities; or
- (iii) The right to receive a discount or rebate based on the purchase or acquisition of goods or services by a bona fide cooperative buying group or association.

(3) "Promote" means to induce one or more other persons to become a participant.

(4) "Pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation to be derived primarily from any person's introduction of other persons into participation in the plan or operation rather than from the sale of goods, services, or other intangible property by the participant or other persons introduced into the plan or operation.

(b) A person may not establish, operate, advertise, or promote a pyramid promotional scheme.

(c) A person who violates the provisions of this section is guilty of a misdemeanor and on conviction is subject to a fine of not more than \$10,000 or imprisonment for not more than 1 year or both.

(d) It is not a defense to a prosecution under this section that:

(1) The plan or operation limits the number of persons who may participate or limits the eligibility of participants; or

(2) On payment of anything of value by a participant, the participant obtains any other property in addition to the right to receive compensation.

[JMT: The provision to repurchase goods for a 90% refund for "marketable inventory within three months from its date of purchase" may sound good. The DSA has been successful in convincing legislatures that such repurchase provision prevents stockpiling. However, statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.

The Maryland statute allows compensation to be based on personal consumption – "by the participant or other persons introduced into the plan or operation."⁴⁹⁵ The "other person" could be a person above the participant in the hierarchy of participants. This allowance for compensation based on personal consumption of downline participants is something for which the DSA lobbies aggressively – and that works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

However, Maryland has a statute that prohibits unfair or deceptive trade practices.⁴⁹⁷ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

MASSACHUSETTS

GENERAL LAWS OF MASSACHUSETTS

Chapter 93: Section 69. Definition; requirements.

Section 69. (a) As used in this section the term "multi-level distribution company" shall mean any person, firm, corporation or other business entity which distributes for a valuable consideration, goods or services through independent agents, contractors or distributors, at different levels, wherein participants in the marketing program may recruit other participants, and wherein commissions, cross-commissions, bonuses, refunds, discounts, dividends or other considerations in the marketing program are or may be paid as a result of the sale of such goods and services or the recruitment, actions or performances of additional participants.

(b) Every multi-level distribution company shall provide in its contract of participation that such contract may be canceled for any reason at any time by a participant upon notification in writing to the company of his election to cancel. If the participant has purchased products while the contract of participation was in effect, all unencumbered products in a resaleable condition then in the possession of the participant shall be repurchased. The repurchase shall be at a price of not less than ninety per cent of the original net cost to the participant returning such goods, taking into account any sales made by or through such participant prior to notification to the company of the election to cancel.

(c) No multi-level distribution company, nor any participant, shall require participants in its marketing program to purchase products or services or pay any other consideration in order to participate in the marketing program unless such products or services are in reasonable quantities and unless it agrees: (1) to repurchase all or part of any products which are unencumbered and in a resaleable condition at a price of not less than ninety per cent of the original net cost to the participant; (2) to repay not less than ninety per cent of the original net cost of any services purchased by the participant; or (3) to refund not less than ninety per cent of any other consideration paid by the participant in order to participate in the marketing program.

⁴⁹⁵ § 14-302

⁴⁹⁶ § 233D (4)

⁴⁹⁷ § 13-301

(d) No multi-level distribution company or participant in its marketing program shall: (1) operate or, directly or indirectly, participate in the operation of any multi-level marketing program wherein the financial gains to the participants are primarily dependent upon the continued, successive recruitment of other participants and where retail sales are not required as a condition precedent to realization of such financial gains; (2) offer to pay, pay or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration to any participants in a multi-level marketing program solely for the solicitation or recruitment of other participants therein; (3) offer to pay, pay or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration to any participants in a multi-level marketing program in connection with the sale of any product or service unless such participant performs a bona fide and essential supervisory, distributive, selling or soliciting function in the sale or delivery of such product or services to the ultimate consumer; or (4) offer to pay, pay or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration to any participant where payment thereof is or would be dependent on the element of chance dominating over the skill or judgment of such participant, or where no amount of judgment or skill exercised by the participant has any appreciable effect upon any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration which the participant may receive, or where the participant is without that degree of control over the operation of such plan as to enable him substantially to affect the amount of finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration which he may receive or be entitled to receive.

(e) Multi-level distribution companies shall not represent, directly or indirectly, that participants in a multi-level marketing program will earn or receive any stated gross or net amount, or represent in any manner, the past earnings of participants; provided, however, that a written or verbal description of the manner in which the marketing plan operates shall not, standing alone, constitute a representation of earnings, past or future. *Multi-level distribution companies shall not represent, directly or indirectly, that additional distributors or sales personnel are easy to secure or retain, or that all or substantially all participants will succeed.*

(f) Each multi-level distribution company numbering among its participants any resident of the commonwealth shall annually file with the attorney general a statement giving notice of this fact and designating the state secretary its agent for service of process for any alleged violation of this section.

(g) Any violation of the provisions of this section shall constitute an unlawful method, act or practice

within the meaning of clause (a) of Section 2 of Chapter 93A.

[JMT: The requirement of a 90% refund for products in "resalable condition" ⁴⁹⁸ may sound good. The DSA has been successful in convincing legislatures that such repurchase provision prevents stockpiling. However, statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.]

The Massachusetts statute includes a great consumer protection if enforced; i.e., rewards to upline requires performance of "a bona fide and essential supervisory, distributive, selling or soliciting function." This means that the promise of time freedom or residual or absentee income from building a downline – needing little or no tending – that would allow one to live a life of ease would be bordering on illegal.

Also, Massachusetts has a law forbidding "unfair or deceptive acts or practices." ⁴⁹⁹ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading, i.e., "unfair and deceptive." It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."]

MICHIGAN

445.903

Unfair, unconscionable, or deceptive methods, acts, or practices in conduct of trade or commerce; rules. [M.S.A. 19.418(3)]

Sec. 3. (1) Unfair, unconscionable, or deceptive methods, acts, or practices in the conduct of trade or commerce are unlawful and are defined as follows:

(a) Causing a probability of confusion or misunderstanding as to the source, sponsorship, approval, or certification of goods or services.
 (w) Representing that a consumer will receive a rebate, discount, or other benefit as an inducement for entering into a transaction, if the benefit is contingent on an event to occur subsequent to the consummation of the transaction.

⁴⁹⁸ §69 (c)

⁴⁹⁹ MGL 93A

FRANCHISE INVESTMENT LAW

Act 269 of 1974

AN ACT to regulate the offer, sale, and purchase of franchises; to prohibit fraudulent practices in relation thereto; to prohibit pyramid and chain promotions; to impose regulatory duties upon certain state departments and agencies; and to provide penalties.

445.1528 Pyramid or chain promotion or distribution. [M.S.A. 19.854(28)]

Sec. 28. (1) A person may not offer or sell any form of participation in a pyramid or chain promotion. A pyramid or chain promotion is any plan or scheme or device by which (a) a participant gives a valuable consideration for the opportunity to receive compensation or things of value in return for inducing other persons to become participants in the program or (b) a participant is to receive compensation when a person introduced by the participant introduces one or more additional persons into participation in the plan, each of whom receives the same or similar right, privilege, license, chance, or opportunity.

(2) A pyramid or chain promotion is declared to be illegal and against the public policy of the state.

Any contract made in violation of this section is voidable at the sole option of the purchaser.

(3) The department shall not accept for filing a franchise which involves a pyramid or chain distribution contrary to the laws of this state.

History: 1974, Act 269, Eff. Oct. 15, 1974.

[JMT: An MLM's "endless chain" structure - or "pyramid or chain promotion" ⁵⁰⁰ is a key red flag for any product-based pyramid scheme. ⁵⁰¹

All MLMs are built on an endless chain of recruitment.

Michigan also has a statute that prohibits 31 specific practices, plus any other deceptive, unfair, or unconscionable acts or practices. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading (deceptive and unfair). It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

MINNESOTA

325F.69

Unlawful practices.

Subdivision 1. Fraud, misrepresentation, deceptive practices. The act, use, or employment by any person of any fraud, false pretense, false promise, misrepresentation, misleading statement or

deceptive practice, with the intent that others rely thereon in connection with the sale of any merchandise, whether or not any person has in fact been misled, deceived, or damaged thereby, is enjoined as provided herein.

Subd. 2. Referral and chain referral selling prohibited.

(1) *With respect to any sale or lease the seller or lessor may not give or offer a rebate or discount or otherwise pay or offer to pay value to the buyer or lessee as an inducement for a sale or lease in consideration of the buyer's or lessee's giving to the seller or lessor the names of prospective purchasers or lessees, or otherwise aiding the seller or lessor in making a sale or lease to another person, if the earning of the rebate, discount or other value is contingent upon the occurrence of an event subsequent to the time the buyer or lessee agrees to buy or lease.*

(2) (a) *With respect to any sale or lease, it shall be illegal for any seller or lessor to operate or attempt to operate any plans or operations for the disposal or distribution of property or franchise or both whereby a participant gives or agrees to give a valuable consideration for the chance to receive something of value for inducing one or more additional persons to give a valuable consideration in order to participate in the plan or operation, or for the chance to receive something of value when a person induced by the participant induces a new participant to give such valuable consideration including such plans known as chain referrals, pyramid sales, or multilevel sales distributorships.*

(b) *The phrase "something of value" as used in paragraph (a) above, does not mean or include payment based upon sales made to persons who are not purchasing in order to participate in the prohibited plan or operation.*

(3) *If a buyer or lessee is induced by a violation of this subdivision to enter into a sale or lease, the agreement is unenforceable and the buyer or lessee has the option to rescind the agreement with the seller or lessor and, upon tendering the property received, or what remains of it, obtain full or in the case of remains, a proportional restitution of all sums paid, or retain the goods delivered and the benefit of any services performed without any further obligation to pay for them.*

(4) *With respect to a sale or lease in violation of this section an assignee of the rights of the seller or lessor is subject to all claims and defenses of the buyer or lessee against the seller or lessor arising out of the sale or lease notwithstanding an agreement to the contrary, but the assignee's liability under this section may not exceed the amount owing to the assignee at the time the claim or defense is asserted against the assignee. Rights of the buyer or lessee under this section can only be asserted as a matter of defense to or setoff against a claim by the assignee.*

(5) *In a sale or lease in violation of this section, the seller or lessor may not take a negotiable*

⁵⁰⁰ M.S.A. 19.854 (28) (1) and (2)

⁵⁰¹ See Chapter 2.

instrument other than a check as evidence of the obligation of the buyer or lessee. A holder is not in good faith if the holder takes a negotiable instrument with notice that it is issued in violation of this section.

(6) Any person who violates any provision of this subdivision shall be guilty of a gross misdemeanor.

[JMT: Subdivision 1 states that fraud, misrepresentation, deceptive practices are enjoined, or forbidden. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading (a deceptive practice). It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

An MLM's "endless chain" - or "chain referrals" (§ 2)(a)) is a key red flag for any product-based pyramid scheme.⁵⁰² All MLMs are built on endless chains of recruitment.

The provision that in chain referral selling, the phrase "something of value," as used in paragraph (2)(a), "does not mean or include payment based upon sales made to persons who are not purchasing in order to participate in the prohibited plan or operation" is good wording for encouraging a retail focus, although MLMs typically do not significantly incentivize retail sales to nonparticipants.]

MISSISSIPPI

§ 75-24-51. Definitions.

As used in sections 75-24-51 to 75-24-61:

(1) The term "sale or distribution" includes the acts of leasing, renting or consigning;

(2) The term "goods" includes any personal property, real property, or any combination thereof;

(3) The term "other property" includes a franchise, license distributorship or other similar right, privilege, or interest;

(4) The term "person" includes an individual, corporation, trust, estate, partnership, unincorporated association, or any other legal or commercial entity;

(5) *The term "pyramid sales scheme" includes any plan or operation for the sale or distribution of goods, services, or other property wherein a person for a consideration acquires the opportunity to receive a pecuniary benefit, which is not primarily contingent on the volume or quantity of goods, services, or other property sold or distributed to be sold or distributed to persons for purposes of resale to consumers, and is based upon the inducement of additional persons, by*

himself or others, regardless of number, to participate in the same plan or operation;

....

(7) "Consideration" as used in sections 75-24-51 to 75-24-61 does not include payment for sales demonstration equipment and materials furnished at cost for use in making sales and not for resale or payments amounting to less than one hundred dollars (\$100.00) when computed on an annual basis.

SOURCES: Laws, 1975, ch. 362, § 1, eff from and after July 1, 1975.

§ 75-24-53. Sales of participation in pyramid sales scheme forbidden; . . .

No person shall, directly or through the use of agents or intermediaries, in connection with the sale, distribution, or lease of goods, services, or other property, sell, offer or attempt to sell a participation or the right to participate in a pyramid sales scheme. . . .

SOURCES: Laws, 1975, ch. 362, § 2, eff from and after July 1, 1975.

....

§ 75-24-57. Sales contract for pyramid sales scheme void; actions for damages.

Any sales contract for a pyramid sales scheme made in violation of section 75-24-53 is void and any person who, directly or through the use of agents or intermediaries, induces or causes another person to participate in a pyramid sales scheme will be subject to the remedy and proceedings authorized in section 75-24-15.

....

SOURCES: Laws, 1975, ch. 362, § 4, eff from and after July 1, 1975.

§ 75-24-59. Injunctive relief.

In addition to other penalties and remedies provided in sections 75-24-51 to 75-24-61, whenever it appears that any person is engaged or is about to engage in any act or practice which constitutes a pyramid sales scheme or which is prohibited by sections 75-24-51 to 75-24-61, the attorney general may bring an action in the name of the state pursuant to the provisions of section 75-24-9 in order to enjoin any such act or practice.

SOURCES: Laws, 1975, ch. 362, § 5, eff from and after July 1, 1975.

§ 75-24-61. Penalties.

Any person willfully violating any of the provisions of section 75-24-53 is guilty of a misdemeanor and, upon conviction, shall be punished by a fine of not more than five hundred dollars (\$500.00) or by imprisonment in the county jail for a term not to exceed six (6) months or by both such fine and imprisonment.

SOURCES: Laws, 1975, ch. 362, § 6, eff from and after July 1, 1975.

⁵⁰² See Chapter 2.

[JMT: The definition of "pyramid sales scheme" seems to allow for compensation based on personal consumption of downline participants – something for which the DSA lobbies aggressively – and that works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

However, Mississippi has a statute that prohibits “deceptive or unconscionable acts or practices.” In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

MISSOURI

Missouri Revised Statutes, Chapter 407
Merchandising Practices Section 407.400
Definitions.

407.400. As used in sections 407.400 to 407.420:

. . . .

(5) *The term "pyramid sales scheme" includes any plan or operation for the sale or distribution of goods, services or other property wherein a person for a consideration acquires the opportunity to receive a pecuniary benefit, which is not primarily contingent on the volume or quantity of goods, services, or other property sold or distributed or to be sold or distributed to persons for purposes of resale to consumers, and is based upon the inducement of additional persons, by himself or herself or others, regardless of number, to participate in the same plan or operation;*

(6) *The term "sale or distribution" includes the acts of leasing, renting or consigning.*

Missouri Revised Statutes
Chapter 407
Merchandising Practices
Section 407.405

Pyramid sales schemes prohibited-- . . .

407.405. No person shall, directly or through the use of agents or intermediaries, in connection with the sale or distribution of goods, service, or other property, sell, offer or attempt to sell a participation or the right to participate in a pyramid sales scheme. . . .

[JMT: The definition of "pyramid sales scheme" seems to allow for compensation based on personal consumption of downline participants – something for which the DSA lobbies aggressively – and that works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

However, Missouri has a statute prohibiting “deceptive or unfair acts or concealment or omission of a material fact from a consumer.” In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading; i.e., deceptive. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

MONTANA

Montana Code
MCA 30-10-324
TITLE 30: TRADE AND COMMERCE
CHAPTER 10: SECURITIES REGULATION
PART 3: OFFENSES AND PENALTIES
Current through the September 13, 2002 Special Session
30-10-324. Definitions

As used in 30-10-324 through 30-10-326, the following definitions apply:

(1) (a) "Compensation" means the receipt of money, a thing of value, or a financial benefit.

(b) Compensation does not include:

(i) payments to a participant based upon the sale of goods or services by the participant to third persons when the goods or services are purchased for actual use or consumption; or

(ii) payments to a participant based upon the sale of goods or services to the participant that are used or consumed by the participant.

(2) (a) "Consideration" means the payment of money, the purchase of goods or services, or the purchase of intangible property.

(b) Consideration does not include:

(i) the purchase of goods or services furnished at cost that are used in making sales and that are not for resale; or

(ii) a participant's time and effort expended in the pursuit of sales or in recruiting activities.

(3) (a) "Multilevel distribution company" means a person that:

(i) sells, distributes, or supplies goods or services through independent agents, contractors, or distributors at different levels of distribution;

(ii) may recruit other participants in the company; and

(iii) is eligible for commissions, cross-commissions, override commissions, bonuses, refunds, dividends, or other consideration that is or may be paid as a result of the sale of goods or services or the recruitment of or the performance or actions of other participants.

(b) The term does not include an insurance producer, real estate broker, or salesperson or an

investment adviser, investment adviser representative, broker-dealer, or salesperson, as defined in 30-10-103, operating in compliance with this chapter.

(4) "Participant" means a person involved in a sales plan or operation.

(5) "Person" means an individual, corporation, partnership, limited liability company, or other business entity.

(6) (a) *"Pyramid promotional scheme" means a sales plan or operation in which a participant gives consideration for the opportunity to receive compensation derived primarily from obtaining the participation of other persons in the sales plan or operation rather than from the sale of goods or services by the participant or the other persons induced to participate in the sales plan or operation by the participant.*

(b) A pyramid promotional scheme does not include a sales plan or operation that:

(i) subject to the provisions of subsection (6)(b)(v), *provides compensation to a participant based primarily upon the sale of goods or services by the participant, including goods or services used or consumed by the participant, and not primarily for obtaining the participation of other persons in the sales plan or operation* and that provides compensation to the participant based upon the sale of goods or services by persons whose participation in the sales plan or operation has been obtained by the participant;

(ii) does not require a participant to purchase goods or services in an amount that unreasonably exceeds an amount that can be expected to be resold or consumed within a reasonable period of time;

(iii) is authorized to use a federally registered trademark or servicemark that identifies the company promoting the sales plan or operation, the goods or services sold, or the sales plan or operation;

(iv) (A) provides each person joining the sales plan or operation with a written agreement containing or a written statement describing the material terms of participating in the sales plan or operation;

(B) allows a person at least 15 days to cancel the person's participation in the sales plan or operation plan; and

(C) provides that if the person cancels participation within the time provided and returns any required items, the person is entitled to a refund of any consideration given to participate in the sales plan or operation; and

(v) (A) provides for, upon the request of a participant deciding to terminate participation in the sales plan or operation, the repurchase, at not less than 90% of the amount paid by the participant, of any currently marketable goods or services sold to the participant within 12 months of the request that have not been resold or consumed by the participant; and

(B) if disclosed to the participant at the time of purchase, provides that goods or services are not considered currently marketable if the goods have been consumed or the services rendered or if the goods or services are seasonal, discontinued, or special promotional items. Sales plan or operation promotional materials, sales aids, and sales kits are subject to the provisions of this subsection (6)(b)(v) if they are a required purchase for the participant or if the participant has received or may receive a financial benefit from their purchase.

History: En. Sec. 1, Ch. 74, L. 1999; amd. Sec. 1, Ch. 322, L. 2001.

MCA 30-10-326

MONTANA CODE ANNOTATED

TITLE 30. TRADE AND COMMERCE

CHAPTER 10. SECURITIES REGULATION

PART 3. OFFENSES AND PENALTIES

Current through the September 13, 2002 Special Session

30-10-326. Notice of activity -- consent to service

(1) A multilevel distribution company with a participant that is a resident of this state shall file with the securities commissioner on a form prescribed by the commissioner:

(a) an annual notice of the company's operation in this state; and

(b) an irrevocable consent designating the commissioner as its agent for service of process for any alleged violation of 30-10-325.

(2) Compliance with this section may not by itself subject a company to the provisions of any other statute of this state or to any taxes, licenses, or fees.

(3) (a) The commissioner may require a multilevel distribution company to disclose the following substantive information:

(i) the names, home or business addresses, social security numbers and birth dates, and titles of the multilevel distribution company's officers, directors, and trustees;

(ii) the corporate name; the headquarters street, mailing, and e-mail addresses, as well as telephone and telefax numbers; and the state of domicile and state of incorporation of the multilevel distribution company; and

(iii) a detailed description of the levels of distribution in the multilevel distribution company, the manner of compensating participants, and the compensation structure of the marketing plan.

(b) The commissioner may not release to the public the social security numbers of officers, directors, or trustees of a multilevel distribution company.

(4) This section does not preclude the commissioner from obtaining additional information required of participants or multilevel distribution companies during the course of an investigation or proceeding initiated under this chapter.

(5) Compliance with this chapter does not confer upon a multilevel distribution company any license or registration or signify that the state has sanctioned, approved, or endorsed a multilevel distribution company or its sales plan or operation.

(6) A multilevel distribution company or any individual or entity affiliated with a multilevel distribution company may not represent that the multilevel distribution company, individual, or entity is licensed, registered, sanctioned, approved, or endorsed in this state by virtue of compliance with 30-10-325 and this section.

(7) A multilevel distribution company or any individual or entity affiliated with a multilevel distribution company that violates subsection (6) is subject to the fines, injunctions, and other remedies specified in 30-10-305.

History: En. Sec. 3, Ch. 74, L. 1999; amd. Sec. 2, Ch. 322, L. 2001.

[JMT: The requirement of repurchase of 90% of marketable goods within twelve months may sound good, and the DSA has been successful in convincing legislatures that such repurchase provision prevents stockpiling. However, statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.

Montana also has a statute prohibiting "unfair methods of competition and unfair or deceptive acts or practices."⁵⁰³ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

The "pyramid promotional scheme" §(6)(b)(i) allows for compensation based on personal consumption, something for which the DSA has aggressively and deceptively lobbied. This works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.]

NEBRASKA

LB 801

LEGISLATIVE BILL 801

Approved by the Governor April 13, 2010

Introduced by Fulton, 29; Pirsch, 4.

FOR AN ACT relating to consumer protection; to amend sections 87-301, 87-303, 87-303.02, 87-303.03, and 87-306, Reissue Revised Statutes of Nebraska, and section 87-302, Revised Statutes Supplement, 2009; to change provisions relating to the Uniform Deceptive Trade Practices Act; to harmonize provisions; and to repeal the original sections.

Be it enacted by the people of the State of Nebraska,

Section 1. Section 87-301, Reissue Revised Statutes of Nebraska, is amended to read:

87-301 For purposes of the Uniform Deceptive Trade Practices Act, unless the context otherwise requires:

...
(8) Commercially reasonable terms means the repurchase of current and marketable inventory within twelve months from the date of purchase at not less than ninety percent of the original net cost, less appropriate setoffs and legal claims, if any;

(9) Compensation means a payment of any money, thing of value, or financial benefit;

(10) Consideration means anything of value, including the payment of cash or the purchase of goods, services, or intangible property. The term does not include the purchase of goods or services furnished at cost to be used in making sales and not for resale or time and effort spent in pursuit of sales or recruiting activities;

...
(12) Current and marketable has its plain and ordinary meaning but excludes inventory that is no longer within its commercially reasonable use or shelf-life period, was clearly described to salespersons prior to purchase as seasonal, discontinued, or special promotion products not subject to the plan or operation's inventory repurchase program, or has been used or opened.

...
(15) Inventory includes both goods and services, including company-produced promotional materials, sales aids, and sales kits that the plan or operation requires independent salespersons to purchase;

(16) Inventory loading means that the plan or operation requires or encourages its independent salespersons to purchase inventory in an amount which exceeds that which the salesperson can expect to resell for ultimate consumption or to a consumer in a reasonable time period, or both;

(17) Investment means any acquisition, for a consideration other than personal services, of personal property, tangible or intangible, for profit or business purposes, and includes, without limitation, franchises, business opportunities, and services. It does not include real estate, securities registered under the Securities Act of Nebraska, or sales demonstration equipment and materials furnished at cost for use in making sales and not for resale;

⁵⁰³ § 30-14-103

. . . (19) Person shall mean an individual, means a natural person, a corporation, a government, or a governmental subdivision or agency, a business trust, an estate, a trust, a partnership, a joint venture, a limited liability company, an unincorporated association, a sole proprietorship, two or more of any of the foregoing having a joint or common interest, or any other legal or commercial entity;

(20) *Pyramid promotional scheme means any plan or operation in which a participant gives consideration for the right to receive compensation that is derived primarily from the recruitment of other persons as participants in the plan or operation rather than from the sales of goods, services, or intangible property to participants or by participants to others.* A limitation as to the number of persons who may participate, or the presence of additional conditions affecting eligibility, or upon payment of anything of value by a person whereby the person obtains any other property in addition to the right to receive consideration, does not change the identity of the scheme as a pyramid promotional scheme;

(21) *Referral or chain referral sales or leases* means any sales technique, plan, arrangement, or agreement whereby the seller or lessor gives or offers to give a rebate or discount or otherwise pays or offers to pay value to the buyer or lessee as an inducement for a sale or lease in consideration of the buyer or lessee giving to the seller or lessor the names of prospective buyers or lessees or otherwise aiding the seller or lessor in making a sale or lease to another person if the earning of the rebate, discount, or other value is contingent upon the occurrence of an event subsequent to the time the buyer or lessee agrees to buy or lease;

. . .
(26) Use or promote the use of, for purposes of subdivision (a)(12) of section 87-302, means contrive, prepare, establish, plan, operate, advertise, or otherwise induce or attempt to induce another person to participate in a pyramid promotional scheme, including a pyramid promotional scheme run through the Internet, email, or other electronic communications. Sec. 2. Section 87-302, Revised Statutes Supplement, 2009, is amended to read: 87-302 (a) A person engages in a deceptive trade practice when, in the course of his or her business, vocation, or occupation, he or she:

(1) Passes off goods or services as those of another;

. . .
(12) Uses or promotes the use of or establishes, operates, or participates in a chain distributor pyramid promotional scheme in connection with the solicitation of business or personal investments from such scheme to members of the public. This subdivision shall not be construed to prohibit a plan or operation, or to define a plan or operation as a

pyramid promotional scheme, based on the fact that participants in the plan or operation give consideration in return for the right to receive compensation based upon purchases of goods, services, or intangible property by participants for personal use, consumption, or resale so long as the plan or operation does not promote or induce inventory loading and the plan or operation implements an appropriate inventory repurchase program;

(13) With respect to a sale or lease to a natural person of goods or services purchased or leased primarily for personal, family, household, or agricultural purposes, uses or employs any referral or chain referral sales technique, plan, arrangement, or agreement;

. . .
Uniform Deceptive Trade Practices Act. Sec. 6. Section 87-303.03, Reissue Revised Statutes of Nebraska, is amended to read: 87-303.03 (1) The Attorney General, in addition to other powers conferred upon him or her by the Uniform Deceptive Trade Practices Act:

(a) May issue subpoenas to require the attendance of witnesses or the production of documents, administer oaths, conduct hearings in aid of any investigation or inquiry, and prescribe such forms and adopt and promulgate such rules as may be necessary to administer the Uniform Deceptive Trade Practices Act. act; and

(b) May issue a cease and desist order, with or without prior hearing, against any person engaged in activities in violation of the act, directing such person to cease and desist from such activity.

(2) Service of any notice or subpoena may be made in the manner prescribed by the rules of civil procedure.

. . .
[JMT: An MLM's "endless chain" structure – or "chain referral sales"⁵⁰⁴ is a key red flag for any product-based pyramid scheme.⁵⁰⁵ All MLMs are built on an endless chain of recruitment.

Unfortunately, the recently revised Nebraska statute allows compensation to be based on personal consumption . . . "rather than from the sales of goods, services, or intangible property to participants or by participants to others."⁵⁰⁶ This allowance for compensation based on personal consumption of downline participants is something for which the DSA has lobbied aggressively – and that works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

"The repurchase of current and marketable inventory within twelve months from the date of

⁵⁰⁴ §20 and §21

⁵⁰⁵ See Chapter 2.

⁵⁰⁶ §20

purchase at not less than ninety percent of the original net cost⁵⁰⁷ may sound good, and the DSA has been successful in convincing legislatures that such repurchase provision prevents stockpiling.

However, statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.]

NEVADA

The Nevada consumer protection statutes contain a prohibition on the operation of pyramid distribution schemes. The Nevada law incorporates a standard definition of a pyramid scheme, defining such devices as any plan where a person gives consideration for the opportunity to receive in return consideration or other things of value; "for procuring or obtaining one or more additional persons to participate in the program, or for the opportunity to receive compensation of any kind when a person introduced to the program or plan by the participant procures or obtains a new participant in such a program."

"Compensation" for inducing others to join the program does not include payments "based on sales of goods or services to persons who are not participants in a pyramid promotional scheme or endless chain and who are not purchasing in order to participate in such a program.;"

"Consideration" is not defined in the Nevada law. Contracts made in Nevada "which have any part of the consideration given for the right to participate in a pyramid promotional scheme" are voidable by the participant. Nevada Revised Statutes §598.100 and 598.120.

[JMT: MLM's characteristic "endless chain" of recruitment is a key red flag for any product-based pyramid scheme⁵⁰⁸. All MLMs are built on endless chains of recruitment.

The provision that compensation for inducing others to join the program does not include payments "based on sales of goods or services to persons who are not participants in a pyramid promotional scheme or endless chain and who are not purchasing in order to participate in such a program" is good wording for prohibiting rewards based primarily in personal consumption of participants – another

key characteristic of a product-based pyramid scheme.

Another Nevada statute⁵⁰⁹ prohibits a number of deceptive trade practices, some of which could apply to MLM. For example, in every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading (a deceptive trade practice). It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."]

NEW HAMPSHIRE

TITLE 31

Trade And Commerce

CHAPTER 358B Chain Distributor Schemes

SECTION 358-B:1

§ 358-B:1 Definitions. – In this chapter:

I. "Chain distributor scheme" means 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.

II. "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. It does not include sales demonstration equipment and materials furnished at cost for use in making sales and not for resale.

[JMT: MLM's characteristic "endless chain" of recruitment (or "chain distributor scheme") is a key red flag for any product-based pyramid scheme.⁵¹⁰ All MLMs are built on an endless chain of recruitment.

MLM defenders may object to equating the word "investment" (§ I.) to what a person pays to join an MLM. However, the word is used frequently in MLM opportunity and training meetings to encourage prospects to pay more than the initial signup fee. Participants are given monthly quotas to qualify for commissions and advancement in the scheme

⁵⁰⁷ §87-301 (8)

⁵⁰⁸ See Chapter 2.

⁵⁰⁹ Title 52, Chapter 598

⁵¹⁰ See Chapter 2.

– and are in addition, often urged and incentivized to buy additional quantities of products in order to “maximize” their opportunity.

New Hampshire also has a statute⁵¹¹ that prohibits any unfair methods of competition or any other unfair or deceptive act or practice. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading (and a deceptive act). It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

NEW JERSEY

56:8-2. Fraud, etc., in connection with sale or advertisement of merchandise or real estate as unlawful practice

The act, use or employment by any person of any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation, or the knowing, concealment, suppression, or omission of any material fact with intent that others rely upon such concealment, suppression or omission, in connection with the sale or advertisement of any merchandise or real estate, or with the subsequent performance of such person as aforesaid, whether or not any person has in fact been misled, deceived or damaged thereby, is declared to be an unlawful practice; provided, however, that nothing herein contained shall apply to the owner or publisher of newspapers, magazines, publications or printed matter wherein such advertisement appears, or to the owner or operator of a radio or television station which disseminates such advertisement when the owner, publisher, or operator has no knowledge of the intent, design or purpose of the advertiser.

L.1960, c. 39, p. 138, s. 2. Amended by L.1967, c. 301, s. 2, eff. Feb. 15, 1968; L.1971, c. 247, s. 1, eff. June 29, 1971; L.1975, c. 294, s. 1, eff. Jan. 19, 1976.

[JMT: Regarding “The act, use or employment by any person of any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation” – In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

NEW MEXICO

57-13-2. Definitions.

As used in the Pyramid Promotional Schemes Act:

A. "compensation" includes a payment based on a sale or distribution made to a person who either is a participant in a pyramid promotional scheme or has the right to become a participant upon payment;

B. "consideration" means the payment of cash or the purchase of goods, services or intangible property but does not include:

(1) the purchase of goods or services furnished at cost to be used in making sales and not for resale; or

(2) time and effort spent in pursuit of sales or recruiting activities; and

C. "pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from any person's introduction of other persons into participation in the plan or operation rather than from the sale of goods, services or intangible property by the participant or other persons introduced into the plan or operation.

57-13-3. Prohibition; defenses excluded.

A. A person shall not establish, operate, advertise or promote a pyramid promotional scheme.

B. A limitation as to the number of persons who may participate or the presence of additional conditions affecting eligibility for the opportunity to receive compensation under the plan or operation does not change the identity of the scheme as a pyramid promotional scheme nor is it a defense under this article that a participant, on giving consideration, obtains any goods, services or intangible property in addition to the right to receive compensation.

57-13-4. Restraint of prohibited acts; restitution; penalties.

A. Whenever the attorney general has reasonable belief that any person is using, has used or is about to use any method, act or practice which is declared by the Pyramid Promotional Schemes Act [this article] to be unlawful and that proceedings would be in the public interest, he may bring an action in the name of the state against that person to restrain, by temporary or permanent injunction, the use of such method, act or practice. The action may be brought in the district court of the county in which the person resides or has his principal place of business or in the district court in the county in which the person is using, has used or is about to use the practice which has been alleged to be unlawful under the Pyramid Promotional Schemes Act. The attorney general acting on behalf of the state shall not be required to post bond when seeking a temporary or permanent injunction.

B. In any action brought under Subsection A of this section, the court may, upon petition of the attorney general, require that the person engaged in the unlawful practice make restitution to all persons of

⁵¹¹ P-335; SA213

money, property or other things received from them in any transaction related to the unlawful practice; and it is further provided that if the court finds that a person is willfully using or has willfully used a method, act or practice declared unlawful by the Pyramid Promotional Schemes Act, the attorney general, upon petition to the court, may recover on behalf of the state a civil penalty not exceeding ten thousand dollars (\$10,000) per violation.

57-13-5. Settlements.

A. In lieu of beginning or continuing an action pursuant to the Pyramid Promotional Schemes Act [this article], the attorney general may accept a written assurance of discontinuance of any practice in violation of that act from the person who has engaged in the unlawful practice. The attorney general may require an agreement by the person engaged in the unlawful practice that by a date set by the attorney general and stated in the assurance, he will make restitution to all persons of money, property or other things received from them in any transaction related to the unlawful practice. All settlements are a matter of public record.

B. A person need not accept restitution pursuant to an assurance. His acceptance of restitution bars recovery of any damages in any action by him or on his behalf against the same defendant on account of the same unlawful practice.

C. A violation of an assurance entered into pursuant to this section is a violation of the Pyramid Promotional Schemes Act.

57-13-6. Private remedies.

A. A person likely to be damaged by any method, act or practice which is declared by the Pyramid Promotional Schemes Act [this article] to be unlawful may be granted an injunction against it under the principles of equity and on terms that the court considers reasonable. Proof of monetary damage, loss of profits or intent to deceive or take unfair advantage of any person is not required.

B. Costs shall be allowed to the prevailing party unless the court otherwise directs. The court may award attorneys' fees to the prevailing party if:

- (1) the party complaining of an unlawful practice has brought an action which he knew to be groundless; or
- (2) the party charged with an unlawful practice has willfully engaged in the practice knowing it to be unlawful.

C. The relief provided in this section is in addition to remedies otherwise available against the same conduct under the common law or other statutes of this state.

57-13-7. Penalties.

Any person violating the Pyramid Promotional Schemes Act [this article] shall be deemed guilty of a fourth degree felony and shall be sentenced to a term of imprisonment pursuant to the provisions of Subsections A through C of Section 31-18-15 NMSA 1978 or fined not less than one thousand dollars (\$1,000) or more than ten thousand dollars (\$10,000), or both.

57-13-8. Pyramid Promotional Schemes Act restitution fund.

A. *All civil penalties collected under Section 57-13-4 NMSA 1978 shall be deposited in the state treasury in a fund to be designated as the "Pyramid Promotional Schemes Act restitution fund", which fund is hereby established and which shall be administered by the attorney general. All expenditures from this fund shall be paid upon petition to the attorney general to those persons adequately establishing injury in money, property or other things in a transaction related to a practice declared unlawful under the Pyramid Promotional Schemes Act [this article] and who were unknown to the court at the time judgment was rendered.*

B. Excepting any amount then being considered as an expenditure pursuant to a petition under Subsection A of this section, the balance of a civil penalty collected shall be transferred to the state general fund eighteen months after collection.

57-13-9. Civil investigative demand.

A. Whenever the attorney general has reason to believe that any person may be in possession, custody or control of an original or copy of any book, record, report, memorandum, paper, communication, tabulation, map, chart, photograph, mechanical transcription or other tangible document or recording which he believes to be relevant to the subject matter of an investigation of a probable violation of the Pyramid Promotional Schemes Act [this article], he may, prior to the institution of a civil proceeding, execute in writing and cause to be served upon the person a civil investigative demand requiring the person to produce documentary material and permit the inspection and copying of the material. The demand of the attorney general shall not be a matter of public record and shall not be published by him except by order of the court.

B. Each demand shall:

- (1) state the general subject matter of the investigation;
- (2) describe the classes of documentary material to be produced with reasonable certainty;
- (3) prescribe the return date within which the documentary material is to be produced, which in no case shall be less than ten days after the date of service; and
- (4) identify the members of the attorney general's staff to whom such documentary material is to be made available for inspection and copying.

C. No demand shall:

- (1) contain any requirement which would be unreasonable or improper if contained in a subpoena duces tecum issued by a court of this state;
- (2) require the disclosure of any documentary material which would be privileged or which for any other reason would not be required by a subpoena duces tecum issued by a court of this state; or
- (3) require the removal of any documentary material from the custody of the person upon

whom the demand is served, except in accordance with the provisions of Subsection E of this section.

D. Service of the demand may be made by:

(1) delivering a duly executed copy thereof to the person to be served or, if the person is not a natural person, to the statutory agent for the person or to any officer of the person to be served; or

(2) delivering a duly executed copy thereof to the principal place of business in this state of the person to be served; or

(3) mailing by registered or certified mail a duly executed copy of the demand addressed to the person to be served at his principal place of business in this state or, if the person has no place of business in this state, to his principal office or place of business.

E. Documentary material demanded pursuant to the provisions of this section shall be produced for inspection and copying during normal business hours at the principal office or place of business of the person served or may be inspected and copied at such other times and places as may be agreed upon by the person served and the attorney general.

F. No documentary material produced pursuant to a demand, or copies thereof, shall, unless otherwise ordered by the district court in the county in which the person resides or has his principal place of business or the person is about to perform or is performing the practice which is alleged to be unlawful under the Pyramid Promotional Schemes Act, for good cause shown, be produced for inspection or copying by anyone other than an authorized employee of the attorney general, nor shall the contents be disclosed to anyone other than an authorized employee of the attorney general or in court in an action relating to a violation of that act.

G. At any time before the return date of the demand, a petition to set aside the demand, modify the demand or extend the return date of the demand may be filed in the district court in the county in which the person resides or has his principal place of business or is about to perform or is performing the practice which is alleged to be unlawful under the Pyramid Promotional Schemes Act, and the court upon a showing of good cause may set aside the demand, modify it or extend the return date of the demand.

H. After service of the investigative demand upon him, if any person neglects or refuses to comply with the demand, the attorney general may invoke the aid of the court in the enforcement of the demand. In appropriate cases, the court shall issue its order requiring the person to appear and produce the documentary material required in the demand and may, upon failure of the person to comply with the order, punish the person for contempt.

I. This section shall not be applicable to criminal prosecutions.

57-13-11. Regulations.

The attorney general is empowered to issue and file as required by law all regulations necessary to implement and enforce any provision of the Pyramid Promotional Schemes Act [this article]. A violation of these regulations shall be unlawful.

57-13-12. Construction.

The Pyramid Promotional Schemes Act [this article] neither enlarges nor diminishes the rights of parties in private litigation.

57-13-13. Enforcement.

In order to promote the uniform administration of the Pyramid Promotional Schemes Act [this article] in New Mexico, the attorney general is to be responsible for its enforcement, but he may in appropriate cases delegate this authority to the district attorneys of the state, and, when this is done, the district attorneys shall have every power conferred upon the attorney general by that act.

57-13-14. Advertising media excluded.

The Pyramid Promotional Schemes Act [this article] does not apply to publishers, broadcasters, printers or other persons engaged in the dissemination of information or reproduction of printed or pictorial matters who publish, broadcast or reproduce material without actual knowledge of its being in violation of that act.

[JMT: The New Mexico statute allows compensation to be based on personal consumption, something for which the DSA lobbies; e.g., "by the participant or other persons introduced into the plan or operation"⁵¹² – and that works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.]

However, New Mexico has a statute prohibiting "unfair or deceptive trade practices"⁵¹³ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

NEW YORK

S 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

⁵¹² §(2)C

⁵¹³ §57-12-3

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.

[JMT: An MLM's "endless chain" of recruitment - or "chain distributor scheme" is a key red flag of a product-based pyramid scheme.⁵¹⁴ All MLMs are built on an endless chain of recruitment.]

Also, MLM defenders may object to equating the word "investment"⁵¹⁵ to what a person pays to join an MLM. However, the word is used frequently in MLM opportunity and training meetings to encourage prospects to pay more than the initial signup fee. Participants are given monthly quotas to qualify for commissions and advancement in the scheme – and are in addition, often urged and incentivized to buy additional quantities of products in order to "maximize" their opportunity.

New York has a Consumer Protection Act which makes unlawful "deceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service in this state." In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading (a deceptive act). It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."]

⁵¹⁴ See Chapter 2.

⁵¹⁵ §2

NORTH CAROLINA

§ 14-291.2. Pyramid and chain schemes prohibited.

(a) Any person who shall establish, promote, operate or participate in any pyramid distribution plan, program, device or scheme whereby a participant pays a valuable consideration for the opportunity or chance to receive a fee or compensation upon the introduction of other participants into the program, whether or not such opportunity or chance is received in conjunction with the purchase of merchandise, shall be deemed to have participated in a lottery and shall be guilty of a Class 2 misdemeanor.

(b) "Pyramid distribution plan" means any program utilizing a pyramid or chain process by which a participant gives a valuable consideration for the opportunity to receive compensation or things of value in return for inducing other persons to become participants in the program;

"Compensation" does not mean payment based on sales of goods or services to persons who are not participants in the scheme, and who are not purchasing in order to participate in the scheme; and "Promotes" shall mean inducing one or more other persons to become a participant.

(c) Any judge of the superior court shall have jurisdiction, upon petition by the Attorney General of North Carolina or district attorney of the superior court, to enjoin, as an unfair or deceptive trade practice, the continuation of the scheme described in subsection (a); in such proceeding the court may assess civil penalties and attorneys' fees to the Attorney General or the District Attorney pursuant to G.S. 75-15.2 and 75-16.1; and the court may appoint a receiver to secure and distribute assets obtained by any defendant through participation in any such scheme.

(d) Any contract hereafter created for which a part of the consideration consisted of the opportunity or chance to participate in a program described in subsection (a) is hereby declared to be contrary to public policy and therefore void and unenforceable.

[JMT: An MLM's "endless chain" of recruitment - or "chain process) is a key red flag for any product-based pyramid scheme⁵¹⁶ All MLMs are built on an endless chain of recruitment.]

Also, the provision that "Compensation" does not mean payment based on sales of goods or services to persons who are not participants in the scheme, and who are not purchasing in order to participate in the scheme" is good wording for encouraging a retail focus, although MLMs typically do not incentivize retail sales to nonparticipants.

⁵¹⁶ See Chapter 2

Another statute⁵¹⁷ prohibits “unfair methods of competition and unfair or deceptive acts or practices.” In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading (an unfair and deceptive practice). It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”

In a Harper’s Magazine article titled “Pyramid Insurance” the author notes: Executives from the multilevel-marketing telecom ACN (formerly American Communications Network) have given \$84,550 to North Carolina attorney general Roy Cooper since the run-up to the company’s relocation there in 2008 – nearly 85 percent of their total contributions during that period. Two ACN executives, Charles Barker and Robert Stevanovski, tied with a few others as the largest individual donors to Cooper’s 2008 reelection campaign.⁵¹⁸]

NORTH DAKOTA

CHAPTER 51-16.1

PYRAMID PROMOTIONAL AND REFERRAL SALES SCHEMES

51-16.1-01. Definitions. As used in this chapter, unless the context or subject matter otherwise requires:

1. *“Compensation” includes a payment based on a sale or distribution made to a person who either is a participant in a pyramid promotional scheme or has the right to become a participant upon payment.*
2. *“Consideration” means the payment of cash or the purchase of goods, services, or intangible property but does not include:*
 - a. *The purchase of goods or services furnished at cost to be used in making sales and not for resale; or*
 - b. *Time and effort spent in pursuit of sales or recruiting activities.*
3. *“Pyramid promotional scheme” means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from any person’s introduction of other persons into participation in the plan or operation rather than from the sale of goods, services, or intangible property by the participant or other persons introduced into the plan or operation.*

⁵¹⁷ N.C. Gen. Stat. § 75-1.1

⁵¹⁸ This figure includes donations by executives’ spouses and members of ACN’s “Circle of Champions.” Much of this money came from employees residing outside North Carolina. Cited in “Pyramid Insurance,” by Jeff Ernsthausen, *Harper’s Magazine*, August 17, 2012.

51-16.1-02. Pyramid promotional schemes prohibited - Defenses excluded.

No person may establish, operate, advertise, or promote a pyramid promotional scheme.

2. It is not a defense to a criminal or civil prosecution under this section that:

a. The plan contains a limitation as to the number of persons who may participate or the presence of additional conditions affecting eligibility for the opportunity to receive compensation under the plan or operation; or

b. A participant, on giving consideration, obtains any goods, services, or intangible property in addition to the right to receive compensation.

51-16.1-03. Referral selling prohibited. No seller or lessor may give or offer a rebate, discount, or anything of value to a buyer or lessee as an inducement for a sale or lease in consideration of his giving to the seller or lessor the names of prospective purchasers or lessees, or otherwise aiding the seller or lessor in making a sale to another person, if the earning of the rebate, discount, or other thing of value is contingent upon the occurrence of an event subsequent to the time the buyer or lessee agrees to the sale or lease.

51-16.1-04. Penalty - Civil remedies. Any person, including the officers and directors of any company, violating any of the provisions of this chapter is:

1. Guilty of a class A misdemeanor, but a person who has been previously convicted of a class A misdemeanor under this chapter may be charged with and convicted of a class C felony for any violation which occurs after the previous conviction;
 2. Deemed to have committed an unlawful practice in violation of section 51-15-02 and subject to all provisions, procedures, and penalties of Chapter 51-15; and
 3. Notwithstanding any agreement to the contrary, subject to the right of any purchaser in a pyramid promotional scheme or referral selling scheme to declare the sale or contract void and also subject to an action in a court of competent jurisdiction by any purchaser to recover three times the damages sustained by the purchaser in participating in the scheme, plus reasonable attorney’s fees and costs.
- 51-16.1-05. Scope of remedies.

1. The rights and remedies that this chapter grants to purchasers in pyramid promotional schemes and referral selling schemes are independent of and supplemental to any other right or remedy available to them in law or equity, and nothing contained herein may be construed to diminish or to abrogate any such right or remedy.

2. The provisions of this chapter are in addition to all other causes of action, remedies, and penalties available to the state or any of its governmental agencies.

[JMT: The North Dakota statute allows compensation to be based on personal consumption, something for which the DSA

lobbied aggressively. Note in Definition 3 the phrase “by the participant or other persons introduced into the plan or operation.” This provision works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

However, North Dakota has a statute that prohibits “deceptive acts or practices, fraud, or misrepresentation with the intent for consumer to rely on the representation”.⁵¹⁹ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

OHIO

As used in sections 1333.91 to 1333.94 of the Revised Code:

(A) "Pyramid sales plan or program" means any scheme, whether or not for the disposal or distribution of property, whereby a person pays a consideration for the chance or opportunity to receive compensation, regardless of whether he also receives other rights or property, under either of the following circumstances:

(1) For introducing one or more persons into participation in the plan or program;

(2) When another participant has introduced a person into participation in the plan or program.

(B) "Compensation" means money, financial benefit, or anything of value. Compensation does not include payment based upon sales made to persons who are not participants in a pyramid sales plan or program, and who are not purchasing in order to participate in the plan or program.

(C) "Consideration" does not include:

(1) Payment for sales demonstration equipment and materials furnished at cost, whereby no profit, commission, fee, rebate or other benefit is realized by any person in the sales plan, for use in making sales and not for resale;

(2) Payment for promotional and administrative fees not to exceed twenty-five dollars when computed on an annual basis.

(D) "Participant" means a person who purchases, proposes, plans, prepares, or offers the opportunity to take part in, or advance into, a pyramid sales plan or program.

[JMT: the provision that “Compensation does not include payment based upon sales made to persons who are not participants in a pyramid sales plan or program, and who are not purchasing in order to participate in the plan or program” is good wording for encouraging a

retail focus, although MLMs typically do not incentivize retail sales to nonparticipants.

Also, the Ohio State Legislature adopted the Uniform Deceptive Trade Practices Act, which prohibits 11 specific deceptive trade practices, and which could apply to MLM. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

OKLAHOMA

§21-1072.

As used in the Oklahoma Pyramid Promotional Scheme Act:

1. "Compensation" means payment of money, thing of value or financial benefit. Compensation does not include:

a. payment to participants based upon sales of products purchased for actual use and consumption, or

b. payment to participants under reasonable commercial terms;

2. "Consideration" means the payment of cash or purchase of goods, services or intangible property. Consideration does not include:

a. purchase of products furnished at cost to be used in making sales and not for resale,

b. purchase of products where the seller offers to repurchase the participant's products under reasonable commercial terms, or

c. participant's time and effort in pursuit of sales or recruiting activities;

3. "Participant" means a person who contributes money into a pyramid promotional scheme;

4. "Person" means an individual, a corporation, a partnership or any association or unincorporated organization;

5. "Promote" means:

a. to contrive, prepare, establish, plan, operate or advertise, or

b. to induce or attempt to induce other persons to be a participant;

6. "Pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from the person's introduction of other persons into the plan or operation rather than the sale of goods, services or intangible property by the participant or other persons introduced into the plan or operation; and

7. "Reasonable commercial terms" includes repurchase by the seller, at the participant's request and upon termination of the business relationship or contract with the seller, of all unencumbered products purchased by the

⁵¹⁹ §10-15-01

participant from the seller within the previous twelve (12) months which are unused and in commercially resalable condition. Repurchase by the seller shall be for not less than ninety percent (90%) of the actual amount paid by the participant to the seller of the products, less any consideration received by the participant for purchase of the products being returned. A product shall not be deemed nonresalable solely because the product is no longer marketed by the seller, unless it is clearly disclosed to the participant at the time of sale that the product is a seasonal, discontinued, or special promotion product, and not subject to the repurchase obligation.

§21-1073.

Any person who promotes a pyramid promotional scheme shall be guilty of a felony, upon conviction, for each violation of the Oklahoma Pyramid Promotional Scheme Act. The fine for a violation shall not be more than Ten Thousand Dollars (\$10,000.00).

[JMT: The Oklahoma statute allows compensation to be based on personal consumption, something for which the DSA lobbies. This works to the benefit of MLMs, but clearly weakens consumer protection against product-based pyramid schemes.

The requirement of repurchase of 90% of commercially resalable products within one year from date of purchase may sound good to regulators, but statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.

Also, the Oklahoma State Legislature adopted the Uniform Deceptive Trade Practices Act, which prohibits 11 specific deceptive trade practices, and which could apply to MLM. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

OREGON

646.608 Unlawful business, trade practices; proof; Attorney General's rules. (1) A person engages in an unlawful practice when in the course of the person's business, vocation or occupation the person does any of the following:

....

(r) Organizes or induces or attempts to induce membership in a pyramid club.

646.609 "Pyramid club" and "investment" defined. As used in ORS 646.608 (1)(r), "pyramid club" means a sales device whereby a person, upon condition that the person make an investment, is granted a license or right to solicit or recruit for economic gain one or more additional persons who are also granted such license or right upon condition of making an investment and who may further perpetuate the chain of persons who are granted such license or right upon such condition. "Pyramid club" also includes any such sales device which does not involve the sale or distribution of any real estate, goods or services, including but not limited to a chain letter scheme. 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 economic gain therefrom, does not change the identity of the scheme as a pyramid club. 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. It does not include sales demonstration equipment and materials furnished at cost for use in making sales and not for resale. For the purpose of ORS 646.608 (1)(r), any person who organizes or induces or attempts to induce membership in a pyramid club is acting in the course of the person's business, vocation or occupation. [1973 c.513 s.3; 1981 c.379 s.1]

[JMT: The term “who may further perpetuate the chain of persons who are granted such license or right” implies an “endless chain” of recruitment – which is a key red flag for any product-based pyramid scheme.⁵²⁰ All MLMs are built on an endless chain of recruitment.

MLM defenders may object to equating the word “investment” to what a person pays to join an MLM. However, the word is used frequently in MLM opportunity and training meetings to encourage prospects to pay more than the initial signup fee. Participants are given monthly quotas to qualify for commissions and advancement in the scheme – and are in addition, often urged and incentivized to buy additional quantities of products in order to “maximize” their opportunity.

Oregon also has a statute that prohibits 20 specific unfair or deceptive acts or practices, some of which could apply to MLM. For example, in every case where average income figures have been released by MLM companies,

⁵²⁰ See Chapter 2.

99% of participants lose money. So to present MLM as a business or income opportunity is misleading (a deceptive act). It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

PENNSYLVANIA

73 P.S. § 201-1. Short Title

This act shall be known and may be cited as the "Unfair Trade Practices and Consumer Protection Law."

73 P.S. § 201-2. Definitions - As used in this act, . . .

(2) Person means natural persons, corporations, trusts, partnerships, incorporated or unincorporated associations, and any other legal entities.

(3) Trade and commerce means the advertising, offering for sale, sale or distribution of any services and any property, tangible or intangible, real, personal or mixed. and any other article, commodity, or thing of value wherever situate, and includes any trade or commerce directly or indirectly affecting the people of the Commonwealth.

(4) Unfair methods of competition and unfair or deceptive acts or practices mean any one or more of the following:

(xii) Promising or offering prior to time of sale to pay, credit or allow to any buyer, any compensation or reward for the procurement of a contract for purchase of goods or services with another or others, or for the referral of the name or names of another or others for the purpose of attempting to procure or procuring such a contract of purchase with such other person or persons when such payment, credit, compensation or reward is contingent upon the occurrence of an event subsequent to the time of the signing of a contract to purchase;

(xiii) Promoting or engaging in any plan by which goods or services are sold to a person for a consideration and upon the further consideration that the purchaser secure or attempt to secure one or more persons likewise to join the said plan; each purchaser to be given the right to secure money, goods, or services depending upon the number of persons joining the plan. In addition, promoting or engaging in any plan, commonly known as or similar to the so-called "Chain Letter Plan" or "Pyramid Club". *The terms "Chain Letter Plan" or "Pyramid Club" mean any scheme for the disposal or distribution of property, services, or anything of value whereby a participant pays valuable consideration, in whole or in part, for an opportunity to receive compensation for introducing or attempting to introduce one or more additional persons to participate in the scheme or for the opportunity to receive compensation when a person introduced by the participant introduces a*

new participant. As used in this subclause the term "consideration" means an investment of cash or the purchase of goods, other property, training or services, but does not include payments made for sales demonstration equipment and materials for use in making sales and not for resale furnished at no profit to any person in the program or to the company or corporation, nor does the term apply to a minimal initial payment of twenty five dollars (\$25) or less;

73 P.S. § 201-3. Unlawful acts or practices; exclusions

Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce as defined by subclauses (i) through (xvii) of clause (4) of section 2 of this act [i.e. 73 P.S. 201-2(4)(i) to (4)(xvii)] and regulations promulgated under section 3.1 of this act [i.e. 73 P.S. 201-3.1] are hereby declared unlawful. . . .

[JMT: A Pennsylvania statute prohibits “unfair methods of competition, deceptive acts or practices, or any fraudulent or deceptive conduct that is likely to create confusion to a consumer.”⁵²¹ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”

“Pyramid club”⁵²² is an apt term for an MLM.]

PUERTO RICO

Puerto Rico has a "Multi-level distribution company" law on its books regulating the operation of network marketing companies which are defined as: "any natural or artificial person who grants in exchange for an economic retribution, a franchise or concession for the distribution and/or sale of properties or services, to dealers who serve as intermediaries to enlist other dealers to the program and where other benefits or economic incentives are also offered for the purpose of promoting said enlistment." Puerto Rico Laws Annotated, tit. 10 §997a

Under the law, no multi-level distribution company may operate a program in which the benefits to the participants depend primarily on recruiting as opposed to the sale of properties or services, or where payment is in consideration only for the search and enlistment of new participants. In addition, no commissions shall be paid unless distributors exercise "actual control and effective supervision" in the sale of products or services to

⁵²¹ 73 P.S. §§201-1 to 201-9.2.

⁵²² 73 P.S. § 201-2(4)(xiii))

an ultimate consumer. Puerto Rico Laws Annotated, tit. 10 §997 et seq.

Every network marketing contract must contain various clauses permitting distributors to cancel the contract for any reason within the first 90 days, or if the distributor can show breach by the company. The notice of cancellation shall be made in writing and shall be sent to the company by registered mail. In the event of such a cancellation of the contract, the multi-level company must "reacquire the total of the products acquired by the dealer which are in his possession and in good condition at a price of not less than ninety (90) percent of their original net cost," and "must refund 90 percent of the original net cost of any services acquired by him," or "of any sum paid by him for the purpose of participating in the business." Puerto Rico Laws Annotated, tit. 10 §997b

Earnings representations are limited as follows: *No multi-level distribution company may, directly or indirectly through its dealers, agents or participants, use as propaganda in the enlistment of new participants information on the profits or benefits obtained in the past by its dealers, agents or participants, or assure to prospective participants in this type of business a given amount of profits or benefits, unless the profits or benefits mentioned are those obtained at present by a reasonable number of participants in the Commonwealth or a similar geographical area and reflect the average profits and benefits obtained by them through the distribution and/or sale of properties or services. Likewise it is prohibited to make use of propaganda aimed at showing the facility of enlisting and retaining new participants and their operational or economic success.* Puerto Rico Laws Annotated, tit. 10 §997 d.

[JMT: This statute by the Commonwealth of Puerto Rico has some outstanding features that could be a model for mainland states. It seeks to correlate rewards with degree of control over the sale, it establishes the need for a reasonable percentage of participants to profit from actual sales, and it prohibits propaganda aimed at profiting primarily from recruiting others. Regarding earnings participants – in every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

RHODE ISLAND

CHAPTER 6-29 Referral Selling

SECTION 6-29-1

§ 6-29-1 Home solicitation referral selling regulated. – No seller in a home solicitation sale or

a cash sale as defined in §6-28-2 shall offer to pay a commission or give a rebate or discount to the buyer in consideration of the buyer's giving to the seller the names of prospective purchasers or otherwise aiding the seller in making a sale to another person, unless the seller actually delivers to the purchaser a chart showing the actual experience of purchasers for the three (3) calendar years ending prior to the contract under consideration, including the number of and monies paid to those who participated in the plan, and unless there shall be a separate, written agreement signed and dated by the buyer and also signed by the seller containing the following in ten-point bold face type or larger, directly above the space reserved in the agreement for the signature of the buyer:

1. No purchase of goods or services between the parties hereto has been induced by the promise of monies to be earned under this agreement.
2. The purchase price of any goods or services in any transaction between the parties hereto has not been increased in any way because of this agreement.
3. No payments due under this agreement may be held up, credited, or set-off toward payment of any obligation between the parties except on written authorization specifically allowing such action.
4. No other representations or agreements, oral or written, have been made by the parties hereto relating to the terms of this agreement.

SECTION 6-29-2

§ 6-29-2 Sales induced by referral offer voidable. – Any sale made in respect to which a commission, rebate, or discount is represented as being given in return for names of other prospective buyers shall be voidable at the option of the buyer, unless there is a written agreement between the parties to the sale containing the provisions set forth in § 6-29-1.

[JMT: Rhode Island has a statute prohibiting “unfair methods of competition or unfair or deceptive practices.” In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

SOUTH CAROLINA

CHAPTER 5.

UNFAIR TRADE PRACTICES

SECTION 39-5-30. *Pyramid clubs and similar operations declared unfair trade practices.*

Any contract or agreement between an individual and any pyramid club, or other group organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by members thereof are to be paid or

given to any other member thereof, which plan or device includes any provision for the increase in such membership through a chain process of new members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues or things of material value from other members, is hereby declared to be an unfair trade practice pursuant to SECTION 39-5-20 (a) of the South Carolina Unfair Trade Practices Act of 1971.

SECTION 39-5-70. Investigative demand by Attorney General.

(a) When it appears to the Attorney General that a person has engaged in, is engaging in, or is about to engage in any act or practice declared to be unlawful by this article, or when he believes it to be in the public interests that an investigation should be made to ascertain whether a person in fact has engaged in, is engaging in, or is about to engage in any act or practice declared to be unlawful by this article, he may execute in writing and cause to be served upon that person or any other person who is believed to have information, documentary material or physical evidence relevant to the alleged or suspected violation, an investigative demand requiring such person to furnish, under oath, a report in writing setting forth the relevant facts and circumstances of which he has knowledge, or to appear and testify or to produce relevant documentary material or physical evidence for examination and copying, at such reasonable time and place as may be stated in the investigative demand, concerning the advertisement, sale or offering for sale of any goods or services or the conduct of any trade or commerce that is the subject matter of the investigation.

(b) At any time before the return date specified in an investigative demand, or within twenty days after the demand has been served, whichever period is shorter, a petition to extend the return date for a reasonable time or to modify or set aside the demand, stating good cause, may be filed in the court of common pleas where the person served with the demand resides or has his principal place of business or conducts or transacts business. This section shall not be applicable to any criminal proceedings, nor shall any information obtained under the authority of this section or SECTION 39-5-80 be admissible in evidence in any criminal prosecution.

SECTION 39-5-110. Civil penalties for willful violation or violations of injunction.

(a) If a court finds that any person is willfully using or has willfully used a method, act or practice declared unlawful by SECTION 39-5-20, the Attorney General, upon petition to the court, may recover on behalf of the State a civil penalty of not exceeding five thousand dollars per violation.

(b) Any person who violates the terms of an injunction issued under SECTION 39-5-50 shall forfeit and pay to the State a civil penalty of not more than fifteen thousand dollars per violation. For the purposes of this section, the court of common pleas issuing an injunction shall retain jurisdiction, and the cause shall be continued and in such cases the Attorney General acting in the name of the State may petition for recovery of civil penalties. Whenever the court determines that an injunction issued pursuant to SECTION 39-5-50 has been violated, the court shall award reasonable costs to the State.

(c) For the purposes of this section, a willful violation occurs when the party committing the violation knew or should have known that his conduct was a violation of SECTION 39-5-20.

[JMT: South Carolina has a statute prohibiting "unfair methods of competition and unfair or deceptive acts or practices" (including "pyramid clubs and similar operations). In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."]

SOUTH DAKOTA

CHAPTER 37-33

PYRAMID PROMOTIONAL SCHEMES

37-33-1. "Promote" defined. For the purposes of §§ 37-33-1 to 37-33-11, inclusive, the term, promote, means contrive, prepare, establish, plan, operate, advertise, or otherwise induce or attempt to induce another person to participate in a pyramid promotional scheme.

Source: SL 2003, ch 213, § 1.

37-33-2. "Appropriate inventory repurchase program" defined--"Inventory" defined--"Commercially reasonable" defined--"Current and marketable" defined. For the purposes of §§ 37-33-1 to 37-33-11, inclusive, the term, appropriate inventory repurchase program, means a program by which a plan or operation repurchases, upon request and upon commercially reasonable terms, when the salesperson's business relationship with the company ends, current and marketable inventory in the possession of the salesperson that was purchased by the salesperson for resale. Any such plan or operation shall clearly describe the program in its recruiting literature, sales manual, or contract with independent salespersons, including the disclosure of any inventory which is not eligible for repurchase under the program.

For the purposes of this section, the term, inventory, includes both goods and services, including company-produced promotional materials, sales aids, and sales kits that the plan or

operation requires independent salespersons to purchase.

The term, commercially reasonable terms, means the repurchase of current and marketable inventory within twelve months from the date of purchase at not less than ninety percent of the original net cost, less appropriate set-offs and legal claims, if any.

The term, current and marketable, excludes inventory that is no longer within its commercially reasonable use or shelf-life period, that was clearly described to salespersons prior to purchase as seasonal, discontinued, or special promotion products not subject to the plan or operation's inventory repurchase program, or that has been used or opened.

Source: SL 2003, ch 213, § 2.

37-33-3. "Pyramid promotional scheme" defined. For the purposes of §§ 37-33-1 to 37-33-11, inclusive, the term, pyramid promotional scheme, means any plan or operation by which a person gives consideration for the opportunity to receive compensation that is derived primarily from the introduction of other persons into the plan or operation rather than from the sale and consumption of goods, services, or intangible property by a participant or other persons introduced into the plan or operation. The term includes any plan or operation under which the number of persons who may participate is limited either expressly or by the application of conditions affecting the eligibility of a person to receive compensation under the plan or operation, or any plan or operation under which a person, on giving any consideration, obtains any goods, services, or intangible property in addition to the right to receive compensation.

Source: SL 2003, ch 213, § 3.

37-33-4. "Compensation" defined. For the purposes of §§ 37-33-1 to 37-33-11, inclusive, the term, compensation, means a payment of any money, thing of value, or financial benefit conferred in return for inducing another person to participate in a pyramid promotional scheme.

Source: SL 2003, ch 213, § 4.

37-33-5. "Consideration" defined. For the purposes of §§ 37-33-1 to 37-33-11, inclusive, the term, consideration, means the payment of cash or the purchase of goods, services, or intangible property. The term does not include the purchase of goods or services furnished at cost to be used in making sales and not for resale, or time and effort spent in pursuit of sales or recruiting activities.

Source: SL 2003, ch 213, § 5.

37-33-6. "Inventory loading" defined. For the purposes of §§ 37-33-1 to 37-33-11, inclusive, the term, inventory loading, means that the plan or operation requires or encourages its independent salespersons to purchase inventory in an amount, which exceeds that which the salesperson can expect to resell for ultimate consumption or to consume in a reasonable time period, or both.

Source: SL 2003, ch 213, § 6.

37-33-7. Pyramid promotional schemes prohibited--Operation of scheme a felony--Participation in scheme a misdemeanor. No person may establish, promote, operate, or participate in any pyramid promotional scheme. A limitation as to the number of persons who may participate or the presence of additional conditions affecting eligibility for the opportunity to receive compensation under the plan does not change the identity of the plan as a pyramid promotional scheme. It is not a defense under this section that a person, on giving consideration, obtains goods, services, or intangible property in addition to the right to receive compensation.

Any person who establishes or operates a pyramid promotional scheme is guilty of a Class 5 felony. Any person who knowingly participates in a pyramid promotional scheme is guilty of a Class 1 misdemeanor.

Source: SL 2003, ch 213, § 7.

37-33-8. Certain plans not defined as pyramid promotional schemes. Nothing in §§ 37-33-1 to 37-33-11, inclusive, may be construed to prohibit a plan or operation, or to define a plan or operation as a pyramid promotional scheme, based on the fact that participants in the plan or operation give consideration in return for the right to receive compensation based upon purchases of goods, services, or intangible property by participants for personal use, consumption, or resale so long as the plan or operation does not promote or induce inventory loading and the plan or operation implements an appropriate inventory repurchase program.

Source: SL 2003, ch 213, § 8.

37-33-9. Attorney general may proceed against pyramid promotional schemes. The provisions of §§ 37-33-1 to 37-33-11, inclusive, do not preclude, preempt, or prohibit the attorney general from proceeding against any plan or scheme or any person involved with such plan or scheme under any other provision of law.

Source: SL 2003, ch 213, § 9.

37-33-10. Civil proceedings by attorney general--Entry of orders--Injunctions--Hearings--Penalties--Payment of costs. If it appears to the attorney general that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of §§ 37-33-1 to 37-33-11, inclusive, or any order under §§ 37-33-1 to 37-33-11, inclusive, the attorney general may do one or more of the following:

- (1) Issue a cease and desist order, with or without prior hearing, against any person engaged in the prohibited activities, directing such person to cease and desist from further illegal activities;
- (2) Bring an action in the circuit court to enjoin the acts or practices to enforce compliance with §§ 37-33-1 to 37-33-11, inclusive, or any order under §§ 37-33-1 to 37-33-11, inclusive; or

(3) Impose by order and collect a civil penalty against any person found in an administrative action to have violated any provision of §§ 37-33-1 to 37-33-11, inclusive, or any order issued under §§ 37-33-1 to 37-33-11, inclusive, in an amount not to exceed ten thousand dollars per violation per person. The attorney general may bring actions to recover penalties pursuant to this subdivision in circuit court. All civil penalties received shall be deposited in the state general fund.

Any person named in a cease and desist order issued pursuant to §§ 37-33-1 to 37-33-11, inclusive, shall be notified of his or her right to file, within fifteen days after the receipt of the order, a written notice for a hearing with the attorney general. If the attorney general does not receive a written request for a hearing within the time specified, the cease and desist order shall be permanent and the person named in the order deemed to have waived all rights to a hearing. Every such order shall state its effective date and shall concisely state its intent or purpose and the grounds on which it is based. Any person aggrieved by a final order issued pursuant to §§ 37-33-1 to 37-33-11, inclusive, may obtain a review of the order in the circuit court pursuant to the provisions of chapter 1-26.

Upon a proper showing a permanent or temporary injunction, restraining order, or writ of mandamus shall be granted and a receiver or conservator may be appointed for the defendant or defendant's assets. In addition, upon a proper showing by the attorney general, the court may enter an order of rescission, restitution, or disgorgement directed to any person who has engaged in any act constituting a violation of any provision of §§ 37-33-1 to 37-33-11, inclusive, or any order under §§ 37-33-1 to 37-33-11, inclusive. The court may not require the attorney general to post a bond. In addition to fines or penalties, the attorney general shall collect costs and attorney fees.

Source: SL 2003, ch 213, § 10.

37-33-11. Burden of proof. The burden of showing compliance with the provisions of §§ 37-33-1 to 37-33-11, inclusive, lies with the plan, scheme, or person involved with such plan or scheme.

Source: SL 2003, ch 213, § 11.

Deceptive Sales Referral Practices:

SOUTH DAKOTA

37-24-6. Deceptive practice as misdemeanor -- Acts declared deceptive. It is a deceptive act or practice for any person to:

(1) *Knowingly and intentionally act, use, or employ any deceptive act or practice, fraud, false pretense, false promises, or misrepresentation or to conceal, suppress, or omit any material fact in connection with the sale or advertisement of any merchandise,*

regardless of whether any person has in fact been misled, deceived, or damaged thereby; . . .

(4) Give or offer a rebate, discount, or anything of value to an individual as an inducement for selling consumer property or services in consideration of giving the names of prospective purchasers or otherwise aiding in making a sale to another person, if the earning of the rebate, discount, or other thing of value is contingent upon the occurrence of an event subsequent to the time the individual agrees to the sale;

(5) Engage in any scheme or plan for disposal or distribution of merchandise whereby a participant pays a valuable consideration for the chance to receive compensation primarily for introducing one or more additional persons into participation in the planner's scheme or for the chance to receive compensation when the person introduced by the participant introduces a new participant;

[JMT: The South Dakota statute allows compensation to be based on personal consumption ("by the participant or other persons introduced into the plan or operation"), something for which the DSA lobbies⁵²³ This works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

The requirement of repurchase of commercially marketable inventory at not less than 90% of original net cost within one year from date of purchase⁵²⁴ does not offer much consumer protection. The DSA has been successful in convincing legislatures that such repurchase provision prevents stockpiling. However while such a repurchase provision may sound good to regulators, statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Also, recruits have been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.]

TENNESSEE

47-18-104. Unfair or deceptive acts prohibited.

(a) Unfair or deceptive acts or practices affecting the conduct of any trade or commerce constitute unlawful acts or practices and are Class B misdemeanors.

(b) Without limiting the scope of subsection (a), the following unfair or deceptive acts or practices affecting the conduct of any trade or commerce are declared to be unlawful and in violation of this part:

⁵²³ §37.33-3

⁵²⁴ §37-33-2

(1) Falsely passing off goods or services as those of another;

....

(18) Using or employing a chain referral sales plan in connection with the sale or offer to sell of goods, merchandise, or anything of value, which uses the sales technique, plan, arrangement or agreement in which the buyer or prospective buyer is offered the opportunity to purchase goods or services and, in connection with the purchase, receives the seller's promise or representation that the buyer shall have the right to receive compensation or consideration in any form for furnishing to the seller the names of other prospective buyers if the receipt of compensation or consideration is contingent upon the occurrence of an event subsequent to the time the buyer purchases the merchandise or goods;

...

(20) Selling or offering to sell, either directly or associated with the sale of goods or services, a right of participation in a pyramid distributorship. As used in this subdivision, a "pyramid distributorship" means any sales plan or operation for the sale or distribution of goods, services or other property wherein a person for a consideration acquires the opportunity to receive a pecuniary benefit, which is not primarily contingent on the volume or quantity of goods, services or other property sold or delivered to consumers, and is based upon the inducement of additional persons, by such person or others, regardless of number, to participate in the same plan or operation;

...

(27) Engaging in any other act or practice which is deceptive to the consumer or to any other person;

[JMT: "Chain referral sales plans" or "pyramid distributorships" are prohibited and (20). MLM's characteristic "endless chain" of recruitment is a key red flag for any product-based pyramid scheme.⁵²⁵ All MLMs are built on an endless chain of recruitment.

Regarding "deceptive act or practice"⁵²⁶ – In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."]

TEXAS

Sec. 17.46. Deceptive Trade Practices Unlawful.

(a) False, misleading, or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful and are subject to

action by the consumer protection division under Sections 17.47, 17.58, 17.60, and 17.61 of this code.

(b) Except as provided in Subsection (d) of this section, the term "false, misleading, or deceptive acts or practices" includes, but is not limited to, the following acts:

(1) passing off goods or services as those of another;

....

(18) using or employing a chain referral sales plan in connection with the sale or offer to sell of goods, merchandise, or anything of value, which uses the sales technique, plan, arrangement, or agreement in which the buyer or prospective buyer is offered the opportunity to purchase merchandise or goods and in connection with the purchase receives the seller's promise or representation that the buyer shall have the right to receive compensation or consideration in any form for furnishing to the seller the names of other prospective buyers if receipt of the compensation or consideration is contingent upon the occurrence of an event subsequent to the time the buyer purchases the merchandise or goods;

....

(20) promoting a pyramid promotional scheme, as defined by Section 17.461;

Sec. 17.461. Pyramid Promotional Scheme.

(a) In this section:

(1) "Compensation" means payment of money, a financial benefit, or another thing of value. The term does not include payment based on sale of a product to a person, including a participant, who purchases the product for actual use or consumption.

(2) "Consideration" means the payment of cash or the purchase of a product. The term does not include:

(A) a purchase of a product furnished at cost to be used in making a sale and not for resale;

(B) a purchase of a product subject to a repurchase agreement that complies with Subsection (b); or

(C) time and effort spent in pursuit of a sale or in a recruiting activity.

(3) "Participate" means to contribute money into a pyramid promotional scheme without promoting, organizing, or operating the scheme.

(4) "Product" means a good, a service, or intangible property of any kind.

(5) "Promoting a pyramid promotional scheme" means:

(A) inducing or attempting to induce one or more other persons to participate in a pyramid promotional scheme; or

(B) assisting another person in inducing or attempting to induce one or more other persons to participate in a pyramid promotional scheme, including by providing references.

(6) "Pyramid promotional scheme" means a plan or operation by which a person gives consideration

⁵²⁵ See Chapter 2.

⁵²⁶ §47-18-104 (a) and (27)

for the opportunity to receive compensation that is derived primarily from a person's introduction of other persons to participate in the plan or operation rather than from the sale of a product by a person introduced into the plan or operation.

(b) *To qualify as a repurchase agreement for the purposes of Subsection (a)(2)(B), an agreement must be an enforceable agreement by the seller to repurchase, on written request of the purchaser and not later than the first anniversary of the purchaser's date of purchase, all unencumbered products that are in an unused, commercially resalable condition at a price not less than 90 percent of the amount actually paid by the purchaser for the products being returned, less any consideration received by the purchaser for purchase of the products being returned. A product that is no longer marketed by the seller is considered resalable if the product is otherwise in an unused, commercially resalable condition and is returned to the seller not later than the first anniversary of the purchaser's date of purchase, except that the product is not considered resalable if before the purchaser purchased the product it was clearly disclosed to the purchaser that the product was sold as a nonreturnable, discontinued, seasonal, or special promotion item.*

(c) A person commits an offense if the person contrives, prepares, establishes, operates, advertises, sells, or promotes a pyramid promotional scheme. An offense under this subsection is a state jail felony.

(d) It is not a defense to prosecution for an offense under this section that the pyramid promotional scheme involved both a franchise to sell a product and the authority to sell additional franchises if the emphasis of the scheme is on the sale of additional franchises.

Added by Acts 1995, 74th Leg., ch. 463, Sec. 2, eff. Sept. 1, 1995.

[JMT: The Texas statute allows compensation to be based on personal consumption, something for which the DSA lobbied. This works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

The requirement of repurchase of 90% of products in commercially resalable condition within one year from date of purchase⁵²⁷ may sound good to regulators, and the DSA has been successful in convincing legislatures that such repurchase provision prevents stockpiling. However, statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have

been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.

However, there is a consumer-protective provision: "False, misleading, or deceptive acts or practices" are "declared unlawful."⁵²⁸ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

UTAH

UTAH Code -- Title 76 -- Chapter 06a -- Pyramid Scheme Act

76-6a-1. Short title.

This act shall be known and may be cited as the "Pyramid Scheme Act."

76-6a-2. Definitions.

As used in this chapter:

- (1) (a) "Compensation" means money, money bonuses, overrides, prizes, or other real or personal property, tangible or intangible.
(b) "Compensation" does not include payment based on the sale of goods or services to anyone purchasing the goods or services for actual personal use or consumption.
 - (2) "Consideration" does not include payment for sales demonstration equipment and materials furnished at cost for use in making sales and not for resale, or time or effort spent in selling or recruiting activities.
 - (3) "Person" includes a business trust, estate, trust, joint venture, or any other legal or commercial entity.
 - (4) "Pyramid scheme" means any sales device or plan under which a person gives consideration to another person in exchange for compensation or the right to receive compensation which is derived primarily from the introduction of other persons into the sales device or plan rather than from the sale of goods, services, or other property.
- Amended by Chapter 247, 2006 General Session

76-6a-3. Schemes prohibited -- Violation as deceptive consumer sales practice -- Prosecution of civil violations.

(1) A person may not participate in, organize, establish, promote, or administer any pyramid scheme.

(2) A criminal conviction under this chapter is prima facie evidence of a violation of Section 13-11-4, the Utah Consumer Sales Practices Act.

(3) Any violation of this chapter constitutes a

⁵²⁷ Sec. 17.46 (b)

⁵²⁸ Sec. 17.46. (a)

violation of Section 13-11-4, the Utah Consumer Sales Practices Act.

(4) All civil violations of this chapter shall be investigated and prosecuted as prescribed by the Utah Consumer Sales Practices Act.

Amended by Chapter 247, 2006 General Session

76-6a-4. Operation as felony -- Participation as misdemeanor -- Investigation -- Prosecution.

- (1) Any person who knowingly organizes, establishes, promotes, or administers a pyramid scheme is guilty of a third degree felony.
- (2) Any person who participates in a pyramid scheme only by receiving compensation for the introduction of other persons into the pyramid scheme rather than from the sale of goods, services, or other property is guilty of a class B misdemeanor.
- (3) The appropriate county attorney or district attorney has primary responsibility for investigating and prosecuting criminal violations of this chapter.

Amended by Chapter 247, 2006 General Session

76-6a-5. Plan provisions not constituting defenses.

It is not a defense to an action brought under this chapter if:

- (1) The sales device or plan limits the number of persons who may be introduced into it;
- (2) The sales device or plan includes additional conditions affecting eligibility for introduction into it or when compensation is received from it; or
- (3) A person receives property or services in addition to the compensation or right to receive compensation in connection with a pyramid scheme.

Enacted by Chapter 89, 1983 General Session

76-6a-6. Rights of persons giving consideration in scheme.

- (1) Any person giving consideration in connection with a pyramid scheme may, notwithstanding any agreement to the contrary, declare his giving of consideration and the related sale or contract for sale void, and may bring a court action to recover the consideration. In the action, the court shall, in addition to any judgment awarded to the plaintiff, require the defendant to pay to the plaintiff interest as provided in Section 15-1-4, reasonable attorneys' fees, and the costs of the action reduced by any compensation paid by the defendant to the plaintiff in connection with the pyramid scheme.
- (2) The rights, remedies, and penalties provided in this chapter are independent of and supplemental to each other and to any other right, remedy or penalty available in law or equity. Nothing contained in this chapter shall be construed to diminish or abrogate any other right, remedy or penalty.

Enacted by Chapter 89, 1983 General Session

13-11-4. Deceptive act or practice by supplier.

(1) A deceptive act or practice by a supplier in connection with a consumer transaction violates this chapter whether it occurs before, during, or after the transaction.

(2) Without limiting the scope of Subsection (1), a supplier commits a deceptive act or practice if the supplier knowingly or intentionally:

(a) indicates that the subject of a consumer transaction has sponsorship, approval, performance characteristics, accessories, uses, or benefits, if it has not;

....

(k) indicates that the consumer will receive a rebate, discount, or other benefit as an inducement for entering into a consumer transaction in return for giving the supplier the names of prospective consumers or otherwise helping the supplier to enter into other consumer transactions, if receipt of the benefit is contingent on an event occurring after the consumer enters into the transaction;

[JMT: The revised Utah statute allows compensation to be based on personal consumption,⁵²⁹ something for which the DSA aggressively lobbied. This works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

I witnessed firsthand the deceptive lobbying maneuvers used by the DSA to gut Utah's Pyramid Scheme Act with the "personal consumption" language in (1) (b). At legislative hearings, Utah's Attorney General testified on behalf of the bill as "protecting against the really bad pyramid schemes – the ones with no real products." I testified against it, as my research had shown the opposite. His testimony was accepted by the legislators. I later learned that he had recently received a \$50,000 campaign contribution from PrePaid Legal and over the past few years close to \$500,000 in total contributions from MLM companies operating in Utah. Consumer advocates pleaded with the Utah's governor to veto the bill, but to no avail, as some of his main backers were also MLMs.

However, the statute has a provision prohibiting "A deceptive act or practice by a supplier."⁵³⁰ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

⁵²⁹ §76-6a-2 (1) (b)

⁵³⁰ §13-11-4 (1) .

VERMONT**§ 2453. PRACTICES PROHIBITED**

(a) Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful.

(b) It is the intent of the legislature that in construing subsection (a) of this section, the courts of this state will be guided by the construction of similar terms contained in section 5 (a) (1) of the Federal Trade Commission act as from time to time amended by the Federal Trade Commission and the courts of the United States.

(c) The attorney general shall make rules and regulations, when necessary and proper to carry out the purposes of this chapter, relating to unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce. The rules and regulations shall not be inconsistent with the rules, regulations and decisions of the Federal Trade Commission and the federal courts interpreting the Federal Trade Commission Act.

(d) Violation of a rule or regulation as made by the attorney general is prima facie proof of the commission of an unfair or deceptive act in commerce.

(e) The provisions of subsections (a), (c) and (d) of this section shall also be applicable to real estate transactions.

SUBJECT: CONSUMER FRAUD - CHAIN DISTRIBUTOR SCHEMES

ATTORNEY GENERAL - CONSUMER FRAUD DIVISION

ADOPTED PURSUANT TO 9 V.S.A. SECTION 2453(c)

RULE CF 101

CF 101.01 Unfair Trade Practice

CF 101.02 Definitions

CF 101.01 Unfair Trade Practice.

The promotion or offer of, or the grant of participation in a chain distributor scheme in connection with the solicitation of investments from members of the public constitutes an unfair and deceptive trade act and practice in commerce under 9 V.S.A. Section 2453(a). When so used the scheme serves as a lure to improvident and uneconomical investment. Many individuals lack commercial expertise and anticipate unrealistic profits or economic gain through use of the chance to further perpetuate a chain of distributors, without regard to actual market conditions affecting further distribution and sale of the property purchased by them or its market acceptance by final users or consumers.

Substantial economic losses to participating distributors have occurred and will inevitably occur by reason of their reliance on perpetuation of the chain distributor scheme as a source of profit.

CF 101.02 Definitions.

(1) "Chain distributor scheme" is a sales device whereby a person, upon a 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 also are 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 the above 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.

(2) "Investment" is any acquisition, for a consideration other than personal services, of property, tangible or intangible, and includes, without limitation, franchises, business opportunities and services. It does not include sales demonstration equipment and materials furnished at cost for use in making sales and not for resale.

[JMT: In my opinion, Vermont's statute is one of the best in the nation for consumer protection. It opens with one of the best rationale I have ever read for why such (MLM) schemes hurt consumers and should be considered an unfair trade practice. An MLM's "endless chain" of recruitment - or "chain distributor scheme"⁵³¹ is a key red flag for any product-based pyramid scheme.⁵³² All MLMs are built on an endless chain of recruitment.

However, MLM defenders may object to equating the word "investment" to what a person pays to join an MLM. However, the word is used frequently in MLM opportunity and training meetings to encourage prospects to pay more than the initial signup fee. Participants are given monthly quotas to qualify for commissions and advancement in the scheme – and are in addition, often urged and incentivized to buy additional quantities of products in order to "maximize" their opportunity.

Also, it was stated at the beginning of the statute⁵³³ that "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful." In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading (and a deceptive practice). It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

⁵³¹ §CF 101.01

⁵³² See Chapter 2.

⁵³³ § 2453 (a)

VIRGINIA

Virginia: Pyramid and Sales Referral Laws
 VIRGINIA ACTS OF ASSEMBLY -- CHAPTER
*An Act to amend and reenact §§ 18.2-239 and
 59.1-200 of the Code of Virginia, relating to
 definition of pyramid promotional schemes;
 penalty.* [S 95]

Approved

Be it enacted by the General Assembly of Virginia:

1. That §§ 18.2-239 and 59.1-200 of the Code of Virginia are amended and reenacted as follows:
 § 18.2-239. Pyramid promotional schemes;
 misdemeanor; definitions; contracts void.

Every person who contrives, prepares, sets up, operates, advertises or promotes any pyramid promotional scheme shall be guilty of a Class 1 misdemeanor. For the purposes of this section:

(1) "Compensation" means the transfer of money or anything of value.

"Compensation" does not mean payment based on sales of goods or services to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme;

(2) "Consideration" means the payment of cash or the purchase of goods, services, or intangible property;

(3) "Promotes" means inducing one or more other persons to become a participant-; and

(4) *"Pyramid promotional scheme" means any plan or operation by which a person gives consideration for the opportunity to receive compensation a majority of which is derived from the introduction of other persons into the plan or operation rather than from the sale or consumption of goods, services, or intangible property by a participant or other persons introduced into the plan or operation.*

All contracts and agreements, now existing or hereafter formed, whereof the whole or any part of the consideration is given for the right to participate in pyramid promotional scheme programs, are against public policy, void and unenforceable. Any violation of the provisions of this section shall constitute a prohibited practice under the provisions of § 59.1-200 and shall be subject to any and all of the enforcement provisions of the Virginia Consumer Protection Act (§ 59.1-196 et seq.).

Deceptive Sales Referral Practices Prohibited:
 § 18.2-242.1

Certain referral transactions in connection with consumer sales or leases prohibited; effect of such transactions

(a) For the purpose of this section, the term "consumer sale or lease of goods or services" means the sale or lease of goods or services which are purchased or leased by a natural person primarily for a personal, family or household purpose, and not for resale.

(b) With respect to a consumer sale or lease of goods or services, no seller or lessor shall give or offer to give a rebate or discount or otherwise pay

or offer to pay value to the buyer or lessee as an inducement for the sale or lease in return for the buyer's giving to the seller or lessor the names of prospective buyers or lessees, or otherwise aiding the seller or lessor in entering into a transaction with another buyer or lessee, if the earning of the rebate, discount, or other value is contingent upon the occurrence of any sale, lease, appointment, demonstration, interview, conference, seminar, bailment, testimonial or endorsement subsequent to the time the buyer or lessee enters into the agreement of sale or lease.

(c) Agreements made in whole or in part pursuant to a referral transaction as above described shall be void and unenforceable by the seller or lessor. The buyer or lessee shall be entitled to retain the goods, services or money received pursuant to a referral transaction without obligation to make any further or future payments of any sort on the transaction total, or he shall be entitled to avoid the transaction and to recover from the seller or lessor any sums paid to the seller or lessor pursuant to the transaction.

[JMT: The Virginia statute allows compensation to be based on personal consumption, something for which the DSA lobbies aggressively; e.g., "by the participant or other persons introduced into the plan or operation."⁵³⁴ This works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

However, Virginia also has a statute⁵³⁵ that prohibits "fraudulent acts or practices committed by a supplier in connection with a consumer transaction." In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity, in connection with a product sale, is misleading (and a fraudulent practice). It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

WASHINGTON

Chapter 19.275 RCW

Anti-pyramid promotional scheme act (Adopted March 15, 2006) 19.275.010

Findings.

The legislature finds that pyramid schemes, chain letters, and related illegal schemes are enterprises:

- (1) *That finance returns to participants through sums taken from newly attracted participants;*
- (2) *In which new participants are promised large returns for their investment or contribution; and*

⁵³⁴ § 18.2-239 (4)

⁵³⁵ § 59.1-200

(3) That involve unfair and deceptive sales tactics, including: Misrepresentations of sustainability, profitability and legality of the scheme, and false statements that the scheme is legal or approved by governmental agencies.

[2006 c 65 § 1.]

19.275.020

Definitions.

The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1) "Compensation" means payment, regardless of how it is characterized, of money, financial benefit, or thing of value. "Compensation" does not include payment based on the sale of goods or services to anyone who is purchasing the goods or services for actual use or consumption.

(2) "Consideration" means the payment, regardless of how it is characterized, of cash or the purchase of goods, services, or intangible property.

"Consideration" does not include:

(a) The purchase of goods or services furnished at cost to be used in making sales and not for resale;

(b) The purchase of goods or services subject to a bona fide repurchase agreement as defined in subsection (5) of this section; or

(c) Time and effort spent in pursuit of sales or recruiting activities.

(3) "Person" means natural persons, corporations, trusts, partnerships, incorporated or unincorporated associations, or any other legal entity.

(4) "Pyramid schemes" means any plan or operation in which a person gives consideration for the right or opportunity to receive compensation that is derived primarily from the recruitment of other persons as participants in the plan or operation, rather than from the bona fide sale of goods, services, or intangible property to a person or by persons to others.

(5)(a) "Repurchase agreement" means an enforceable agreement by the seller to repurchase, at the buyer's written request, all currently marketable inventory within one year from its date of purchase; and the refund must not be less than ninety percent of the original net cost, less any consideration received by the buyer when he or she bought the products being returned.

(b) Products shall not be considered currently marketable if returned for repurchase after the products' commercially reasonable usable or shelf life has passed, or if it has been clearly disclosed to the buyer that the products are seasonal, discontinued, or special promotion products that are not subject to the repurchase obligation.

[2006 c 65 § 2.]

19.275.030

Pyramid scheme — Prohibition.

(1) No person may establish, promote, operate, or participate in any pyramid scheme.

(2) A limitation as to the number of persons who

may participate, or the presence of additional conditions affecting eligibility for the opportunity to receive compensation under the scheme, does not change the identity of the scheme as a pyramid scheme.

(3) It is not a defense under Chapter 65, Laws of 2006 that a person, on giving consideration, obtains goods, services, or intangible property in addition to the right to receive compensation, nor is it a defense to designate the consideration a gift, donation offering, or other word of similar meaning. [2006 c 65 § 3.]

19.275.040

Application of the consumer protection act.

The legislature finds that the practices covered by this chapter are matters vitally affecting the public interest for the purpose of applying the consumer protection act, Chapter 19.86 RCW. A violation of this chapter is not reasonable in relation to the development and preservation of business and is an unfair or deceptive act in trade or commerce and an unfair method of competition for the purpose of applying the consumer protection act, Chapter 19.86 RCW.

[2006 c 65 § 4.]

19.275.900

Short title — 2006 c 65. This act may be cited as the "antipyramid promotional scheme act."

[2006 c 65 § 5.]

[JMT: While the 2006 revised legislation may have been well-intentioned, it has the fingerprints of the DSA all over it. In particular, compensation can be based on personal consumption⁵³⁶; i.e., compensation from recruitment "rather than from the bona fide sale of goods, services, or intangible property to a person or by persons to others" – which could include sales of participants to other participants. This language works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.]

The statute also provides acceptance of MLMs with a "repurchase agreement" requiring 90% refund for "marketable inventory within one year from its date of purchase." This may sound good to regulators, but statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have been encouraged to open and use the products, so they seldom qualify for refunds anyway. And some MLMs make the process of claiming refunds difficult.

⁵³⁶ §19.275.020 – (4)

However, Washington has a statute specifying that “Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.”⁵³⁷ In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

WEST VIRGINIA

ARTICLE 15. PYRAMID PROMOTIONAL SCHEME.

§47-15-1. Definitions.

(a) "Pyramid promotional scheme" shall mean the organization of any chain letter club, pyramid club, or other group organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by members thereof are to be paid or given to any other member thereof, which plan or device includes any provision for the increase in such membership through a chain process of any members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues or things of material value from other members.

(b) "Promote" or "promotion" shall mean the initiation, preparation, operation, advertisement, or the recruitment of any person or persons in the furtherance of any pyramid promotional scheme as defined in subsection (a) of this section.

§47-15-2. Unlawful act.

No person shall promote any pyramid promotional scheme, either personally or through an agent or agents.

§47-15-3. Contracts void and unenforceable.

All contracts and agreements entered into after the effective date of this article wherein the whole or any part of the consideration of such contract or agreement is given in exchange for the right to participate in any pyramid promotional scheme are hereby declared to be against public policy and are hereby declared to be void and unenforceable.

§47-15-4. Restraining prohibited acts.

§47-15-5. Criminal penalties.

Any person who shall violate the provisions of this article shall be guilty of a misdemeanor, and, upon conviction thereof, shall be fined not less than three hundred nor more than one thousand dollars, or confined in jail for a period not to exceed six months, or both.

§47-15-6. Severability.

If any provision of this article is declared unconstitutional or the application thereof to any person or circumstance is held invalid, the constitutionality of the remainder of the article and the applicability thereof to other persons and circumstances shall not be affected thereby.

[JMT: The concept of “chain process”⁵³⁸ for securing new members is a key red flag for any product-based pyramid scheme.⁵³⁹ All MLMs are built on an endless chain of recruitment.

West Virginia also has a statute that prohibits unfair methods of competition and unfair or deceptive practices. In every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading (and a deceptive practice). It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

WISCONSIN [NOTE: much of this information was supplied by Bruce Craig, former assistant Attorney General for Wisconsin.]

(Regulations) ATCP 122.02 Definitions.

"(1) 'Chain distributor scheme' is a sales device whereby a person, upon a condition that the person make an investment, is granted a license or right to recruit for profit one or more additional persons who also are 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 the above license or right to recruit or the receipt of profits therefrom, does not change the identity of the scheme as a chain distributor scheme.

"(2) 'Investment' is any acquisition, for a consideration other than personal services, (Emphasis added) of personal property, tangible or intangible, for profit or business purposes, and includes, without limitation, franchises, business opportunities and services. It does not include real estate, securities registered under ch. 551, Stats., or sales demonstration equipment and materials furnished at cost for use in making sales and not for resale. The prosecuting attorney of any county or the attorney general, or any person, may petition the circuit court to enjoin the continued operation of any pyramid promotional scheme as defined in this article. The procedure in any such suit shall be the same as the procedure in other suits for equitable relief, except that no bond shall be required upon the granting of either a temporary or permanent injunction therein, when such proceedings are initiated by a prosecuting attorney of any county or the attorney general.

[JMT: The concept of “endless chain” or “chain distributor scheme”⁵⁴⁰ is a key red flag for any

⁵³⁷ RCW 19.86.020

⁵³⁸ §47-15-1. (a)

⁵³⁹ See Chapter 2.

⁵⁴⁰ § ATCP 122.02

product-based pyramid scheme.⁵⁴¹ All MLMs are built on an endless chain of recruitment.

Also, MLM defenders may object to equating the word “investment” to what a person pays to join an MLM. However, the word is used frequently in MLM opportunity and training meetings to encourage prospects to pay more than the initial signup fee. Participants are given monthly quotas to qualify for commissions and advancement in the scheme – and are in addition, often urged and incentivized to buy additional quantities of products in order to “maximize” their opportunity.

Wisconsin also has a statute that prohibits 14 specific practices, plus other untrue, deceptive, or misleading representations; unfair methods of competition; and unfair trade practices. The statute applies to virtually any transaction due to the broad scope of the statutory language.

A MODEL STATUTE AGAINST “CHAIN DISTRIBUTOR SCHEMES”

In the Wisconsin law a Chain Distributor Scheme (MLMs) is considered an unfair trade practice (The FTC should take note.):

ATCP 122.01 Unfair trade practice. The promotional use of a chain distributor scheme in connection with the solicitation of business investments from members of the public is an unfair trade practice under s. 100.20, Stats. When so used the scheme serves as a lure to improvident and un-economical investment. Many small investors lack commercial expertise and anticipate unrealistic profits through use of the chance to further perpetuate a chain of distributors, without regard to actual market conditions affecting further distribution and sale of the property purchased by them or its market acceptance by final users or consumers. Substantial economic losses to participating distributors have occurred and will inevitably occur by reason of their reliance on perpetuation of the chain distributor scheme as a source of profit.

Applying this to MLM, in every case where average income figures have been released by MLM companies, 99% of participants lose money. So to present MLM as a business or income opportunity is misleading. It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

WYOMING

CHAPTER 3

MULTILEVEL AND PYRAMID DISTRIBUTORSHIPS

40-3-101. Short title.

This act [40-3-101 through 40-3-125] may be cited as the "Wyoming Multilevel and Pyramid Distributorship Act."

40-3-102. Definitions.

(a) As used in this act [40-3-101 through 40-3-125]:

(i) "Multilevel distribution companies" means any person, firm, corporation or other business entity which sells, distributes or supplies for a valuable consideration, goods or services through independent agents, contractors or distributors, at different levels wherein such participants may recruit other participants, and wherein commissions, cross-commissions, bonuses, refunds, discounts, dividends or other considerations in the program are, or may be, paid as a result of the sale of such goods or services or the recruitment, actions or performances of additional participants;

(ii) "Multilevel distribution marketing plan" means any agreement for a definite or indefinite period, either expressed or implied, in which a person agrees, for a valuable consideration, to distribute goods or services of a multilevel distribution company to members of the public or to persons who occupy different levels in the multilevel distribution company's distribution system;

(iii) "Distributor" means any independent contracted person, agent, employer or participant who has agreed to perform, at one (1) or more levels in a multilevel distribution marketing plan, the functions of distributing the goods or services of the multilevel distribution company or the recruitment of subordinate distributors or both functions;

(iv) "Resalable condition" means products that will pass without objection in the trade, or are still fit for the ordinary purposes for which the products are used;

(v) "Referral sale" means any inducement offered to a person, for the purpose of selling a product or service, which is the opportunity to receive compensation without exercising a bona fide and commensurate responsibility for the sale of the product or service to the ultimate customer; or any offer to a person of an opportunity to receive compensation related to the recruitment of third persons who will be entitled to substantially similar recruiting opportunities when the offer is used as an inducement for the payment of an entrance fee, given toward a purchase or other consideration,

⁵⁴¹ See Chapter 2.

except for the actual cost of necessary sales materials by the persons to whom the offer is made;

(vi) "Endless chain" means any scheme or plan for the disposal or distribution of property or services whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one (1) or more additional persons into participation in the scheme or plan or for the chance to receive compensation when the person introduced by the participant introduces a new participant;

(vii) "Documentary material" means the original or a copy of any book, record, report, memorandum, paper, communication, tabulation, map, chart, photograph, mechanical transcription, other tangible document or recording, reproductions of information stored magnetically, file layout, code conversion tables, computer programs to convert file to readable printout, wherever situate.

40-3-103. *Endless chains and referral sales prohibited.*

No person may contrive, prepare, set up, propose or operate an endless chain or referral sale.

40-3-104. Prohibitions and requirements.

Every multilevel distribution company shall provide in its contract of participation that the contract may be cancelled for any reason at any time by a participant upon notification in writing to the company of his election to cancel. If the participant has purchased products while the contract of participation was in effect, all unencumbered products in a resalable condition then in the possession of the participant shall be repurchased by the multilevel distribution company. The repurchase shall be at a price of not less than ninety percent (90%) of the original net cost to the participant returning such goods, taking into account any sales made by or through such participant prior to notification to the company of the election to cancel.

40-3-105. Restrictions on marketing programs.

(a) No multilevel distribution company, nor any participant, shall require participants in its marketing program to purchase products or services or pay any other consideration in order to participate in the marketing program unless the multilevel distribution company agrees in writing:

(i) *To repurchase all or part of any products which are unencumbered and in a resalable condition at a price of not less than ninety percent (90%) of the original net cost to the participant, taking into account any sales made by or through such participant prior to notification to the company of election to cancel;*

(ii) *To repay not less than ninety percent (90%) of the original net cost of any services purchased by the participants; or*

(iii) *To refund not less than ninety percent (90%) of any other consideration paid by the participant in order to participate in the marketing program.*

40-3-106. Additional restrictions in marketing programs.

(a) No multilevel distribution company or participant in its marketing program shall:

(i) Operate or, directly or indirectly, participate in the operation of any multilevel marketing program wherein the financial gains to the participants are primarily dependent upon the continued, successive recruitment of other participants and where sales to nonparticipants are not required as a condition precedent to realization of the financial gains;

(ii) Offer to pay, pay or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration to any participant in a multilevel marketing program solely for the solicitation or recruitment of other participants therein;

(iii) Offer to pay, pay or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration to any participant in a multilevel marketing program in connection with the sale of any product or service unless the participant performs a bona fide supervisory, distributive, selling or soliciting function in the sale or delivery of the product or services to the ultimate consumer;

or

(iv) Offer to pay, pay or authorize the payment of any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration to any participant:

(A) If payment thereof is or would be dependent on the element of chance dominating over the skill or judgment of the participant;

(B) If no amount of judgment or skill exercised by the participant has any appreciable effect upon any finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration which the participant may receive; or

(C) If the participant is without that degree of control over the operation of the plan as to enable him substantially to affect the amount of finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration which he may receive or be entitled to receive.

40-3-107. Representations of prospective income restricted.

Multilevel distribution companies shall not represent directly or by implication that participants in a multilevel marketing program will earn or receive any stated gross or net amount, or represent in any manner the past earnings of participants. A written or verbal description of the manner in which the marketing plan operates shall not, standing alone, constitute a representation of earnings, past or future. Multilevel distribution companies shall not represent directly or by implication, that it is relatively easy to secure or retain additional distributors or sales personnel or that all or substantially all participants will succeed.

40-3-108. Licensed activities excluded.

Nothing in W.S. 40-3-101 through 40-3-125 shall apply to acts or practices permitted under the laws of this state or under rules, regulations or decisions interpreting the laws, or to any person who has procured a license as provided by W.S. 39-17-106(a) or (b).

40-3-109. Notice of activity and consent to service of process.

Each multilevel distribution company numbering among its participants any resident of this state shall file with the state's attorney general a statement giving notice of this fact and designating the secretary of state of this state its agent for service of process for any alleged violation of this act [40-3-101 through 40-3-125]. The written notice shall further set forth the intention of the multilevel distribution company to abide by the provisions of this act. Compliance with this section shall not subject any multilevel distribution company to the provisions or consequences of any other statute of this state.

40-3-110. Secretary of state agent for service of process for violations.

Any multilevel distribution company, which fails to comply with W.S. 40-3-109 is deemed to have thereby appointed the secretary of state its agent for service of process for any alleged violation of this act [40-3-101 through 40-3-125].

40-3-111. Investigatory powers.

(a) If the attorney general has reason to believe that a person has engaged in activity which violates the provisions of this act [40-3-101 through 40-3-125], he shall make an investigation to determine if this act has been violated, and, to the extent necessary for this purpose, may administer oaths or affirmations, and, upon his own motion or upon request of any party, may subpoena witnesses, compel their attendance, adduce evidence, and require the production of any matter which is relevant to the investigation, including the existence, description, nature, custody, condition and location of any books, documents or other tangible things and the identity and location of persons having knowledge of relevant facts or any other matter reasonably calculated to lead to the discovery of admissible evidence.

(b) If the person's records are located outside this state, the person at his option shall either make them available to the attorney general at a convenient location within this state or pay the reasonable and necessary expenses for the attorney general or his representative to examine them at the place where they are maintained. The attorney general may designate representatives, including comparable officials of the state in which the records are located, to inspect them on his behalf.

(c) Upon failure without lawful excuse to obey a subpoena or to give testimony and upon reasonable notice to all persons affected thereby, the attorney general may apply to the district court for an order compelling compliance.

40-3-112. Service of process.

(a) Service of any type of process authorized by this act [40-3-101 through 40-3-125] shall be personal within this state, but if such personal service cannot be obtained, substituted service may be made in the following manner:

(i) By service as provided by W.S. 40-3-109 and 40-3-110;

(ii) By service on the secretary of state;

(iii) Personal service without the state;

(iv) By registered or certified mail to the last known place of business, residence or abode of such persons for whom it is intended;

(v) As to any person other than a natural person, in the manner provided in the rules of civil procedure as if a complaint or other pleading which institutes a civil action has been filed; or

(vi) By such service as a district court may direct in lieu of personal service within this state.

40-3-113. Venue of action for injunctive relief.

An action under this act [40-3-101 through 40-3-125] may be brought in the district court of the county in which the alleged violator resides or has his place of business or in the district court of Laramie county, Wyoming.

40-3-114. Injunctive relief against violations; remedy not exclusive.

The attorney general may, whenever it appears to him that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this act [40-3-101 through 40-3-125] or any rule or order hereunder, bring an action in the name of the people of the state in a district court to enjoin the acts or practices or to enforce compliance with this act or any rule or order hereunder. Upon a proper showing, a permanent or preliminary injunction or restraining order shall be granted.

The court shall not require the attorney general to post a bond. This section is not deemed to be exclusive of the remedies available to the state and the criminal penalties found in this act may also apply to individuals who are the subject of an action brought under this section.

40-3-115. Civil penalty for violating injunction.

The attorney general, upon petition to the court, may recover, on behalf of the state, a civil penalty of not more than five thousand dollars (\$5,000.00) per violation from any person who violates the terms of an injunction issued under W.S. 40-3-114.

40-3-116. Acceptance of assurance of voluntary compliance authorized.

In the enforcement of this act [40-3-101 through 40-3-125], the attorney general may accept an assurance of voluntary compliance with respect to any act or practice alleged to be violative of this act from any person who has engaged in, is engaging in or is about to engage in such act or practice.

40-3-117. Jurisdiction retained by court.

The court shall retain jurisdiction in any case where an injunction is entered or a consent agreement is reached or an assurance of voluntary compliance is agreed upon.

40-3-118. Additional relief authorized; appointment of receiver.

The court may make such additional orders or judgments as may be necessary to restore to any person in interest any monies or property, real or personal, which the court finds to have been acquired by means of any act or practice committed in violation of this act [40-3-101 through 40-3-125]. Such additional relief may include the appointment of a receiver whenever it appears to the satisfaction of the court that the defendant threatens or is about to remove, conceal or dispose of his property to the damage of persons to whom restoration would be made under this act.

40-3-119. Receiver's power to acquire and dispose of property.

Any receiver appointed pursuant to W.S. 40-3-118 has the power to sue for, collect, receive and take into his possession all the goods and chattels, rights and credits, monies and effects, land and tenements, books, records, documents, papers, choses in action, bills, notes and property of every description derived in violation of this act [40-3-101 through 40-3-125] by any multilevel distribution company or any distributor in any multilevel distribution marketing plan sponsored by such company, including property which has been commingled with company or distributor property, if it cannot be identified in kind because of such commingling, and to sell, convey and assign the same and hold and dispose of the proceeds thereof under the direction of the court.

40-3-120. Civil penalty for willful violation; willful violation defined.

In any action brought pursuant to this act [40-3-101 through 40-3-125], if the court finds that any person has engaged in prohibited activities in willful violation of or in reckless disregard for any provision of this act, the attorney general or county attorney in any county in which the violation occurred, upon petition to the court, may recover, on behalf of the state, a civil penalty of not more than two thousand dollars (\$2,000.00) per violation. For purposes of this section, a willful or reckless disregard occurs when the party committing the violation knew or should have known that his conduct was a violation of this act.

40-3-121. Property acquisition and disposition remedy available in action for private remedy. The remedy provided by W.S. 40-3-119 is available to any person in any action brought for a private remedy against any multilevel distribution company or any distributor in the multilevel distribution marketing plan sponsored by the company.

40-3-122. Penalties for violations; other criminal remedies unimpaired.

Any person who willfully violates any provision of this act [40-3-101 through 40-3-125], or who willfully violates any rule or order under this act, shall upon conviction be fined not more than five hundred dollars (\$500.00) or imprisoned in a county jail for not more than one (1) year, or be punished by both such fine and imprisonment, but no person may be imprisoned for the violation of

any rule or order if he proves that he had no knowledge of the rule or order. Nothing in this act limits the power of the state to punish any person for any conduct which constitutes a crime under any other statute.

40-3-123. Limitation of actions.

No action shall be maintained to enforce any liability created under this act [40-3-101 through 40-3-125] unless brought before the expiration of three (3) years after the act or transaction constituting the violation or the expiration of one (1) year after the discovery by the plaintiff of the fact constituting the violation.

40-3-124. Causes of action under other law unimpaired.

Nothing in this act [40-3-101 through 40-3-125] shall in any way affect causes of action arising under other laws of this state or under the common law brought by any private person.

40-3-125. Severability of provisions.

If a part of this act [40-3-101 through 40-3-125] is invalid, all valid parts that are severable from the invalid part remain in effect. If a part of this act is invalid in one (1) or more of its applications, the part remains in effect in all valid applications that are severable from the invalid applications.

[JMT: The concept of “endless chain”⁵⁴² or “chain distribution scheme” is a key red flag for any product-based pyramid scheme.⁵⁴³ All MLMs are built on an endless chain of recruitment. If the Wyoming stature were strictly applied, no MLM would be permitted in the state.

The requirement to repurchase 90% of products in resalable condition⁵⁴⁴ may sound good to regulators, but statistics I have seen show less than 5% of products are returned for a refund, even though 99% of participants lose money. Few understand the inherent flaws in the business model and the fact that they have been victimized by a money trap. Recruits have been encouraged to open and use the products so that they are not eligible for a refund.

Nothing better describes MLM than “entrepreneurial chains.” And its effects are well articulated in an early FTC warning (before the ill-fated Amway decision) that such schemes possess an intolerable capacity to mislead.

⁵⁴² §40-3-103.

⁵⁴³ See Chapter 2.

⁵⁴⁴ §40-3-104. (i)

Chapter 11: WHERE IS LAW ENFORCEMENT IN ALL THIS?

If MLMs were technically illegal, why don't regulators act against them? Does politics play a role, and if so, how? What can be done to protect consumers?

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Introduction and summary

In this chapter, I will share observations that I and other consumer advocates firmly believe deserve diligent attention by federal and state regulators, consumer advocate groups, investigative journalists, attorneys, and consumers.

We shall first look at issues facing law enforcement, including the problems with complaint-based or reactive enforcement of MLMs, the role of DSA/MLM lobbyists in weakening consumer protection, political considerations, and the seeming inability of state and federal law enforcement to stem the tide of abuse – demonstrating the need for adequate disclosure to counteract the natural tendency of MLMs to misrepresent products and earnings of distributors. They misrepresent because – as a flawed system – they must do so in order to survive. If prospects knew and understood the abysmal odds of success, only those who do not understand the significance of statistical odds would participate. Some – with a "lottery mentality" will do so regardless of the odds.

Finally, we look at recent developments in law enforcement, which reinforces the need for proactive consumer protection through warnings and adequate disclosures.

ISSUES FACING LAW ENFORCEMENT

The silence of victims explains why complaint-based law enforcement does not work in addressing MLM abuse.

As explained in Chapter 9, MLMs are protected against action by authorities because only a tiny percentage of victims file complaints with law enforcement. And in law enforcement, the squeaky wheel gets the grease.

MLMs are protected against action by authorities because only a tiny percentage of victims file complaints with law enforcement. And in law enforcement, the squeaky wheel gets the grease.

From 20 years of feedback, I have found four reasons victims don't complain:

- They are kept in ignorance of MLMs inherently flawed, unfair, and deceptive program by the MLM company's dialogue of deceptions.
- In endless chain recruitment schemes every major victim is or necessarily a perpetrator – recruiting friends and family and anyone who will listen. If they file a complaint, they fear self-incrimination and/or consequences from or to those they recruited, or who recruited them – often close friends or relatives.
- Victims often blame themselves for their “failure,” having been led to believe that MLM is legitimate and that those who fail did not try hard enough to “work the system.”
- The failure of regulators to act against MLM fraud reinforces the MLMs' claims to legitimacy. MLM promoters bellow: “If (our MLM) were illegal it would have been stopped long ago.”

According to my research and world-wide feedback, I estimate that no more than one in 500 victims (including those who have lost tens of thousands of dollars) ever files a complaint with either a federal or state regulatory agency. No complaints results in no action by regulatory officials. And no action by regulators facilitates MLM abuse. This is another reason for considering all endless chains illegal per se – as is the case for “pay to play” chain letters, Ponzi schemes, and no-product pyramid schemes.

Victims also rarely report their losses to the Better Business Bureau for the same reasons. We have observed “A” ratings for some of the most damaging product-based pyramid schemes, having had few or even no complaints registered with the BBB. For example, Amway gets an A+ rating, which (to

those who understand their numbers and practices) says more about the BBB than it does about Amway. It should also be noted that the DSA, Amway, and other MLMs are “corporate partners of the BBB.” As explained in Chapter 9, this calls into question the advice to “check out a company with your Better Business Bureau” – at least for MLMs.

Lack of complaints shield MLMs from public scrutiny. Lack of complaints also affects the media, which can be easily manipulated by powerful MLM companies with large public relations staff. Whenever media representatives are considering reporting on the downside of MLM, they want victims they can interview. It is hard getting victims to be vocal about their losses, so reporters often accept glowing but untrue releases from an MLM's PR staff.

Academia is also virtually silent on this issue. This may be due not only to lack of public outcry at MLM abuses, but also to donations made to universities by MLM PR slush funds in areas where MLMs are based.

On rare occasions, academics express themselves on MLM, but with reports more favorable than critical. For example, a favorable report of MLM's potential and the need for better regulations to protect consumers while not thwarting the industry emanated from a respected institution – Yale Law School.⁵⁴⁵ I would not be surprised to find that some donor dollars from the MLM industry influenced the report.

Another academic, Dr. Charles King, professor of marketing at University of Illinois at Chicago, acts as a voice for the MLM industry, testifying on behalf of MLMs in court cases and speaking at MLM events. He has even taught MLM courses. The source of much of his funding by MLMs is no secret.

Brigham Young University has received a considerable amount of funding from Nu Skin Enterprises, Inc., which is also located in Provo, Utah. At one time, the web site for the College of Business featured instructions on how to start an MLM company. When (as an alumnus of that

⁵⁴⁵ “The Chaos of Multi-level Marketing and Pyramid Sales Laws: A Federal Remedy,” by Raymond J Faltinsky, Analytical writing supervised by Dean Guido Calabresi, Yale Law School, Spring 1992.

school) I strenuously objected, they removed that page.

Harper's Magazine came out with an insightful article explaining the success of the DSA's MLM member firms in neutralizing regulatory efforts by targeted donations to politicians connected with law enforcement at the state and federal levels.

Carefully placed donations and campaign contributions – together with lack of complaints – provide MLMs protection against regulatory scrutiny.

Legislators who may be tempted to propose legislation controlling MLM abuse are also affected by campaign contributions by the DSA/MLM lobby. This was forcefully demonstrated to me at hearings before committee hearings of the 2006 Utah State Legislature considering a bill (initiated by the DSA) that would exempt MLMs from prosecution as pyramid schemes. SB182 would exempt “direct selling” companies from the definition of a pyramid scheme as long as consumable products were sold.

In legislative hearings, I strenuously objected to the bill and wrote a series of 11 bulletins to legislators to educate them on the fallacies of the bill, in the hope that truth would prevail. However, Utah's Attorney General Mark Shurtleff testified that the bill was “designed to protect against the worst schemes – those that don't sell any products.” The bill passed.

I checked Shurtleff's campaign contributions. He had recently received \$50,000 from one MLM and has received more than \$475,000 million since 1999 from members of the DSA. Those of us advocating for consumers appealed to Utah's Governor Jon Huntsman to veto the bill, but he too had received substantial political contributions from MLMs and could not be persuaded by myself and other consumer advocates to veto the bill. Huntsman later travelled to China to encourage officials to accept MLMs in China.

I was shocked at the utter corruptness of the whole proceeding. I am convinced that if Utah's citizens, the media, the legislators, and

the governor had a clear understanding of the massive damages caused by Utah-based MLMs; if so much money and political influence had not come from the DSA/MLM cartel; and if enough victims had filed complaints to create public resistance to the bill, SB182 never would have passed.

According to an article in *Harper's Magazine*, titled “Pyramid Insurance”⁵⁴⁶:

John Swallow, who in June became the Republican Party's candidate to replace Shurtleff, also enjoys the support of the industry. Of the \$680,000 he has raised for his election campaign to date, \$114,000 can be traced to Utah-based DSA member companies, their executives, or their spouses.⁵⁴⁷

Swallow, who was forced from office less than a year into his first term, was charged in a district court with 11 felonies and two misdemeanors, including multiple counts of receiving or soliciting bribes, accepting gifts, tampering with evidence, obstructing justice and participating in a pattern of unlawful conduct. Mark Shurtleff was also arrested on multiple charges.⁵⁴⁸

This pattern of DSA/MLM influence on Attorneys General offices is seen in other states in which major MLMs are based as well. Continuing the Harper's “Pyramid Insurance” quote:

Executives from the multilevel-marketing telecom ACN (formerly American Communications Network) have given \$84,550 to North Carolina attorney general Roy Cooper since the run-up to the company's relocation there in 2008 – nearly 85 percent of their total campaign contributions during that period. Two ACN executives, Charles Barker and Robert Stevanovski, tied with a few others as [the largest individual donors](#) to Cooper's 2008 reelection campaign.⁵⁴⁹

⁵⁴⁶ By Jeff Ernsthansen, *Harper's Magazine*, Aug. 17, 2012

⁵⁴⁷ The \$114,000 included \$40,000 given to Utah's Prosperity Foundation PAC. Though the PAC is registered to Shurtleff, it gave \$132,000 of the first \$220,000 it raised to Swallow at the end of 2011 and over \$10,000 to his primary campaign in 2012.

⁵⁴⁸ “Swallow, Shurtleff arrested, face 23 counts, up to 30 years prison,” *Salt Lake Tribune*, July 19, 2014

⁵⁴⁹ This figure includes donations by executives' spouses and members of ACN's “[Circle of Champions](#).” Much of this money came from employees residing outside North Carolina.

Idaho attorney general Lawrence Wasden raised \$25,000 of his \$182,268 war chest for his 2002 campaign from Idaho-based Melaleuca, making the company his single biggest donor.⁵⁵⁰

And the families controlling the Amway fortune have given more than \$145,000 to attorney-general campaigns in Michigan since 1996, including \$87,500 to current AG Bill Schuette. Altogether, Amway donations were among the largest sources of funding for Schuette's 2010 campaign.⁵⁵¹

There are other disturbing revelations that came from this article:

When class-action attorney Douglas Brooks appeared alongside Sole-Smith on NPR's On Point last month, he linked regulatory inaction against multilevel marketers to the lobbying efforts of the Direct Selling Association, an industry trade group whose members are known for making contributions to elected officials. The families who control the multibillion-dollar Amway fortune, for example, have been making headlines since the 1980s for their donations to the G.O.P., which included \$4 million in 2004 to a 527 supporting George W. Bush's reelection campaign. This spring, Stephanie Mencimer of *Mother Jones* detailed Mitt Romney's multilevel-marketing connections, which included more than \$3 million in contributions to a Romney super PAC by executives at Nu Skin Enterprises and Melaleuca. As for Mary Kay, Richard Rogers, the company's chairman (and Mary Kay Ash's son), has given more than \$300,000 to federal campaigns since 2006, most of it to Republicans, including members of Senate and House committees that oversee the Federal Trade Commission.

I find this latter revelation very disturbing. I also learned during the 2006 Utah legislative hearings that the DSA touts their large membership to legislators, implying a large voting block that could influence their re-election. They even managed to get 86 members of Congress to

⁵⁵⁰ A year after taking office, minutes of the Idaho state legislature show that Wasden met with a DSA lobbyist to discuss the Association's model legislation, which became law in Idaho in 2004.

⁵⁵¹ Figures include a \$34,000 donation given to Schuette by the Great Lakes Education Project, a PAC controlled by Amway heirs Betsy and Dick DeVos.

sign a joint comment objecting to MLMs having to comply with the Business Opportunity Rule.

Consumer protection requires proactive measures, including disclosure of vital information.

After over two decades of consumer advocacy on this issue, I and others with whom I have worked have become somewhat cynical about the prospect of getting the FTC or other law enforcement agencies to undertake responsible steps to control MLM abuse. It may be that some of this is due to the background of those who work in these regulatory agencies. Many are lawyers or officials who have worked in a resource or administrative capacity in conjunction with the agency's legal teams.

This is not a harangue against attorneys. Some of my best friends are attorneys – we even laugh at the same lawyer jokes. But as a consumer advocate with wide business experience, I have to agree with the former president of American Motors and candidate for U.S. president, George Romney (father of Mitt Romney), who said that a key difference between businessmen and attorneys is that successful business leaders look forward and attorneys look backwards.

Attorneys of necessity must be thoroughly grounded in legal precedents, and when they try a case they look for evidence of what has happened from a legal perspective, not what could or will happen to cause harm. Or to put it another way, a business executive is often having to estimate what effects current decisions and actions will have on the bottom line for the next year or quarter – or beyond. What's past is prologue. To be successful, they must of necessity be proactive, not just reactive.

Unfortunately, those who are making critical decisions affecting literally hundreds of millions of consumer worldwide are looking backwards, not forward. A good example was the FTC's determination – under pressure from the DSA/MLM lobby – to exempt MLMs from inclusion in its Business Opportunity Rule (BOR), which was enacted in 2011.

The intent of BOR was to provide at least some protection to consumers by requiring minimal disclosures to help prospects make informed decisions about participation. The DSA/MLM lobby mounted a \$4 million campaign⁵⁵² and got thousands of MLM participants to object to including MLM in the rule. The FTC caved and chose instead to rely on case-by case enforcement of Section 5, proudly proclaiming that they had acted against about 14 MLMs in the past ten years.

This is almost totally reactive, not proactive. By the time an MLM is prosecuted, thousands – or even millions – of participants may have been defrauded of their resources, and any action coming from the FTC will recover but a tiny fraction (if any) of their losses. And it could be argued that 14 MLMs represents less than 1% of total MLMs that have violated Section 5.

It should also be emphasized that enforcement actions do little to warn consumers of what they can do to avoid losses from MLM participation. It certainly does not provide disclosure of information that is crucial for making an informed decision. How can MLM prospects make an informed decision when MLM promoters are allowed to blatantly misrepresent their “opportunity” and their products?⁵⁵³

The FTC decision to use Section 5 to go after fraudulent MLMs is like using a hearse to collect the bodies of those who have driven over a cliff, rather than building a fence to prevent drivers from going over the cliff in the first place.

The DSA/MLM lobby

I have suggested that the DSA/MLM lobby acts as a cartel in directing the dialogue of deception upon which MLM depends. It seeks to strengthen and legitimize member MLMs by weakening laws and by misleading legislators, regulators, consumers, and the media into accepting the deceptive arguments of MLM promoters. Let’s take a closer look at the DSA, or Direct Selling Association.

Legitimate direct selling has virtually disappeared. The DSA represented legitimate direct selling companies, such as Fuller Brush, Tupperware, World Book Encyclopedia, etc., in an earlier time period when door-to-door selling was in vogue, and information about products and efficient transportation to get them to consumers was lacking. However, as advertising and transport developed, and supermarkets and other retail outlets flourished – to say nothing of the Internet – price competition led to the demise of most legitimate direct selling, and to almost total elimination of door-to-door selling. And following the 1979 Amway decision, a plethora of new MLMs literally exploded in the marketplace, like a fast-growing cancer.

It should be noted that two of the icons of door-to-door direct selling have had to make drastic changes. Fuller Brush filed for Chapter 11 bankruptcy protection, and Encyclopedia Britannica ceased its print editions to concentrate on its online version, eliminating the need for direct selling. Door-to-door selling is an anachronism of the past.

MLM rescued the DSA, and the DSA enhanced the image of MLM. MLM leaders soon saw the advantage of joining the DSA to give them an air of legitimacy as a form of “direct selling”. “Multi-level marketing” sounded too much like a pyramid scheme, and “network marketing” wasn’t much better. The situation was like a farmer who gets more money selling horses than pigs. So he fastens horse hairs on the buttocks of the pigs and marches them into the horse corral and announces, “See there, they are no longer pigs, but horses because they are in the horse corral.”

This move to join the DSA helped the MLMs by rebranding them – in their laying claim to be “direct sellers.” It also helped the DSA because it gave new life to a decaying membership. The majority of DSA members now are MLMs, who provide most of its support. And not surprisingly, the DSA promotes the interests of its MLM members, not the interests of consumers, despite the purported implementation of its “code of ethics” – which gives the appearance of consumer protection while allowing fundamentally flawed MLM programs⁵⁵⁴ as members in good

⁵⁵² Statement by DSA president Neil Offen in a DSA news report following the issuance of the final Rule

⁵⁵³ Over 110 misrepresentations used by MLM companies and defenders are listed in Chapter 8.

⁵⁵⁴ See Chapter 2.

standing, including some which have been prosecuted as pyramid schemes.

Below is a chronological breakdown of the gradual takeover of the DSA by MLMs⁵⁵⁵:

- In 1970, less than 5% of U.S. DSA members were multilevel (as opposed to single-level)
- In 1990, 25% of U.S. DSA members were multilevel;
- By 1996, over 70% of U.S. DSA members were multilevel;
- By 1999, 77.3% of U.S. DSA members were multilevel;
- By 2000, 78% of U.S. DSA members were multilevel;
- And by 2009, *over 90%* of U.S. DSA members classified themselves as multilevel.

DSA: “Direct Selling Association” – or what might be termed “Deceptive Selling Alliance” The DSA has endeared itself to the MLM industry by becoming chief articulator of the litany of misrepresentations that sustain the whole industry – over 110 of which were listed in Chapter 8. DSA could just as appropriately stand for “Deceptive Selling Alliance.”

This is not to excuse their actions, but DSA officials face a tough challenge. They must work hard to defend MLM, a system that is inherently flawed and dependent on a litany of deceptions⁵⁵⁶ to survive.

DSA’s deceptive lobbying efforts. As mentioned above, I witnessed DSA representatives at committee hearings at the Utah State Legislature for both the 2005 and 2006 sessions testify for proposed bills obviously crafted by the DSA to exempt MLMs from prosecution as pyramid schemes. Their arguments were full of deceptions, including the statement in 2005 by Neal Offen, president of the DSA, that the DSA represented 90,000 direct sellers in the state of Utah (translation: 90,000 votes). What he didn’t say was that most of the 90,000 participants were victims of product-based pyramid schemes, since over 99% of them lose money.⁵⁵⁷

In the 2006 hearings, DSA representative Misty Fallock quoted FTC attorney James

Kohm out of context to suggest that internal consumption by participants in an MLM satisfies the retail requirement to exempt it from the definition of a pyramid scheme. The DSA had managed to get eight state senators as co-sponsors and – as mentioned above – even saw that Utah’s Attorney General and governor received large contributions from DSA members to assure their support.

Using similar deceptive tactics, DSA-initiated bills appear to have been passed in several other states, including Georgia, Idaho, Kentucky, Louisiana, Maryland, Montana, New Mexico, North Dakota, Oklahoma, South Dakota, and Texas. Such bills typically amended existing statutes. In statutes influenced by DSA lobbying, consumers are deprived of what little consumer protection they had against product-based pyramid schemes. By now other states may have passed such laws as well, while critics weren’t looking – or lacked the resources to contest.

The DSA even attempted to get a bill⁵⁵⁸ passed in the U.S. Congress that would officially legalize the non-retailing, endless chain recruitment model of MLM. Fortunately, that effort failed. However, the DSA was successful in an all-out \$4 million lobbying campaign to get the FTC to exempt MLMs from having to comply with the Business Opportunity Rule (BOR) which was finalized in December of 2011.⁵⁵⁹ As a result, MLM promoters can continue to promote their bogus business opportunities without having to disclose vital information, such as average income, references, lawsuits against the MLM, etc.

Political considerations

Without question, the decades-long push for deregulation by conservative politicians has weakened consumer protection from some of the most damaging schemes in history. The mortgage meltdown, the Enron and Bernie Madoff scandals, speculation in derivatives with depositor’s money by big banks, and depth of the recession in the

⁵⁵⁵ Per article “All you need to Know about MLM” – available for download from web site – www.financialindustry.com/mlm.htm

⁵⁵⁶ See Chapters 2 and 8.

⁵⁵⁷ See Chapter 7

⁵⁵⁸ HR1220 was proposed in 2004.

⁵⁵⁹ For a revealing account of the rulemaking process that resulted in the final Rule, see my report titled “REGULATORY CAPTURE: The FTC’s Flawed Business Opportunity Rule”

period from 2007 to 2010, were in no small part direct consequences of such deregulation. And of course the weakening of the FTC and its enforcement powers against MLM abuses were a part of that, as MLM promoters capitalize on peoples' misfortunes.

The 1979 FTC decision that Amway was “not a pyramid scheme” (assuming compliance with its “retail rules”) could be considered “the great FTC blunder.”

The FTC should take corrective action to alleviate at least some of the devastating effects of its Amway decision.

George W. Bush rewards his Amway supporters with very little action against MLMs from 2001 to 2008.

In the 2000 presidential campaign, the second largest contributor to the George W. Bush campaign was the Amway family. After coming into office in 2001, President Bush rewarded Amway by replacing Chairman Pitofsky with Timothy Muris, an MLM sympathizer who had worked for Amway's legal firm⁵⁶⁰. And you guessed it, MLMs found in him a safe haven for the duration of his tenure, with only about three cases (NexGen 3000, Trek Alliance, Burnlounge) pursued out of hundreds of MLMs that could – and should – have been prosecuted. This inaction against MLMs continued through the Obama administration, probably due to the fact that some key officials appointed to positions in the FTC remained in office, especially at the Bureau of Consumer Protection.

In fact, one of the very few officials who were actually making headway in deciphering the fraud in MLMs was soon replaced. Dr. Peter J. VanderNat, FTC's Senior Economist, had developed a formula or test that could be used to determine the legitimacy of an MLM

⁵⁶⁰ Muris worked at the law firm of Collier, Shannon, Rill & Scott from 1992-2000, was an anti-trust lawyer whose largest client was the multi-level marketing company, Amway.

by measuring how much retail sales to non-affiliating consumers would have to occur for an MLM to pay legitimate commissions rather than rewards for illegal pyramid recruiting.⁵⁶¹

One of Muris's first actions was to move Dr. VanderNat out of the arena of MLM fraud investigation to another department of the FTC where he could do no harm to MLMs. He was replaced by economist David Scheffman, who had argued that Equinox was not a pyramid scheme, largely based on the assertion that Equinox operated *just like Amway*.⁵⁶² (Equinox was shut down by the FTC, with the help of eight states.)

State agencies are typically too weak to control MLM abuse.

Attorneys general and consumer protection agencies in only a few states have made significant efforts to control MLMs, or what I have labeled “product-based pyramid schemes”.⁵⁶³ This may be due in part to lack of information and resources – and the lack of prosecutorial will to go after promoters of these schemes, which are often very well-financed and politically powerful.

Also, MLM executives can afford the best attorneys. Kristine Lanning, former assistant to the Attorney General in North Carolina, told me that *it would take twenty times the resources to prosecute an established MLM as what is needed to prosecute the typical cases brought before them*.

For some important lessons regarding the David vs. Goliath struggle of states attempting to enforce laws against MLM/pyramid schemes, read Robert FitzPatrick's article on Montana vs. ACN:⁵⁶⁴

⁵⁶¹ Robert FitzPatrick, quoted by Marc Sylvestre in the article “*Probable cover-up, protection of Ponzi, pyramid schemes by FTC*,” Subworld News, Charlotte, Carolina, Sunday Dec. 5, 2010

⁵⁶² Robert FitzPatrick, *The Main Street Bubble: How the FTC Ignored and now Protects Business Opportunity Fraud on Main Street*. Download from his web site: pyramidschemealert.org.

⁵⁶³ Douglas M. Brooks, LLP, who has acted as lead plaintiff attorney for victims of major MLMs, wrote me that the term “product-based pyramid schemes” to correctly label MLM is “spot on.”

⁵⁶⁴ “*Analysis: Montana/ACN Settlement Displays the MLM Loophole, Once Again*.” Go to – <http://pyramidschemealert.org/montana-vs-acn-a-david-and-goliath-battle/>

The FTC's role in protecting consumers from "unfair and deceptive practices" by MLMs is crucial – but not happening.

Why FTC is the most appropriate agency for dealing with MLM abuse. Since 2000, the Federal Trade Commission has demonstrated little commitment to protecting consumers from the hundreds of product-based pyramid schemes that have cropped up since the 1979 Amway decision. Still, the FTC is the appropriate agency for such action. There are two reasons for this:

First, all MLMs have compensation plans that are based on an endless chain of recruitment and are therefore extremely viral – quickly spreading like a fast-growing cancer across state borders. Even beginning distributors often find themselves having to recruit persons they know in other states because their city or state is so heavily saturated with MLM recruiters. So in effect, all MLMs are engaging in interstate commerce.

Second, a primary mission of the FTC is to protect consumers against "unfair and deceptive practices." As one who has taught business, performed extensive research on literally thousands of self-employment options and hundreds of MLMs, I can say with utmost confidence that it would be impossible to find a business practice that is more unfair and deceptive, and more viral and predatory, than MLM. A careful reading of prior chapters, especially Chapters 2, 7, and 8, should convince anyone with an open mind that this is true.

The great FTC blunder. For these reasons, I refer to the 1979 Amway decision that Amway was "not a pyramid scheme" (assuming compliance with its "retail rules") as "*the great FTC blunder.*" Of course, in 1979 prosecutors simply did not have the research to guide them that we have now, and under pressure by conservative politicians, the political climate at the time was moving towards deregulation. *It is time for the FTC to take corrective action to alleviate at least some of the devastating*

effects of the 1979 Amway decision. A new rule requiring disclosure of average income of participants and other information similar to the Franchise Rule would be a good start. The FTC missed a golden opportunity to do just that when it yielded to pressures from the DSA/MLM cartel in exempting MLM from having to comply with the Business Opportunity Rule – requiring only a single page handout – which DSA/MLM spokesmen complained was "too great a burden." (The Franchise Disclosure Document the franchisors are required to provide for prospective franchisees can be hundreds of pages long.)

Warnings ignored. One of the most knowledgeable persons to point out the fundamental flaws in multi-level marketing was Bruce Craig, former assistant to the Attorney General of Wisconsin. He litigated several historic MLM cases over a period of decades and continued expressing his concerns for years following his retirement. Letters he wrote to Chairman Robert Pitofsky in 2000 and to the FTC's chief economist Peter VanderNat in 2001 are well worth reading for anyone who wants a basic understanding of the history and issues related to regulations affecting MLM. (See Appendices 2F and 2G in Chapter 2.)

As one who has taught business, performed extensive research on literally thousands of self-employment options and hundreds of MLMs, I can say with utmost confidence that one could not find a business practice that is more unfair and deceptive, and more viral and predatory, than MLM.

OTHER DECISIONS & ACTIONS DEMONSTRATE THE NEED FOR ADEQUATE DISCLOSURE BY MLMs

Rulings in MLM cases preceded proposal for Business Opportunity Rule.

All we need to assess the need for a rule requiring MLMs to disclose average incomes of participants is to look back at significant cases that highlight that need.

Nu Skin was ordered to cease misrepresenting earnings of its distributors. In 1994, the FTC went after Nu Skin, alleging unsubstantiated claims for the income opportunity and products. The company and its distributors were ordered to cease its misrepresentations of distributors' earnings. Later, in 2003, I presented evidence to the FTC in a "*Report of Violations*"⁵⁶⁵ that Nu Skin's misrepresentations continued. Some modifications were made in Nu Skin's "Report of Average Incomes" of its distributors, but major deceptions remained in their reporting, as I have found to be true for all MLMs that publish average income data.

In 1997, Nu Skin paid a \$1.5 million civil penalty to settle its case but as the above report alleges, Nu Skin continued to disobey the 1994 FTC Order against it — with the FTC failing to enforce it.

Jewelway was ordered to disclose information needed for making an informed decision. In 1997 the FTC went after MLM Jewelway, alleging it was an illegal pyramid scheme that emphasized recruiting over retailing. Jewelway, its assets frozen under temporary restraining order, agreed under duress to exactly the language that had been so dangerous in Omnitrition: JewelWay's sales revenue must come "primarily from retail sales" to *nonparticipants*. In addition, Jewelway

agreed to some very onerous restrictions in order to enforce compliance so Jewelway could continue its business. Among other things, the settlement required Jewelway to:

- *Disclose the percentage of all representatives in the program who have received a particular reward* (e.g., a specific income level, car or home allowance, vacation package) at the time a claim is made regarding income potential or likelihood of earning other types of rewards;
- Implement a *90 day "cooling off" period*, under which the purchaser of JewelWay's jewelry cannot join the company as a representative for 90 days;
- Review all representatives' advertisements before allowing the ads to run;
- Obtain from each new representative a signed *verification form*, which the defendants must review before depositing any of the representative's money, *to ensure that none of the prohibited claims were made* (if the defendants do not receive a completed verification form from a consumer, the purchase price must be refunded).⁵⁶⁶

World Class Network – ditto. Later that year, in a case involving World Class Network, the FTC made similar stipulations.

Fortuna Alliance claimed fabulous earnings by participants. Using fabulous earnings claims, promoters induced tens of thousands of consumers in over 60 countries around the world to pay between \$250 and \$1750 to join their pyramid scheme, claiming that members would receive over \$5,000 per month in 'profits' as others were induced to 'enroll.' In addition, Fortuna and its officers provided advice and promotional materials for members to recruit others to join the pyramid, both through direct contact and by setting up their own web sites. The FTC's case against Fortuna was settled in 1998.

FutureNet illustrated the need for sales to non-participants and for honest disclosure. In an FTC release dated April 8, 1998, the headline reads: FutureNet

⁵⁶⁵ The full name of the report was descriptive: "*Report of Violations of the FTC Order for Nu Skin to stop misrepresenting earnings of distributors – and the need for FTC action to redress damages and to prevent further worldwide consumer losses – including evidence (Appendix) of recent misrepresentations and failure to implement meaningful disclosure to correct them*"

⁵⁶⁶ Quoted from the "Army Dillar" article "All You Need to Know about MLM": Is MLM a Scam?," cited in "Notes regarding other resources" at the end of this chapter.

Defendants settle Charges; \$1 Million in Consumer Redress for "Distributors." Some of the more interesting passages follow:

On March 3, 1998, the Court modified the order substituting a monitor for the receiver and allowing the defendants to resume the sale of goods and services, *but only to persons not participating in defendants' marketing program -- in effect maintaining the injunction against pyramiding included in the initial restraining order. . .*

There you have it again. *Sales must be to non-participants in order for it not to be a pyramid scheme.*

. . . according to the FTC, a major portion of the income the defendants promised was not based on sales of the devices, which are easily available at other retail distributors, including Sears and Circuit City, at comparable or lower prices. Instead, the promised income came from fees paid by newly recruited distributors who would then bring on more recruits to provide a nonstop "downstream" of paying members. FutureNet claimed that their recruits -- so called "Internet Consultants" -- would receive \$200 - \$400 when they personally recruited another consultant, and \$25 - \$50 when a person in their downline recruited a new member. The agency charged that income from the FutureNet multilevel marketing plan did not depend on sales of the Internet devices they were purportedly selling, but rather on the recruitment of new distributors -- the typical profile of an illegal pyramid. Since almost 90 percent of investors in any pyramid program actually lose money, the defendants' earnings claims were false, and violated federal law, the FTC alleged.

Again, the 90% loss rate is for no-product pyramid schemes. As explained in Chapter 7, for product-based schemes, or MLMs, the loss rate is approximately 99.7%. Looking at the inverse -- or success rate -- a person has approximately 33 times as great a chance of profiting from a classic pyramid scheme as from an MLM!

Also, the final settlement would, among other things,

- Prohibit misrepresentations about earnings or sales and *require that if the defendants make specific earnings claims, they must disclose the number and percentage of*

distributors who achieved those earnings or the stated level of sales figures;

- *Require the defendants to obtain a completed written verification form from investors before they collect payment, to assure that no one in the marketing structure made any of the prohibited claims;*

This supports the importance the FTC at one time placed on honest disclosure of information necessary to make an informed decision about participation in an MLM.

Bigsmart pyramid promoters settled FTC charges. In FTC release dated March 27, 2001, the following was stated regarding the settlement, which included \$5 million in redress for victims:

The FTC charged that the claims that consumers who invested in Bigsmart would make substantial income were false; that promotional materials that made the false and misleading claims provided the means and instrumentalities for others to deceive consumers; and that Bigsmart was actually a pyramid scheme. All three were violations of the FTC Act.

Hold on here. *Have not the violations identified in these cases become boilerplate for hundreds of MLMs operating with the same business model? Read on.*

The FTC found that 96% of Skybiz participants lost money. 96%? Try 99.7% after expenses. In May 2001 the FTC charged that Skybiz was a classic pyramid scheme in which promoters misrepresented the income opportunity and products. Evidence showed at least 96% of participants lost money in the scheme. My research on all the MLMs for which I could obtain valid data, suggests this loss rate excludes all participants who dropped out and fails to factor in minimum operating expenses. Based on my research, I would strongly suggest *the loss rate is closer to 99.7%*⁵⁶⁷. Be that it may, it was a misrepresentation to even refer to Skybiz as a profitable business opportunity.

The 2002 settlement provided for \$20 million in redress to consumers and barred the promoters from participating in or encouraging others to start another MLM for

⁵⁶⁷ See Chapter 7.

varying periods, ranging from seven to 22 years. This was likely FTC Chairman Pitofsky's last significant case against pyramid schemes. But while he remained in office, a few significant actions were taken against some MLMs.

Trek Alliance was ordered to disclose material information. Quoting an FTC release⁵⁶⁸:

In December of 2002, the Federal Trade Commission sued the California-based operation Trek Alliance for using deceptive earnings claims to lure recruits into investing hundreds or thousands of dollars in their illegal scheme. The FTC alleged that Trek told recruits that they could earn money by selling products or recruiting, but emphasized that more money could be made through recruiting.

While the company promised monthly incomes ranging from \$2,000 to \$20,000, the FTC complaint alleged that the vast majority of consumers made less money than they had paid for front-end expenses, and that many made little or nothing. The complaint also alleged that compensation was not sufficiently linked to retail sales, and that Trek did not adequately enforce policies and requirements that were ostensibly designed to assure such a link.

The FTC charged that Trek's earnings claims, as well as its claims implying that employment opportunities were available, were false. The FTC also charged that the defendants deceptively failed to disclose that most investors would not make substantial income. Finally, the FTC alleged that the program is a pyramid scheme and most participants lose money. The practices violate federal law, the complaint says..

To one who has studied the behavior and effects stemming from recruitment-driven compensation plans in hundreds of MLM recruitment campaigns, I have to say that *the language in the complaint above accurately describes what happen in MLM recruitment across the industry. With an average loss rate of 99.7%, it is no more appropriate to refer to MLM as an income or business opportunity than it is to refer to craps or Roulette in Las Vegas as a business opportunity. False earnings claims have become the standard*

for the industry, and actual loss rates are horrendous.

In his order, Federal District Court judge Spencer Letts barred the defendants from making misrepresentations about the financial gains, or benefits of multi-level marketing program, business investment opportunity, or pyramid marketing scheme. Among other items, the Order also prohibited the defendants from failing to disclose all information material to a consumer's decision to participate in such programs.

The FTC was on the right track in this case. "Failing to disclose all information material to a consumer's decision to participate in such programs" is a major factor in losses of tens of billions of dollars by tens of millions of MLM victims worldwide every year. This again begs the question: So why did the FTC back away from such disclosure in its Business Opportunity Rule? Methinks something's fishy in Denmark – or at least at the Commission's offices in Washington, D.C.

Misrepresentations by BurnLounge were singled out among hundreds of MLMs that do the same thing. In June of 2007, the FTC filed a complaint for the Federal District Court of California against BurnLounge, Inc. Quoting from the FTC June 2007 release:

The complaint charges that BurnLounge sold opportunities to operate on-line digital music stores that was, in fact, an illegal pyramid scheme.

According to the FTC, BurnLounge recruited consumers through the Internet, telephone calls, and in-person meetings. The sales pitch represented that participants in BurnLounge were likely to make substantial income. BurnLounge recruited participants by selling them so-called "product packages," ranging from \$29.95 to \$429.95 per year. More expensive packages purportedly provided participants with an increased ability to earn rewards through the BurnLounge compensation program.

The BurnLounge compensation program primarily provided payments to participants for recruiting of new participants, not on the retail sale of products or services, which the FTC alleges would result in a substantial percentage of participants losing money.

⁵⁶⁸ FTC.gov – release dated August 4, 2003

The FTC specifically alleges that the defendants operate an illegal pyramid scheme, make deceptive earnings claims, and fail to disclose that most consumers who invest in pyramid schemes don't receive substantial income, but lose money, instead. These practices violate the FTC Act, the agency alleges.

Again, what is striking about this language is that it describes exactly what goes on every day in hundreds of MLMs in this country – and abroad in vulnerable markets where many MLMs are finding easy pickings. So why single out one or two companies instead of the whole industry (including least 600 that I have analyzed and found to be similarly recruitment-driven and top-weighted)?

The release goes on to state proudly:

Over the last 10 years, the Commission has halted 17 pyramid schemes and has collected almost \$90 million in consumer redress and tens of millions of additional dollars in suspended judgments.

That's 17 out of perhaps over 1,700 who are or were doing essentially the same things during that 10-year period. That means *the FTC is acting on at best one out of 100 MLMs that are violating Section 5, based on my research and their own admission. Can you as the reader not see that going after MLMs one by one is totally impractical – and even irresponsible? Not only can they not possibly pursue all the violators without increasing their staff 50 to 100 times, but in the meantime, millions of consumers would be victimized while the actions are pending.*

The release goes on to proclaim:

. . . The FTC works for the consumer to prevent fraudulent, deceptive, and unfair business practices in the marketplace and to provide information to help consumers spot, stop, and avoid them.

Oh really! Is addressing merely 17 cases⁵⁶⁹ of pyramid schemes (I assume most were MLMs, or product-based pyramid

schemes) out of at least 1,700 pyramid schemes that are or were following the same flawed business model accomplishing the mission they had just articulated? Is anyone missing the point here? *A strict disclosure rule such as ordered in the Trek Alliance case would be at least 100 times as cost-effective and whole lot more responsible than relying on Section 5 of the FTC Act. The FTC simply does not have the resources to go after hundreds of MLMs that are currently violating the Act.*

Announcements about the outcomes of the above and other cases are included in Appendix 10E, in which I have highlighted significant wording supporting the conclusions suggested here.

Misrepresentations about income potential for MLM participation has become standard practice. Misrepresenting or exaggerating potential income of participants, especially in a program guaranteed to cause losses for 99% of participants, is unfair and deceptive – and probably illegal. But since such misrepresentations have become standard practice in the MLM industry, a good disclosure rule is essential if the FTC is to accomplish its mission to protect consumers from unfair and deceptive practices.

The above rulings should have been given more weight in the FTC's final Business Opportunity Rule. The above rulings fairly shout out the need for income disclosure by MLMs. The evidence of extreme loss rates⁵⁷⁰ also explains why *disclosure is such a threat to the MLM industry that Neil Offen of the DSA claimed the industry spent over \$4 million⁵⁷¹ fighting the FTC's Business Opportunity Rule (BOR).* This commitment to gaining an exemption from having to comply with the Rule was demonstrated by its first comment filed in response to the proposed Rule – (1) a 356-page salvo of deceptive arguments against applying the Rule to legitimate direct selling companies, (2) an appeal to millions of MLM participants to send In a form letter objecting to including MLMs in

⁵⁶⁹ (or 14 cases) In an article titled "State of Supplements: FTC drops direct sellers as target," by Matt Canham, the FTC's Monica Lewinski is quoted as referring to "past FTC lawsuits against 14 direct selling companies," *Salt Lake Tribune*, March 22, 2011.

⁵⁷⁰ Chapter 7: "MLM's Abysmal Numbers"

⁵⁷¹ Brittany Glenn, "A United Industry Makes Its Case: FTC Revises Proposed Rule," April 2008 Direct Selling News

the Rule, and (3) pressure on U.S. Congressmen to sign on to their objections to the Rule.

But in the revised and final versions of the Rule, the FTC had yielded to pressure from the DSA and completely backed away from assuring transparency through requiring such disclosures to protect consumers. It would instead rely on Section 5, which would ensure massive losses by tens of millions of participants before the FTC could possibly prosecute even a tiny fraction of the hundreds of MLMs which my research and the observations of other consumer advocates suggest are blatantly violating The FTC Act.

Other lessons to be learned from these cases.

Classic no-product pyramid schemes are outmoded. Those who have observed these trends for the past three decades have seen classic, no-product pyramid schemes virtually disappear – only to be replaced by product-based pyramid schemes, or MLMs. Why would anyone start a no-product scheme – which is easily recognized and stopped by authorities – when a product-based scheme (MLM) can be initiated and carried out under the guise of “direct selling” with little or no action by authorities?

Pyramid schemes are easily camouflaged as MLMs. Several years ago, I posted an article on my web site that has amused many readers. It is called “How to Start a Pyramid Scheme that Is Very Profitable for the Founders – and Get Away with It” and is included in Appendix 11C. It satirizes how easily officials, the media, and the public are deceived by MLM promoters.

“Retail” means sales to non-participants. Also, while not specified in the FTC v. Amway decision, it became made clear in these later cases that retail sales, or sales to end users, means sales to non-participants in the scheme.

MLM’s gravity-defying money funnel. The following is another lesson worth remembering: *Any “business” in which total potential commissions per sale exceeds the finite marketable retail markup of the product has only one purpose: funneling money up a*

chain. Most recruits will join because of the “business opportunity” and because they are led to believe the products are not only in high demand but are unique, exclusive, elite, upscale, innovative, super-concentrated, miraculous, healthier, more environmentally friendly, etc. They are also conveniently consumable, so that participants can be incentivized to subscribe to monthly auto-ship.

When the business opportunity fails, they either accept the theft-by-deception because they’ve had it drilled into their heads that only losers quit and settle on believing that they’re buying these products at some tremendous discount because they’re in a “buying club”, or quit and feel so guilty they fail to understand they’ve been conned.

Now imagine an entire legion of MLMrs paying for millions of these overpriced, noncompetitive products just so they can participate in a compensation plan they believe is leveraged to help them earn a reasonable part-time supplemental income – if not a vast fortune – *and you’ve got MLM’s gravity-defying money funnel, which is more aptly compared to a vacuum cleaner sucking the income stream from the bottom up.*

State and private actions

States act while the FTC sleeps. In 2008, California Attorney General Edmund G “Jerry” Brown alleged that YTB (YourTravelBiz.com) operated a “gigantic pyramid scheme that is immensely profitable to a few individuals on top and a complete rip-off for most everyone else” (So what else is new?) and won \$1 million for California consumers in May 2009.

In May 2009, Illinois Attorney General Lisa Madigan filed a similar suit against YTB in her state, and Texas acted against Mannatech. In 2010 Montana took action against ACN. These and other state actions beg the question: ‘where has the FTC been?’ (For references to state laws applicable to MLM, go to Appendix 10G)

Private or class actions. Numerous class actions have been filed against MLM companies, but to undertake such a case is so expensive that few legal firms have the resources. The challenge is daunting because the MLMs can afford powerful legal teams

that will use every trick in the book to delay and frustrate their opposition. The case that the Boston plaintiff firm Gilman and Pastor litigated against Nu Skin on behalf of 50,000 distributors in Canada dragged on for eight years before a settlement was finally reached.

For attorneys willing to initiate a class action against an MLM, it can be difficult to find victims who have the patience and determination to stand up as lead plaintiffs. Even victims who have lost tens of thousands of dollars fear consequences from or to those they recruited, as well as the emotional toll and demands on their time they may have to endure for years. They may be so drained from futile efforts and investments in their MLM that they have little time or energy left,

However, for those who persist, a class action can be a viable option, and MLM abuse may be an ideal target for diligent plaintiff attorneys because – (1) government inaction leaves the field wide open for private class actions, and (2) both misrepresentations about products and income potential is widespread in MLM. For more information on what is involved in a class action, read about Rule 23 in Chapter 10, including information on the biggest class action against an MLM – the recent \$55 million Amway/Quixtar settlement.

Persons who lost only a few thousand dollars could consider taking their grievances to a small claims court, but no one to my knowledge has taken the initiative to do so. If hundreds of MLM victims did that, it might get some attention.

Federal and state agencies have been unable to stem the tide of MLM abuse, except in extremely rare cases that are prosecuted. This is due in part to the silence of victims and to the lack of skill, prosecutorial will, and resources needed to meet the challenge.

CURRENT DEVELOPMENTS

Compliance by MLMs with federal and state laws is questionable at best.

A wide range of laws are likely being violated by MLMs. A careful review of state statutes affecting pyramid schemes, chain referral schemes, multi-level marketing, etc., leads one to conclude that law enforcement and consumer protection officials, attorneys, and consumers are justified in being confused as to what is and what is not legal and in what states specific prohibitions or restrictions apply. See Appendix 10B for a quick overview of the confusion that can result from a state-by-state comparison of applicable statutes.

A careful analysis of the evidence in prior chapters could easily lead an impartial analyst to conclude that virtually all of the hundreds of operating MLMs are breaking at least some federal and/or state laws. Examples of possible violations by MLM founders, promoters, and/or recruiters (including participants) include but are not limited to the following:

- Establishing, promoting and engaging in unfair and deceptive practices.⁵⁷²
- Promoting an MLM as an “income opportunity” or “business opportunity” when almost all participants (except for a tiny few at or near the top) lose money.
- Establishing and promoting illegal pyramid schemes, chain referral schemes, endless chain selling schemes, etc. – depending on the definition⁵⁷³
- Failure to file as investment security when MLM promoters present their programs as “passive income,” “residual income,” etc.
- Presenting an MLM as “like a franchise” while refusing to file with the FTC as a franchise with franchise disclosure documentation, etc.
- Promoting a lottery in the form of a pyramid scheme, chain referral scheme, etc., where success is dependent on chance elements not under the control of the participant, but

⁵⁷² See Chapters 2, 7, and 8.

⁵⁷³ See Chapter 2.

of an unpredictable “downline” that could make them rich – or not.

- Violating employment laws in applying excessive control over distributors they classify as independent contractors.
- Establishing and promoting a scheme in which earnings are contingent on procurement of customers or occurrence of some event after purchase or transaction.
- Establishing and promoting a scheme in which participants are not contributing to sales efforts to qualify for commissions, bonuses, etc., from downline sales.
- Unreasonable purchase quotas
- No repurchase or buyback provision – or misrepresentation of the same
- Conducting what appears to be a buyers’ club but calling it something else.

Careful review of the evidence could lead to the conclusion that virtually all MLMs are breaking at least some federal and/or state laws. This is because MLM is inherently flawed, uneconomic, and deceptive. In fact, it is the epitome of an unfair and deceptive practice.

The FTC still fails to protect against MLM, the most unfair and deceptive of business practices.

MLMs are best regulated on a national level – by the FTC. As explained above, endless chain recruitment schemes quickly spread beyond state boundaries and become national in scope – even international. It therefore becomes a formidable challenge for states to adequately control MLMs or to protect consumers from abuses. MLM is best regulated on a national basis. And since a primary mission of the FTC is to protect against unfair and deceptive practices, MLM – the most unfair and deceptive of all business practices – comes under the ambit of the FTC’s responsibility.

The FTC is ill-equipped to cope with MLM on a case-by-case basis. What was noted in an American Bar Association Commission study of the FTC clear back in 1972, is just as true today:

The recurrent flaws of FTC enforcement – failures of detection, under-commitment of resources to important projects, timidity in instituting formal proceedings and failure to engage in an effective compliance program – tend to outweigh its occasional successes.

On November 7, 2002, Robert FitzPatrick and I gave presentations at a seminar in Washington, D.C. (sponsored by Pyramid Scheme Alert) on Product-based Pyramid Schemes to federal and state regulators. We then went to the FTC offices to meet with FTC attorney James Kohm, Acting Director of Marketing Practices, and his staff. After I got through explaining that my research had enabled me to identify the causative and defining characteristics of product-based pyramid schemes, Mr. Kohm called us aside to talk with us privately. I quote from my journal for that day:

I presented the tight summary of my research on MLM’s to Jim Kohm and his staff at the FTC legal offices in DC. The reception was mixed, since obviously there were some differences within the group on the issues we raised. Afterwards, Jim lectured Bob and I for over 40 minutes as to why they were doing the best they could, were putting in long hours, and did not need to be instructed on how to improve.

I was struck with his tacit admission that they were simply not up to the task of confronting this massive challenge of enforcing the law against powerful MLMs. It should be obvious to all that case-by-case prosecution of hundreds of MLMs is simply not possible, given the resources available to the FTC. A blanket rule would be far more cost-effective. It may be the only way the FTC could cope with MLM abuse, given its limited resources.

The FTC exempted MLM from its Business Opportunity Rule – a huge setback for consumer protection. As I’ve said repeatedly, the Federal Trade Commission is the nation’s agency charged with the responsibility to protect consumers

from unfair and deceptive trade practices. But as has been discussed, after aggressive lobbying by the DSA/MLM lobby, the FTC essentially reneged on its responsibility in the MLM arena in enacting a Business Opportunity Rule that exempts MLMs from having to comply. It justifies this action by instead enforcing Section 5 of the FTC code when violations occur.

The problem with this decision is that virtually all of the hundreds of operating MLMs are violating Code 5, in that they are all engaging in unfair and deceptive practices. Dependent on an endless chains of recruitment, they all assume infinite expansion in finite markets. MLMs are therefore inherently flawed, uneconomic, and deceptive.

Worldwide feedback leads those of us advocating for consumers to conclude that they are also extremely viral and predatory, preying on the most vulnerable among us – especially in times of economic uncertainty. They can cause great harm (financial and personal) to those who invest heavily in them.

This is not a company-specific complaint, but a return to the original arguments put forth by FTC prosecutors prior to the 1979 FTC v. Amway decision. The prosecutors working on the case did not have the experience or research behind them that we have now, and the judge's final decision reflects this, as well as a climate of deregulation that placed protection against unfair and deceptive practices in a low priority position. This remains true to this day where MLM is concerned.

How can MLM prospects make an informed decision when MLM promoters are allowed to blatantly misrepresent their “opportunity” and their products?

The FTC still flounders with its final Business Opportunity Rule. In a news release prior to the final Rule, an FTC Business Center blog was titled “FTC Staff Recommends Changes to Business Opportunity Rule.” It appeared the FTC is tripping all over itself in its continued efforts to exempt MLM from having to disclose

information that could help to protect consumers from MLM abuse. The FTC caved to demands from the DSA/MLM lobby and comments filed by 17,000 MLM participants (out of millions who were urged via the Internet to file comments) to exempt MLM (“direct selling”) from its proposed Business Opportunity Rule.

Over 80 U.S. Congressmen also commented that the Rule should not apply to MLMs. In Utah where I live, Congressmen parroting the DSA line are given a lot of political support from MLMs in the state, and I assume the same is true elsewhere. Even if they don't donate money to their campaigns, the DSA is fond of touting their large constituency – the millions of minions whose votes they claim to influence.

What DSA/MLM lobbyists fail to tell these lawmakers is that almost all of these “direct sellers” are victims of endless chain recruitment schemes – hoping to someday cash in on their investments in the MLMs to which they have subscribed. Read my comments submitted at my appearance at the FTC's RPBOR Workshop and at other stages in the BOR rulemaking in my report titled *“REGULATORY CAPTURE: The FTC's Flawed Business Opportunity Rule.”*⁵⁷⁴

Comments from former high level FTC officials who “flipped” and moved from consumer protection to fraud protection. Other persons of interest who submitted letters supporting the DSA position included former FTC officials who became part of a “revolving door” of consumer protection to MLM fraud protection. These included Joan “Jodie” Bernstein, former Director of Consumer Protection with the FTC, who wrote on behalf of Amway/ Alticor/Quixtar, and none other than Timothy Muris, the former FTC Chairman (after working on the Amway legal team, who wrote on behalf of Primerica Financial Services. *In the Primerica letter Mr. Muris had the nerve to state: “There Is No Evidence of Widespread Fraud in the Direct Selling Industry.” The comment by Mr. Muris was essentially*

⁵⁷⁴ Available for free download from our research-based web site at – mlm-thetruth.com – or by contacting the author.

*parroted in the October 2010 staff report on the Business Opportunity Rule.*⁵⁷⁵

Those of us advocating for consumers – plus millions of MLM victims – would beg to differ. And now with the evidence presented in this book, *the evidence for business opportunity fraud by MLMs is overwhelming.*

Another contributor to that same comment letter for Primerica is J. Howard Beales III, who had served under Muris as the FTC's Director of the Bureau of Consumer Protection. *This revolving door from consumer protection to fraud protection is very disturbing. We expect Congressmen to be manipulated by special interests, but FTC members who are appointed to protect consumers should not have that conflict of interest, even after leaving the FTC.*

My research rejected by FTC staff. During BOR rulemaking, I submitted some 40 comments and rebuttals and traveled to D.C. at my own expense to participate in the BOR workshop panel in June of 2009. According to a memo obtained through the Freedom of Information Act, a staff official wrote that “the FTC does not accept the research of Dr. Taylor.” – this in spite of the fact that I frequently cited the leading independent experts, and used information published from over 500 MLM companies (to that point in time) – sales pitches, compensation plans, average incomes (where available), etc. And my methodology and calculations were confirmed by five financial experts⁵⁷⁶. Apparently, the FTC staff doesn't understand statistics – or doesn't want to read them. The official's attitude can be summed up in the statement: “Don't confuse me with the facts – my mind is made up.”

Why the FTC's reliance on enforcement of Section 5 with MLMs is shortsighted and totally impractical. Challenged by myself and several other consumer advocates, the FTC's response was to fall back on enforcement in individual cases of MLM violations of Section 5 of the

FTC Act. *But this is totally avoiding the issue of consumer protection. The FTC admits to prosecuting only about 17 MLM cases in ten years. Yet my research demonstrates that all of the over 600 MLMs I have analyzed (and also that Robert FitzPatrick of Pyramid Scheme Alert analyzed⁵⁷⁷) are blatantly violating the Act⁵⁷⁸, and that is only a sampling of hundreds of MLMs that are constantly coming and going – no doubt virtually all of them likewise violating the Federal Trade Commission Act. In most cases, I do not believe this is because founders deliberately seek to scam people, but because of the inherent flaws in MLM as a business model.*

Let me put it another way. Reliance on enforcement on a case-by-case basis assumes there are a few bad actors in the MLM arena. The FTC blindly ignores (or fails to recognize) the reality that *it is a fraudulent system that is to blame for the defrauding of 99% of MLM recruits, upon which all MLMs are built.*

At the rate at which the FTC has been acting against fraudulent MLMs, it would have to increase its staff by at least 50 times just to keep up with needed prosecutions of current and newly hatched MLMs. Failure to do so would mean tens of millions of additional victims would be without any substantive consumer protection – and could easily fall victim to the deceptive recruitment of hundreds of MLMs. The impact worldwide could over time total hundreds of millions of additional victims, based on DSA “direct sales” figures.

Obviously, a good rule requiring adequate disclosure of crucial information to prospects would be far more cost effective than falling back on punitive enforcement action after the damage has been done. Another reason that enforcement of Section 5 would be far less effective in providing consumer protection than a disclosure rule is that case-by-case law enforcement is dependent on complaints and evidence gathering. As explained in Chapter 9, this simply does not work with endless chain

⁵⁷⁵ Disclosure Requirements and Prohibitions Concerning Business Opportunities Staff Report to the Federal Trade Commission and Proposed Revised Trade Regulation Rule (16 CFR Part 437)

⁵⁷⁶ See Appendix 7A.

⁵⁷⁷ See “The Myth of ‘Income Opportunity’ in Multi-level Marketing,” Robert FitzPatrick,. Go to – pyramidschemealert.org.

⁵⁷⁸ See prior chapters for compelling evidence that MLMs are “Unfair and deceptive practices.”

recruitment schemes. Victims of these schemes rarely file complaints because every major victim is of necessity a perpetrator – having recruited friends and family in hopes of recovering (and profiting from) ongoing investments, including “pay to play” purchases from the company. So they fear self-incrimination and consequences from or to those they recruited or those who recruited them. They also have been taught to blame themselves for their “failure.”

The FTC’s avoidance of issues related to MLM fraud – to the detriment of consumers – is becoming more evident.

With MLMs, the FTC has been choosing – not on the side of consumers – but on the side of the DSA/MLM lobby, with whom some FTC officials seem altogether too cozy. Again, this collusion between the DSA/MLM lobby and the Commission is demonstrated by the revolving door of former high level FTC officials hired by MLM companies to write comments to the FTC on behalf of the MLM industry. This includes former Chairman Timothy Muris and J. Howard Beales III, former Director of the Division of Consumer Protection, who commented on behalf of Primerica; and Jodie Bernstein, another former Director of Consumer Protection, who commented for Quixtar (Amway).

This symbiotic relationship between the FTC and the DSA is also demonstrated by blatant ex parte communications between FTC rule-making officials and with DSA officials during the rule-making process, as explained in the my report titled: *“REGULATORY CAPTURE: The FTC’s Flawed Business Opportunity Rule.”*

An interesting phenomenon appears to be happening here as happened at the Securities & Exchange Commission. Harry Markopolos, the whistleblower who exposed the incompetence and impotence of the SEC in the Bernie Madoff scandal, reported Madoff as saying:

“These guys, they work for five years at the Commission, then they become a compliance manager at a hedge fund.” And he said he knew that was true because every time an SEC investigator came up to his office he or she would ask for an employment application.⁵⁷⁹

Watch for this pattern to be repeated in the future at the FTC. Pay particular attention to the officials responsible for the Business Opportunity Rule. When they leave the FTC, will they flip and lobby on behalf of the DSA/MLM cartel – and against the interests of consumers they were once pledged to protect? History suggests some may do as other high level FTC officials have done.

Pre-launch kickoff of new MLMs. It has become customary for new MLM startups to announce a pre-launch kickoff, stressing the importance of getting in early to get one’s place established before others. The implications are that those who get in early have a huge advantage over those who come in later. Of course, they are right. In any endless chain recruitment program, whether it be a chain letter, naked pyramid scheme, or MLM (a.k.a. product-based pyramid scheme), the pay plans favor early entrants.

For those who understand the fundamental flaws in such a system, such an announcement is tantamount to a blatant admission that they are conducting a pyramid scheme. MLMs, with unlimited recruitment, are at odds with laws of supply and demand. In order to prevent market saturation and collapse (since there is little actual customer base), they must expand or “re-pyramid”⁵⁸⁰ into new market areas and/or introduce new products and services.

We can find instances of the first entrants in a new MLM becoming rich, but only at the expense of thousands of downline recruits who lose their entire investment in products and operating expenses (which can be substantial over time – to say nothing of a great amount of time and effort). *As a general rule in MLM, the more one invests, the more one loses – except for the TOPPs (top-of-the-pyramid promoters) who get positioned at or near the top of a huge pyramid of participants – who are often those who got in at the start.*

⁵⁷⁹ Markopolos, Harry, *op. cit.*, p. 159

⁵⁸⁰ “Re-pyramiding” is explained in Chapter 2.

CFPB prosecutes “abusive” practices on case-by-case basis

The jurisdiction of the new Consumer Financial Protection Bureau includes primarily financial institutions but could conceivably apply to abuses of MLMs that are promoted as financial products. While CFPB has the authority to take action against widespread abuses of MLM participants, I seriously doubt that the agency will take an activist stance against MLM or any other industry as a whole. So far, it has handled abuse on a case-by-case basis and has not demonstrated the muscle to bring about real industry-wide reform in the financial markets, let alone the field of business opportunities.

Worldwide expansion of viral and predatory MLMs

Because of the viral and predatory nature of MLM and the need to feed off of less saturated markets, MLMs are expanding – or “re-pyramiding”⁵⁸¹ – rapidly overseas. World-wide feedback convinces us consumer advocates that great harm is being done to vulnerable populations that can least afford to be impoverished by these fraudulent schemes.

Sadly, some of our respected U. S. trade representatives are encouraging expansion of MLM overseas. This could come back to haunt us, as more and more people become educated or victimized by MLMs and point the finger of blame at the U.S. for allowing such fraudulent exports to expand unchecked in such a viral fashion worldwide. Many foreigners believe that U.S. businesses operate on principles of honesty and fairness, and this can only tarnish that image.

World-wide feedback convinces us consumer advocates that great harm is being done to vulnerable populations that can least afford to be impoverished by these fraudulent schemes.

⁵⁸¹ Ibid

Recent developments suggest potential enforcement actions:

Controversies concerning MLM, focused primarily on Herbalife, have intensified over the past several years, as illustrated by the following series of events⁵⁸²:

- On May 1, 2012, Herbalife, one of the largest publicly traded MLM firms, held an investor conference call during which David Einhorn of the hedge fund Greenlight Capital, asked several questions concerning the percentage of Herbalife's sales "outside the distributor network," i.e., to consumers.⁵⁸³ While Einhorn made no accusations of impropriety and did not reveal any investment thesis, short or long, Herbalife shares plunged 20%, apparently in the belief that Mr. Einhorn was shorting Herbalife shares and would publish a detailed analysis supporting his views. Greenlight never did publish any report concerning Herbalife. To date Herbalife has failed to provide any actual data in response to Mr. Einhorn's questions.
- In August of 2012, an independent financial analyst firm, Citron Research, released a report accusing Nu Skin Enterprises (NUA), another large, publicly traded MLM firm, of operating an illegal pyramid scheme in China.⁵⁸⁴
- In November of 2012, the U.S. District Court in San Francisco approved a \$55 million class action settlement on behalf of distributors of Quixtar, also known as

⁵⁸² “The Pyramid Scheme Industry: Examining Some Legal and Economic Aspects of Multi-Level Marketing,” a “white paper” by Douglas A. Brooks, Boston attorney who has litigated significant cases against MLMs, Bruce Craig, former assistant AG for Wisconsin, and Robert FitzPatrick, consumer advocate. Cited in *Seeking Alpha*, March 17, 2014. The full article, with business and legal insights, can be downloaded at - <http://seekingalpha.com/article/2093383-the-pyramid-scheme-industry-examining-some-legal-and-economic-aspects-of-multi-level-marketing>

⁵⁸³ See <http://www.businessinsider.com/david-einhorn-herbalife-2012-5> (accessed 2/7/14).

⁵⁸⁴ See http://www.citronresearch.com/page/2/?search-class=DB_CustomSearch_Widget-db_customsearch_widget&widget_number=preset-default&cs-stock_ticker=0=NUS&cs-all-1&search=Search (accessed 2/4/14).

Amway, the largest and one of the oldest MLM firms.⁵⁸⁵ The plaintiffs had alleged that Quixtar/Amway was an illegal endless chain scheme and that high level Quixtar/Amway distributors made deceptive earnings claims and sold overpriced products and business support materials to lower level distributors.

- In December of 2012, William Ackman and his hedge fund, Pershing Square Capital, made a detailed presentation supporting their thesis that Herbalife, one of the largest MLM firms and a publicly traded company, is a pyramid scheme.⁵⁸⁶ Mr. Ackman stated that Pershing Square had sold short approximately \$1 Billion worth of Herbalife stock, betting that its price would drop to zero when appropriate action was taken against Herbalife.. Other investors came out in support of Herbalife, including Carl Icahn, George Soros, Daniel Loeb and Bill Stiritz.⁵⁸⁷
- In January of 2013, the Federal Trade Commission (FTC), working with regulators in the states of Kentucky, North Carolina and Illinois, shut down an MLM firm called Fortune Hi-Tech Marketing, alleging that it was a pyramid scheme and that promoters made deceptive earnings claims.⁵⁸⁸
- In April of 2013 Herbalife distributor Dana Bostick filed a class action in the U.S. District Court for the Central District of California (Los Angeles), alleging that Herbalife was violating the California Endless Chain Scheme Law and other claims. The court denied Herbalife's motion to dismiss in October.⁵⁸⁹
- In May of 2013, the CEO of Amway India was arrested for fraud in the Indian

state of Kerala.⁵⁹⁰ This was only the latest in a series of legal proceedings involving Amway's subsidiary in India.

- In June of 2013, Representative Linda Sanchez (D. Calif.) sent a letter to the FTC requesting that it investigate allegations that Herbalife is a pyramid scheme that is harming consumers, including low-income Hispanics and African Americans.⁵⁹¹
- In July of 2013, a group of Hispanic and consumer organizations met with the FTC to request an investigation of Herbalife, arguing that Herbalife was targeting deceptive earnings claims at poor, Hispanic would-be entrepreneurs.⁵⁹²
- On October 24, 2013, an international ad hoc coalition of consumer advocates filed a formal petition with the Federal Trade Commission, urging that the FTC investigate the entire MLM industry and promulgate regulations to protect consumers from unfair and deceptive MLM "business opportunities."⁵⁹³
- On January 16, 2014, Chinese regulators announced that they were investigating allegations in the *Chinese People's Daily* that Nu Skin was operating an illegal pyramid scheme in China.⁵⁹⁴ Shares in Nu Skin dropped 40% over several days; shares in Herbalife and USANA (USNA), another publicly traded MLM with operations in China, also dropped sharply, despite the absence of any evidence that Chinese regulators were investigating them. A

⁵⁸⁵ See <https://quixtardclass.com/Home.aspx> (accessed 2/14/14).

⁵⁸⁶ *Facts about Herbalife*. Web site of Pershing Square Capital Mgt. at - , <http://www.factsaboutherbalife.com/>

⁵⁸⁷ "In the Last Year, Bill Ackman Has Lost Hundreds of Millions as Herbalife Shares Skyrocketed," Julia La Roche, *Business Insider*, Dec. 17, 2013

⁵⁸⁸ "FTC Action Leads Court to Halt Alleged Pyramid Scheme." FTC web site - www.ftc.gov/news-events/, Jan. 28, 2013,

⁵⁸⁹ U.S. District Court, Central District of California, Civil Minutes, Oct. 11, 2013, Case No. CV 13-02488-BRO

⁵⁹⁰ See <http://www.theverge.com/2013/6/28/4472608/the-indian-express-pyramid-scheme-investigations-amway-herbalife> (accessed 2/7/14).

⁵⁹¹ See nypost.com/2013/06/13/congresswoman-asks.../ (accessed 2/14/14).

⁵⁹² See <http://articles.latimes.com/2013/jul/19/business/la-fi-herbalife-latino-20130719> (accessed 2/7/14).

⁵⁹³ See Exhibit 11A and the following web sites:

<http://pyramidschemealert.org/wordpress/wp-content/uploads/2014/02/Petition-of-Ad-Hoc-Coalition-Concerning-MLM-Final.pdf> and -
<http://pyramidschemealert.org/wordpress/wp-content/uploads/2014/02/Members-of-Ad-Hoc-Coalition-Concerning-MLM.pdf>

⁵⁹⁴ "Nu Skin Faces New Pressure in China Report in People's Daily Prompts Second Probe of Direct Marketer," by Lilian Lin and Carlos Tejada , *Wall Street Journal*, Jan. 17, 2014 See also - (accessed 2/7/14). <http://online.wsj.com/news/articles/SB10001424052702303465004579323840382392148>

class action on behalf of investors who were affected by these developments was pending.

- On January 22, 2014, Senator Edward J. Markey (D. Mass.) requested the FTC and the Securities and Exchange Commission to investigate the business practices of Herbalife.⁵⁹⁵
- On January 28, 2014, the New York Post reported that the Canadian Competition Bureau was investigating allegations that Herbalife was operating a pyramid scheme in Canada.⁵⁹⁶
- On Jan. 29, 2014, Representative Linda Sanchez (D. Calif.) held a briefing for other lawmakers regarding pyramid schemes.⁵⁹⁷
- On February 5, 2014, Hispanic consumer groups met with Edith Ramirez, chair of the FTC, concerning Herbalife.
- On February 18, 2014, the government of India announced that an Inter-Ministerial Group was investigating the functioning of MLM and evaluating the regulatory framework for MLM companies.⁵⁹⁸
- On March 12, 2014, Herbalife announced that it had received a Civil Investigative Demand (CID) from the FTC.⁵⁹⁹

On April 24, 2014, Samir Vojdani, a contrarian investor challenged those shorting Herbalife's stock with extensive data analysis. Though favoring the stock, he mentioned three more significant recent events⁶⁰⁰:

- On April 11, the *Financial Times* alleges that the FBI and DOJ are conducting a criminal probe into HLF. HLF has not received any formal or informal requests by either agency.
- On April 14, the *New York Post* reported that the New York Attorney General is conducting investigations.

⁵⁹⁵ See <http://nypost.com/2014/01/23/senator-delves-deeper-into-herbalifes-business-practices/> (accessed 2/7/14).

⁵⁹⁶ See <http://nypost.com/2014/01/28/canadian-regulator-probing-herbalife/> (accessed 2/7/14).

⁵⁹⁷ See <http://nypost.com/2014/01/30/pyramid-scheme-tal.../> (accessed 2/14/14).

⁵⁹⁸ See http://www.business-standard.com/article/pti-stories/high-level-img-looking-into-functioning-of-mlm-nbfc-cis-114021800886_1.html (accessed 2/24/14).

⁵⁹⁹ See <http://online.wsj.com/news/articles/SB10001424052702303730804579435303342418222?mod=djemalertMARKET>

⁶⁰⁰ "Herbalife: Analyzing through the Speculation." by Samir Vojdani, *Seeking Alpha*, April 24, 2014.

- On April 17, it was confirmed that the Illinois Attorney General has joined investigations into HLF.

Finally, on July 15, 2016, the FTC announced a settlement with Herbalife, requiring a fine of \$200 million in consumer redress and procedures to assure that 80% of its products are being sold to legitimate end users (which could include distributors). Herbalife is also barred from misleading distributors about their earnings potential. (For the details of the settlement, see Chapter 10, Appendix 10E: "Herbalife Will Restructure Its Multi-level Marketing Operations and Pay \$200 Million For Consumer Redress to Settle FTC Charges.")

A flurry of articles have appeared on the www.SeekingAlpha.com web site, primarily by authors on both sides of the issue of the outlook for Herbalife for those betting short or long on the (HLF) stock. A lively debate has ensued in the comments following the articles. For the serious researcher, many Seeking Alpha articles and comments are worth reading for their unique insights.

On his web site⁶⁰¹, Ackman continues to provide excellent videos, reports, and presentations, demonstrating the MLM fraud perpetrated against poor minorities.

Vemma temporarily shut down. On August 15, 2015, the FTC announced: "Vemma Nutrition Company had been temporarily shut down for operating a pyramid scheme that promised college students riches if they sold its nutritional drinks, but most ended up losing money." For details, see last case announcement in Appendix 10E.

For an excellent article by Bruce Craig, former assistant to the Attorney General for Wlstonin, on the challenges this and related developments pose for legal, financial, and market analysts, as well as for regulators, see Appendix 11B.

The DSA scored again with the FTC's "Cooling Off Period" rule changed to favor MLMs

⁶⁰¹ www.factsabouttherbalife.com

According to an FTC press release dated January 6, 2015:

The Federal Trade Commission has approved a [final amendment to its Cooling-Off Rule](#) that increases the exclusionary limit for certain “door-to-door” sales. The Cooling-Off Rule previously provided that it is unfair and deceptive for sellers engaged in “door-to-door” sales valued at more than \$25 to fail to provide consumers with disclosures regarding their right to cancel the sales contract within three business days of the transaction.

Under the final rule, the revised definition of “door-to-door sales” distinguishes between sales at a buyer’s residence and those at other locations. The revised definition retains coverage for sales made at a buyer’s residence that have a purchase price of \$25 or more, and *it increases the purchase price to \$130 or more for all other covered sales at temporary locations.*

In retaining the \$25 limit for in-home sales, the Commission stated that the rulemaking record reflected significant concern about high-pressure sales tactics and deception that can occur during in-home solicitations. Because the sellers’ practices did not appear to be as problematic when sales were made away from consumers’ homes, the Commission concluded that raising the value to \$130 for those sales would reduce compliance burdens for sellers while still protecting consumers who make purchases from sellers located in temporary locations.

The final rule amendment follows [the Commission’s December 2012 notice proposing to increase the \\$25 limit](#) to \$130 to account for inflation.⁶⁰²

While comments regarding the proposed rule from consumer groups favored this protection against unscrupulous door-to-door salesmen, nearly all of them vigorously objected to raising the limit for sales at temporary locations away from home.⁶⁰³

Knowing that most MLM recruitment occurs at temporary meeting rooms, the DSA praised the ruling, especially the \$130 limit. This allows for signup fees up to \$129 at hotels and other facilities, which are soon followed up with huge incentives to buy

products and services to qualify for commissions and for “fast start” rank advancement. As one commenter noted:

. . . Inflation formulas are irrelevant and rendered meaningless in the face of these often sophisticated solicitations. The initial payment is, in all cases, only a first step toward further solicitations, financial requirements, and other costs that a consumer is likely to incur upon initially paying. Further payments that the consumer may be subjected to after signing the initial sales contract may include monthly inventory purchase requirements, fee-paid seminars, marketing tools, travel costs, or purchases of sales leads.⁶⁰⁴

Douglas M. Brooks, who has acted as plaintiff attorney for several MLM cases and done much pro bono work for consumer advocates, summarized the views and experience of other consumer advocates with these comments:

At first glance, the Commission's proposal to increase the exclusionary limit from \$25 to \$130 to account for the effects of inflation since 1972 appears to be reasonable. However, the increase would have the unintended consequence of exempting most multi-level marketing (MLM) plans from coverage under the Cooling Off Rule. Most MLM plans call for prospective "distributors" to purchase a "start-up kit," including product samples, in conjunction with enrolling in the plan. MLM recruitment generally does not occur at fixed retail locations; therefore the solicitation and sale of MLM start-up kits is within the scope of the Rule. The Direct Selling Association (DSA), most of whose members employ MLM compensation plans, states that "the median cost for the start-up kit is \$99."⁶⁰⁵ Accordingly, most MLM start-up kits (i.e., all such kits costing over \$25) are subject to the Cooling Off Rule. Increasing the exclusionary amount will have the effect of exempting most MLM start-up kits. The DSA's comment in support of changing the Rule fails to mention these facts or the impact the increase will have on its members. In fact, the proposed increase would benefit most of the DSA's members

⁶⁰² Go to - <http://www.ftc.gov/news-events/press-releases/2015/01/ftc-approves-changes-cooling-rule>)

⁶⁰³ To read these comments, go to –

⁶⁰⁴ Submission no. 563691-00038 by Robert FitzPatrick, founder of Pyramid Scheme Alert, March 2, 2013

⁶⁰⁵ See www.dsa.org/ethics/legitimatecompanies.pdf.

by exempting start-up kit purchases costing less than \$130, and it will harm consumers who will lose the protections of the Rule when they are recruited to join MLM sales organizations. Moreover, if the increase becomes effective, those few MLM companies which currently charge more than \$130 for a start-up kit will lower their prices to take advantage of the exclusionary amount, while those which currently charge less will be free to raise their start-up kit price to \$129.

The consumer's purchase of an MLM start-up kit is a critical event in the MLM recruitment process. As explained in the comment submitted by economist Stacey Bosley,⁶⁰⁶ the cooling off period is vital for consumers, given the importance of "urgency" in MLM recruitment. Once committed to the MLM company via the start-up kit purchase, the consumer will be more likely to continue making qualifying purchases in order to advance in the scheme, and will suffer losses well in excess of the exclusionary amount. It is well established that the vast majority of participants in MLM schemes lose their investments. See Fitzpatrick, Robert *The Myth of the MLM Income Opportunity*, <http://pyramidschemealert.org/PSAMain/resources/MythReport.html> and Taylor, Jon, *The Case (For and) Against Multi-level Marketing* (now *Multi-level Marketing Unmasked*), <http://mlm-thetruth.com/research/case4and-against-mlm/>. Since the Commission has seen fit to exempt MLM plans from its Business Opportunity Rule, the Cooling Off Rule is one of the few protections consumers have against being pressured into joining deceptive MLM business opportunities.

In addition, the inflation justification is itself suspect. As explained by economist William Keep in his comment, the poorest U.S. households have barely kept up with inflation since 1972. These are the households which are most susceptible to the typical MLM pitch, which promises financial independence and job security while making deceptive earnings claims.

I urge the Commission to keep the exclusionary amount at \$25.⁶⁰⁷

We might echo the response of one consumer expert that with this rule change the FTC is "defending the sanctity of the home against invading scam artists wearing gold and bad suits, long after the "direct selling" tricksters stopped operating in living rooms and moved into hotel ballrooms, nutrition clubs, and infomercials."⁶⁰⁸

The FTC press release closed with its usual claim:

The Federal Trade Commission works for consumers to *prevent fraudulent, deceptive, and unfair business practices and to provide information to help spot, stop, and avoid them.*⁶⁰⁹

Oh really? Unwittingly (or intentionally), by this *change the FTC has facilitated – not prevented – fraudulent, deceptive, and unfair business (MLM) practices*. And having in 2012 granted MLMs an exemption to the Business Opportunity Rule, *the FTC allows masking, rather than disclosing information to spot, stop, and avoid such practices.*

The DSA/MLM lobby has good reason to celebrate its influence over the FTC. Conversely, consumer advocates have reason for sorrow that "the nation's consumer watchdog" caved to the DSA once again, leaving consumers with little or no protection against the most unfair and deceptive (and often the most viral and predatory) of business practices – multi-level marketing.

The DSA attempts to influence Congress by initiating a "direct selling caucus."

In October of 2015, according to Robert FitzPatrick, writing on behalf of the International Coalition of Consumer Advocates in "Congress Blog"⁶¹⁰:

Thirty-one members of the House have recently joined a caucus to "support

⁶⁰⁶ Submission no. 563691-00032, by Stacie Bosley, dated March 1, 2013

⁶⁰⁷ Submission no. 563691-00033 by attorney Douglas M. Brooks, March 3, 2013

⁶⁰⁸ Letter dated January 7, 2015, from Robert FitzPatrick, president of Pyramid Scheme Alert, to members of the International Coalition of Consumer Advocates, an ad hoc group of consumer advocates.

⁶⁰⁹ Op. cit.

⁶¹⁰ "Direct Selling Deception," by Robert L. FitzPatrick, *The Hill's Congress Blog*, October 28, 2015

opportunities for independent work,” according to the Direct Selling Association (DSA).

But did the DSA, which lobbies for “multi-level marketing” and organized the so-called “direct selling” caucus, provide these representatives adequate and correct information? There is a world of difference between “direct selling” and “multi-level marketing” (MLM), which caucus members may not know about or were not told.

As the ad hoc chairman of the consumer watchdog group, International Coalition of Consumer Advocates, I signed a letter to each of the caucus members cautioning them against lending their names to “multi-level marketing” and its “work-from-home” proposition. The letter specifically refers to the legal, securities, and regulatory controversies that MLM is embroiled in and includes a pending petition sent to the FTC.

Following the FTC’s latest anti-pyramid action against a DSA member, the “direct selling” caucus was established by the DSA, possibly for influencing law enforcement.

Full information would reveal that 99 percent of those who invest in MLM’s famously “unlimited” income proposition actually lose money. The few that gain a profit don’t get it from “direct selling.”

Correct information would reveal that the MLM company, “Vemma”, the latest target of FTC -pyramid scheme prosecutions, was honored by the DSA for “highest standards in business practices and ethics.” More than 200,000 households were being scammed, according to the FTC.

Full disclosure would show that another MLM, Herbalife, also a DSA member, is under investigation by the FTC, SEC and the Dept. of Justice for pyramid allegations. Herbalife is also at the center of Wall Street accusations by short sellers of pyramid fraud and exploitation of vulnerable consumers. While Vemma specialized in recruiting students, Herbalife aims at struggling Latinos.

MLMs promise “unlimited” income, not by selling products person-to-person, but from recruiting additional “distributors”, who purchase inventory and then recruit yet more to do the same. Funds expended by later recruits are transferred to earlier ones. Most of the rewards flow to the top 1%. We wrote the caucus members that MLM belongs under the same regulatory spotlight focused on subprime mortgages, toxic securities, payday loans, and for-profit colleges.

In the face of regulatory, investor and consumer scrutiny, MLMs amassed large lobbying and legal defense funds. But now, public awareness has dramatically increased, extraordinary consumer losses have been verified, class action suits have pulled back the curtain and recent federal court decisions bolster law enforcement.

The International Coalition of Consumer Advocates (ICCA) is asking these thirty-one caucus members to rethink their decision to support a type of business that deceives millions of Americans a year. At a minimum, they should be aware of several key deceptions that MLM promoters spread:

Deception 1: Multi-Level Marketing is “direct selling.”

In fact, few MLM participants earn profit from selling to personal customers. Rather, the MLM “income opportunity” is based upon recruiting a “downline” of later participants to an “endless chain” and receiving financial rewards based on what those recruits and their subsequent recruits’ purchase.

Deception 2: MLMs provide a broad-based income opportunity for families.

In fact, less than one-percent of all participants in MLMs gains any net profit each year and this is only achieved by a transfer of funds from those that lost. Most quit the schemes within a year.

Deception 3: Multi-level marketing “sales” are based on consumers seeking the products and most join the sales channel only to purchase the goods for their own use with no income expectation.

In fact, MLM purchases are incentivized by the “income” plan. The marketing message is about an “extraordinary income opportunity” based on paying fees, buying goods and recruiting others to do the same.

Deception 4: Short sellers such as William Ackman of Pershing Square present false information to manipulate stock values. Short selling of MLM companies’ shares is harmful to the public interest.

The information now debated on Wall Street had been presented for years in lawsuits as well as securities filings and media reports. It parallels thousands of complaints received annually by the FTC against MLMs. The Wall Street controversy is forcing more transparency in the public interest.

Total consumer losses from MLM solicitations amount to tens of billions each year, far exceeding the harm suffered by victims of the

Madoff and similar Ponzi-type schemes. It's time for the FTC and other federal agencies to investigate MLM and take action. We asked the caucus members to support greater law enforcement and regulation.

FTC Chairwoman Edith Ramirez proposes reforms to the DSA to operate lawfully and to prevent consumer harm.

On October 25, 2016, FTC Chairwoman, Edith Ramirez spoke to a DSA Business and Policy Conference in Washington, D.C. She boldly outlined what needs to be done by MLMs to operate lawfully, and prevent consumer harm. She stressed that the industry must take steps to assure that MLMs focus on actual sales to real customers. She proposed four core principles:

- First, a legitimate MLM must be focused on real customers;
- Second, a legitimate MLM opportunity must be based on sales that are both profitable and verifiable;
- Third, a legitimate MLM should not use targets or thresholds that are met by mere product purchases; and
- Fourth, the compensation paid by a legitimate MLM must be tied to retail sales.

Those of us advocating for consumers were greatly encouraged by the courageous and insightful remarks of Ms. Ramirez. Unfortunately, she resigned from the FTC in January of 2017. It remains to be seen if her replacement will be as focused on consumer protection as she was.

My positive reaction to her remarks is likely shared by anyone who has read the information in this book. If reforms she suggests were vigorously acted upon, MLM as an industry would fold or be replaced by a more legitimate direct selling model.

NOTE: The text of the address by Edith Ramirez can be found in Appendix 11C. It is well worth reading.

CONCLUSIONS

MLM is arguably the most unfair and deceptive of business practices today. Both state and federal laws are routinely broken by MLM companies. Federal and state agencies have been unable to stem the tide of MLM abuse, except in extremely rare cases that are prosecuted. This is due in part to the silence of victims and in part due to the lack of resources and prosecutorial will to confront their powerful legal teams.

The DSA/MLM lobby works tirelessly to orchestrate the dialogue of deception on which MLM depends. It has been successful in weakening the laws in several states to favor MLMs, to the detriment of consumers.

While recent reports of investigations and potential actions against specific MLMs for their abuses is encouraging to consumer advocates, experienced observers see little chance of significant action that would address the fundamental structural flaws in all MLMs. These include incentivizing endless chains of recruitment of participants as primary customers.

The bare minimum of consumer protection would be a rule requiring that MLMs disclose information essential to prospects' making informed decisions about participation. Consumers should be warned against the inherent flaws in all endless chain recruitment programs, including MLM.

Additional information. Two web sites are recommended to keep current on developments – one by Dr. Jon Taylor (Consumer Awareness Institute, or CAI), and another by Robert FitzPatrick of Pyramid Scheme Alert (PSA). CAI focuses on education and consumer awareness, while offering assistance to law enforcement and consumer protection agencies and attorneys. Numerous consumer aids and research reports can be accessed from the web site – mlm-thetruth.com. PSA also works with media and law enforcement and reports on new developments important to those working in the field. The PSA web site is – pyramidschemealert.org

Appendix 11A

Global Coalition Petitions FTC to Protect Consumers against Unfair and Deceptive Practices in the MLM (multi-level marketing) Industry

“In our view, any MLM program which permits unlimited recruiting and rewards distributors with commissions paid on the purchases of other distributors should be deemed to be a pyramid scheme without the need for further analysis.”

[NOTE: For a list of ICCA members, including background and web sites, go to <http://mlmpetition.com/icca-members/>]

Summary of Petition

The signers of this Petition ask the Federal Trade Commission and other federal and state governmental agencies to investigate the Multi-Level Marketing (MLM) industry and take action to protect people. The MLM industry has proven incapable of regulating itself, is rife with fraudulent and deceptive earnings claims and has caused – and will continue to cause – untold financial harm and social disruption to people who are seeking a legitimate business opportunity. It is not enough to prosecute a few MLM companies after they have had years to deceive hundreds of thousands of participants out of hundreds of millions of dollars, most of which will never be recovered. There should be laws and regulations that require full disclosure of material facts by MLM companies and their high level distributors, and which prohibit MLM compensation plans that reward unlimited recruiting of new distributors over personally retailing products to non-participants.

The Petition

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

IN RE: PETITION TO TAKE ENFORCEMENT ACTION AND PROMULGATE TRADE REGULATION RULE CONCERNING UNFAIR AND DECEPTIVE ACTS AND PRACTICES IN THE MULTI-LEVEL MARKETING INDUSTRY

The undersigned are an ad hoc coalition of consumer advocates, entrepreneurs, economists, professionals and former participants in multi-level marketing (“MLM”) programs. None of us are receiving any compensation from any source for submitting this petition. We come from different backgrounds, experiences and political persuasions, but we share a concern that the MLM industry has become a substantial cause of injury to consumers. The MLM industry has proven incapable of regulating itself, is rife with fraudulent and deceptive earnings claims and has caused – and will

continue to cause – untold financial harm and misery to the poorest and most vulnerable of the consumers whom the Commission was formed to protect.

For the reasons set forth in more detail below, we respectfully request that the Commission do the following:

1. Investigate the MLM industry for the purpose of determining whether owners, developers and promoters of MLM programs are using unfair or deceptive acts or practices, including but not limited to operating as pyramid schemes, making fraudulent or deceptive earnings claims and product claims, and selling expensive and ineffective “lead generation systems” and other sales aids to MLM distributors.
2. Promulgate a trade regulation rule concerning the MLM industry which (a) requires pre-sale disclosure of important information to prospective MLM distributors including but not limited to data concerning earnings claims, business expenses, attrition rates, litigation history; (b) requires a “cooling off” period before participants in MLM programs make any material payments; (c) prohibits MLM compensation plans which promote recruitment of new distributors instead of retailing products or services and thereby tend to become pyramid schemes; and (d) prohibits unfair and deceptive practices in the marketing and sale of products and services related to MLM programs, including the sale of lead generation systems and other adjunct products and services to MLM distributors.

1. The MLM Industry Involves Millions of Participants Spending Billions of Dollars

Reliable data concerning the MLM industry is hard to come by, but it is undeniably a large industry affecting tens of millions of consumers who are induced to purchase billions of dollars’ worth of products and services, ostensibly to resell as MLM distributors. The Direct Selling Association (“DSA”), which is the primary MLM industry trade association and lobbying group, estimates that in 2012, total sales of the industry were \$31.63 billion, and the total number of MLM distributors was 15.9 million.^[1] The DSA currently has 171 member companies.^[2] In 2001 an industry expert estimated that there were over 1,000 MLM firms in the United States.^[3] About a dozen MLM firms are publicly traded in the United States, with a combined market capitalization of over \$30 billion.^[4]

2. Unfair and Deceptive Practices are Prevalent in the MLM Industry

In its seminal 1975 decision in *In re Koscot Interplanetary, Inc.* the Commission analyzed one of the largest MLM companies then in existence, found it to be a pyramid scheme, and noted that “[t]he record also reveals a staggering human toll – money borrowed, jobs quit, homes mortgaged, and personal bankruptcy for some who dared to be great.”^[5] Modern MLM plans may be more sophisticated than Koscot, but the human toll remains just as devastating.

The Commission has recognized that “fraud in the sale of business opportunities is not only prevalent but persistent.”^[6] In the rule-making proceedings during the 1970s which led to the Franchise Rule, the Commission “found that franchise and business opportunity fraud was widespread, causing serious economic harm to consumers.”^[7] In the April 12, 2006 Notice of Proposed Rulemaking concerning the Business Opportunity Rule, the Commission noted that between 1997 and 2005 it had received 17,588 complaints concerning pyramid schemes, amounting to over \$46 million in aggregate

losses. These losses grossly understate the total losses suffered by consumers since, in light of the Commission's 2004 Consumer Survey, "consumers who had purchased a pyramid scheme were the least likely to complain" as compared with all other types of consumer fraud.^[8] The lack of reporting is even more profound when MLM firms target immigrant or minority communities, as Herbalife, Amway and other MLM firms do.^[9] As the Assistant Director, Marketing Practices has stated, "complaints filed with the FTC do not capture all of the problems that the most vulnerable communities face."^[10]

As further evidence of the prevalence of unfair and deceptive acts and practices in the MLM industry, we submit the results of a petition posted on the Pyramid Scheme Alert web site (the "PSA Petition").^[11] The PSA Petition was signed by over 1,000 people, many of whom added notes concerning their experiences in the MLM industry. The collected responses are submitted with this Petition as Exhibit A. The responses reference over 50 different MLM firms, including some of the largest firms in the industry. Most of the signers are from the United States, but there are signers from over 30 other countries, reflecting the fact that deception in the MLM industry is a worldwide problem, with many U.S.-based MLM firms exporting their deceptive practices to foreign markets, in a never ending effort to find new sources of recruits to fill the ranks of distributors lost through attrition.^[12]

Some sample, unedited comments from the PSA Petition are set forth below. The comments indicate that the harm caused by MLM is not only financial but includes damage to relationships with friends and family.

A signer from Atlanta, Georgia wrote:

The victims of these scams wholeheartedly believe that if they work hard enough, they will make a living for themselves. These scams prey on a belief in the American Dream, on the entrepreneurial spirit, on the naive, the under-educated, those who are unemployed, those with low self-esteem and poor support systems, and the poor. Please protect consumers (and the family members of victims who wind up having to support them) from these vultures.

A signer from Ottsville, Pennsylvania wrote:

My family has been victimized and almost saw a divorce over the scamming from a well-known MLM that sucked my wife's bank accounts dry with their endless pulp mill of "necessary" sales aids, meetings, and other marketing scams. They are a cancer on our society with their appeal to greed and wondrous "opportunity" always just around the next corner [but never arriving] The DSA direct sales association is their lobby arm. BEWARE these wolves in sheep's clothing selling these de facto pyramid schemes. BAN THEM

A signer from Oregon City, Oregon wrote:

During desperate measures, my spouse had become disabled, and not able to work. While waiting for SSD (took 4 years) to be approved, we invested our last bit of savings, plus borrowed some from family to "become a wage earner from home". We spent over \$6,000 trying to build our base and it never ever happened. Constantly told not doing enough, needing to always put more money in, over and over. Finally cut my loss, the financial impact finally took a toll and had to file bankruptcy, which now doesn't help our US economy or financial bill. Anything I can do?

Eloquently explaining why we should care about the impact of U.S.-based MLM's doing business abroad, a signer from Australia wrote:

I have recently resigned as a member of HERBALIFE AUSTRALIA PTY.LTD. 5 Butler Boulevard, Adelaide Air Port SA 5950 Australia. My own inquiries ,plus my daughter in Pretoria South Africa, sending me copies the High Court judgment in the EC Belgium, which condemned the operation of Herbalite in Europe, convinced me to sever my ties with them. Their so called marketing methods are extremely forceful and unethical. All their products are made in the USA. Surely this monster must be dealt with from the base where IT is spawned the USA.

And a signer from Florida wrote:

Multi-level marketing scams damage relationships. Family, friends, neighbors, fellow church members and countless others are targeted as recruitees, often causing or resulting in resentment and alienation, where otherwise healthy, harmonious relationships previously existed. The incessant mind control tactics used in these groups that are perceived by those enrolled as "encouraging," "inspiring," "life-changing," etc., serve only to enslave and deceive the masses. Those enrolled become "close friends" seemingly with only their fellow MLM enrollees & find a new "family" in them in which to dwell. Financial ruin coupled with previously cherished relationships in ruin is a much different picture than the one the MLM powers that be consistently paint to their "followers." Please put an end to these invasive, destructive scams.

Based on our collective experience, as confirmed by the responses to the PSA Petition, MLM firms and promoters engage in a variety of unfair and deceptive acts and practices,^[13] including:

- Selling "business opportunities" to millions of consumers that are based upon the buyer reselling the same opportunity, ad infinitum, with the false promise that exponentially increasing rewards will flow to all participants in the recruiting chain.
- Making false and deceptive income claims concerning the MLM business opportunity through the use of charts and bogus hypotheticals.
- Permitting high level MLM distributors to make testimonial earning claims with perfunctory disclaimers and without disclosing unique or special circumstances that make the testimonials deceptive.
- Claiming that regardless of market saturation factors and population limitations, the income opportunity, based upon expansion of the sales chain, is unlimited and available to all forever.
- Failing to disclose failure rates, dropout rates, sources of income for those at the top of pyramid chain, and international income sources of high level US-based distributors.
- Failing to disclose the types and amounts of business expenses incurred by MLM distributors.^[14]
- Presenting misleading and incomplete income "disclosures" that omit unprofitable participants, using skewed "mean" averages; factoring data for only one year or one month to conceal the annually compounding attrition, failure and/or dropout

rates; and failing to disclose the number of existing or previous investors in the business opportunity in any geographic area.

- Presenting misleading and incomprehensible MLM compensation plans which cover up the reality that more commissions are transferred to those positioned at the top of the sales chain than to those who actually make the sale, and that between 50-80% of all commissions are transferred annually to the top 1% of the sales chain.
- Withholding information about the impact on the commission payouts for dropouts that “compress” or “roll up” payments to the distributors at the top of the chain.
- Withholding or disguising the facts that high monthly purchases, specified recruitment quotas and other costs are effectively required in order to sustain “qualification” for the promised commission payments and that failure to meet any of those qualifications results in substantial or total loss of accrued rewards.
- Withholding data and facts regarding actual retail sales to end-users, which is information essential for determining whether the MLM is an illegal pyramid scheme.
- Making false and exaggerated health and medical claims about MLM “pills, potions and lotions” and food-related products.
- Permitting “independent” distributors to make deceptive health and medical claims, thus enabling the MLM firm to maintain “plausible deniability.”
- Charging inflated “wholesale” prices for the products purchased by MLM distributors, based on the false claim that the high prices are balanced by their high income potential or is unique, when typically they are generic, commodity type products manufactured by third party contractors who sell similar products under different brand names to other sellers.
- Using false claims of high income potential to entrap millions of consumers into making automatic monthly inventory purchases charged to their credit cards.
- Charging sales tax based on the suggested retail pricing level for wholesale purchases by the sales force that are known to be unsold.
- Charging excessive shipping and handling charges on inventory purchases by distributors that are unrelated to actual costs.
- Delaying or making it difficult for participants to stop charges to their credit cards for “auto-orders” and making return of goods contingent on quitting the business and losing accrued payments.
- Selling lead generation or promotional materials to MLM distributors which are expensive, ineffective and represent a substantial, undisclosed source of income to the high level MLM distributors who market them to their “downline” distributors, with the explicit or tacit support of the MLM firm.^[15]
- Requiring MLM distributors to submit to onerous and unfair terms in their distributor agreements, including arbitration clauses, class action waivers, jury trial waivers, and provisions which permit the MLM company to make unilateral

changes to the distributor agreement or compensation plan without the consent of the distributor.^[16]

- Utilizing deceptive Search Engine Optimization (SEO) tactics to manipulate search results so that web sites with negative or objective information concerning an MLM or the MLM industry are “buried.”
- Suing or threatening to sue bloggers and web site owners who attempt to post factual information concerning MLM business opportunities, or to provide a forum for MLM participants to discuss their experiences.

3. The Multi-Level Marketing Industry Causes Substantial Injury to Consumers

Several of the signers of this Petition have attempted to estimate the losses to consumers caused by the MLM industry.^[17] The task is made difficult by the fact that MLM firms do not release relevant data concerning the actual incomes of their distributors. In fact, few if any MLM firm even collect data concerning retail sales made by their distributors, or business expenses incurred by their distributors. Without such data it is not possible to know the actual rates of success or failure of MLM distributors. That the rate of failure is extremely high is not open to serious dispute, given the high attrition rates reported by MLM firms.^[18]

As an example of the extent of financial losses incurred by participants in MLM schemes, we note the settlement in *Jacobs v. Herbalife* (C.D.Cal. No. CV-02-01431), a class action on behalf of Herbalife distributors who participated in a lead generation system known as “The Newest Way to Wealth” (“NWTW”). The claims were reviewed and evaluated by a professional claims administrator, whose report revealed that there were 7,779 class members who were entitled to submit claims for their economic losses.^[19] Of these, 2,481 or about 32%, submitted eligible claims. The aggregate economic losses of eligible claimants totaled \$19,731,186, indicating an average loss of \$7,953. Several individuals claimed – and proved to the satisfaction of the claims administrator – losses in excess of \$100,000. Based on our collective experience, including discussions with distributors in many different MLM plans, these types of losses are not limited to cases such as the NWTW case; they are distressingly common. If a relatively small group of claims by 2,500 MLM distributors can result in aggregate losses of close to \$20 million, the aggregate losses caused throughout the MLM industry are at minimum several billion dollars per year.

4. Existing Laws and Regulations are Inadequate to Protect Consumers from Unfair and Deceptive MLM Schemes

There is a patchwork quilt of federal and state laws and regulations which affect the MLM industry. These laws and regulations are inadequate to protect consumers for the following reasons:

- There is substantial confusion concerning how to determine whether an MLM is operating as an illegal pyramid scheme.
- The determination that a particular MLM is operating as a pyramid scheme may not be made until the scheme has been running for years, with thousands of victims suffering millions of dollars in losses, most of which will prove to be unrecoverable.

- Whether or not they constitute pyramid schemes under any definition, MLM firms and their high level distributors continue to make deceptive earnings claims and engage in other unfair and deceptive practices, as described in this Petition.
- MLM firms have avoided the requirement for making pre-sale disclosures under the Franchise Rule by the simple expedient of keeping the initial fees under \$500.
- The MLM industry obtained an exemption from the Business Opportunity Rule and its pre-sale disclosure requirements, after extensive lobbying of the Commission and Congress.

5. Outline of Existing Laws and Regulations Affecting MLM

Both the FTC and the SEC have jurisdiction to bring enforcement actions against MLM firms which operate as pyramid schemes, because pyramid schemes are considered to be both unfair practices within the scope of Section 5 of the Federal Trade Commission Act and “investment contracts” subject to the Federal securities laws.^[20] In addition, most states have laws prohibiting pyramid or endless chain schemes. All of these remedies suffer from the flaw that they are only utilized after a fraudulent MLM has been up and running for a lengthy period of time. In addition, as discussed in more detail below, there are conflicting precedents and standards for determining what constitutes a “pyramid scheme,” which has generated significant confusion and misinformation for consumers, attorneys and regulators.

The Commission has broad authority to bring enforcement actions for other types of unfair and deceptive practices, such as making deceptive earnings or product claims, as do state enforcement authorities acting under the various state “little FTC” acts. These remedies suffer from the same flaw as pyramid scheme prosecutions in that they are enforced – if ever – only after a scheme has been operating for a period of time long enough to generate a volume of consumer complaints sufficient to attract regulatory attention.

The Commission has promulgated several rules which may affect certain aspects of MLM recruiting, including the Cooling Off Rule, 16 C.F.R. Part 429, and the Guides Concerning the Use of Endorsements and Testimonials in Advertising, 16 C.F.R. Part 255. The Cooling Off Rule is of limited benefit, since it likely applies only to a distributor’s initial purchase, if at all. Given the widespread use of deceptive testimonial earnings and product claims in the MLM industry, the utility of the Guides is limited by the failure to enforce them.

Pre-sale disclosure of such facts as the attrition and failure rates of MLM distributors, the backgrounds of MLM promoters, the costs to operate as an MLM distributor, and the dismal earnings of most MLM distributors, might protect some consumers from the harm caused by MLM schemes. MLM firms have been able to avoid the disclosure requirements of the Franchise Rule by the simple expedient of setting the initial fees for joining the plan, such as the “starter kit,” below the \$500 threshold. This gap in coverage was set to be closed by the original version of the Commission’s Business Opportunity Rule. However, after intense lobbying by the DSA and many firms in the MLM industry, the Commission revised the new Business Opportunity Rule, 16 C.F.R. Part 437, to exempt most MLM firms from coverage.

Even if there were pre-sale disclosure requirements applicable to MLM, consumers would need more protection. Some MLM compensation plans are so extremely weighted to favor recruitment over retailing that they are “unsafe at any speed.” As the Commission stated in *Koscot*, “[t]hat these schemes so often do not allow recovery of investments by means of retail sales ... merely points up that there is very little positive value to be lost by not allowing such schemes to get started in the first place.”^[21]

6. There is Substantial Confusion over what is a Pyramid Scheme.

While there are some essential similarities among the various federal and state anti-pyramid laws, there are also some serious inconsistencies and contradictions. We are not attempting a full exposition of this issue in this Petition.^[22] To consider just one aspect of the problem, there is a great deal of confusion concerning the significance of retail sales to persons who are not participants in the plan. The Commissions’ own precedents indicate that retail sales – that is, sales to persons who are not participating in the MLM – are essential for distinguishing “legitimate” MLMs from pyramid schemes. For instance, the final order in *In re Koscot Interplanetary, Inc.* provided that an MLM firm could legitimately pay commissions only on “actually consummated sales of goods or services to persons who are not participants in the plan or program and who do not purchase such goods or services in order to resell them.”^[23] The Commission explained that “by requiring that compensation for recruitment be based in all cases upon retail sales by those recruited, the order provides a readily monitored means to ensure that recruitment of distributors is based on market demand, which is the goal of any legitimate business enterprise.”^[24] In *Koscot* the Commission also cautioned that “indeed, even where rewards are based upon sales to consumers, a scheme which represents indiscriminately to all comers that they can recoup their investments by virtue of the product sales of their recruits must end up disappointing those at the bottom who can find no recruits capable of making retail sales.”^[25]

The provision in the *Koscot* final order that commissions for recruiting be based on “actually consummated” retail sales was not followed in *In re Amway*, in which the Administrative Law Judge found that Amway was not a pyramid scheme because it had a buyback rule, a 70% resale rule and a 10 customer per month rule, all of which supposedly had the effect of encouraging retail sales to customers.^[26] As a result, most sophisticated MLM’s have purported to adopt these “Amway rules” in their distributor agreements; we are not aware of any currently operating MLM which limits the payment of commissions to “actually consummated” retail sales. In effect, the Amway rules tacitly approve the concept of an “advance commission,” that is, the payment of a commission based on a retail sale that has not yet taken place but presumably will take place in the future. In our view, this was a serious mistake which has allowed the MLM industry to flourish while causing increasing harm to consumers.

The Ninth Circuit in *Omnitrition* emphasized that it is not enough to pay lip service to the Amway rules; the rules must be actually enforced and effective in ensuring retail sales.^[27] The Ninth Circuit also commented that a distributor’s personal use of the products could not satisfy the requirement that commissions be based on sales to “ultimate users” of the product. The DSA and other MLM proponents argue that this language is “dicta” and that “internal sales” may be used to generate commissions.

More recently, the amended final order in *Burnlounge* adopted the *Omnitrition* view that a distributor’s personal use does not constitute retail sales.^[28] However,

the Burnlounge order did not adopt the “actually consummated” requirement from Koscot.

To add to the confusion, a Staff Advisory Opinion dated January 14, 2004 stated that “the amount of internal consumption in any multi-level compensation business does not determine whether the FTC will consider the plan a pyramid scheme.”^[29] This language has been used by the DSA and others to support the proposition that sales to MLM participants for their “personal use” do satisfy the retail sales requirement, notwithstanding Omnitrition. The DSA has successfully lobbied several state legislatures to modify their anti-pyramid laws to legitimize the payment of commissions on such “internal sales,” thereby legalizing what would otherwise be considered to be pyramid schemes.

Accordingly, there is considerable confusion concerning what constitutes a pyramid scheme. Consumers who are recruited to join an MLM program cannot readily determine whether the program is an illegal pyramid scheme. If the existence of substantial retail sales is to be the touchstone of whether an MLM is a pyramid scheme, the determination cannot be made until the scheme has been operating for a substantial period of time and only after an extensive investigation. The Commission needs to address and clarify this situation. In our view, any MLM program which permits unlimited recruiting and rewards distributors with commissions paid on the purchases of other distributors should be deemed to be a pyramid scheme without the need for further analysis. Such a bright line rule will provide essential guidance to consumers, regulators, investors and the MLM industry.

7. Conclusion

The MLM industry has taken advantage of the confusion over what constitutes a pyramid scheme, and the lack of any pre-sale disclosure requirement, to become a multi-billion dollar behemoth in which the vast majority of participants lose their investments and eventually drop out, while a tiny percentage of distributors at the top of the chain become very wealthy. In its 1975 Koscot decision, the Commission stated that “it is regrettably clear that responsible authorities, including this Commission, have acted far too slowly to protect consumers from the manipulations of respondents and others like them. . . . the necessity to prove that a marketing plan, deceptive on its face, has in fact resulted in injury to numerous consumers, is a lengthy process.”^[30]

The problems recognized by the Commission in Koscot have continued to fester, as MLM firms have modified their practices in response to cases such as Koscot, Amway and Omnitrition, but have failed to change the fundamental flaws of the entrepreneurial chain. We urge the Commission to act now both to investigate the MLM industry and bring enforcement actions against those firms and individuals which are committing unfair and deceptive acts and practices, and to promulgate a trade regulation rule to prevent further harm.

We appreciate the opportunity to address the Commission on this important issue, which will affect millions of consumers in the United States who have suffered and will suffer many billions of dollars of injury from their participation in the MLM industry.

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REFERENCES:

[1] See <http://www.dsa.org/research/industry-statistics/> (retrieved 8/22/2013). The term “direct selling” refers to the sale of a consumer product or service, person-to-person, away from a fixed retail location. All MLM programs involve direct selling; however, not all direct selling companies utilize MLM compensation plans. The DSA reports that approximately 95% of its members utilize an MLM type of compensation plan. See <http://www.dsa.org/research/industry-statistics/11gofactsheet.pdf> (retrieved 8/22/2013).

[2] See <http://www.dsa.org/forms/CompanyFormPublicMembers/search?action=find> (retrieved 8/22/2013).

[3] See Zig Ziglar; John P Hayes, PhD (2001), Network Marketing for Dummies. Another source lists over three thousand MLM firms, many of which are apparently defunct. See <http://www.financialindustryscam.com/mlm.htm>

[4] Publicly traded MLM firms, and their approximate market capitalization as of the date of this Petition, include Avon (AVP, \$8.8 billion); Herbalife (HLF, \$6.5 billion); Nu Skin (NUS, \$5.1 billion); Tupperware (TUP, \$4.3 billion); Primerica (PRI, \$2.1 billion); Oriflame (ORFLY, \$1.7 billion); Usana (USNA, \$1.1 billion); Medifast (MED, \$357.5 million); Nature’s Sunshine (NATR, \$289.2 million); Lifevantage Corp. (LFVN, \$275.9 million); Blyth, Inc. (BTH, \$147.3 million); Mannatech (MTEX, \$54.9 million); Reliv’ Int’l (RELV, \$28.4 million); and Forever Green (FVRG, \$9 million). Of the companies on this list, at least two (MED and BTH) distribute through multiple channels including MLM, and one (ORFLY) does not distribute in the U.S. Prominent, privately held MLM firms include Amway, Mary Kay, Melaleuca, Monavie, ACN, Shaklee, Sunrider, Pre-Paid Legal, Neways, Market America, Advocare, Arbonne, Xango, Nikken, and Vemma Nutrition Company.

[5] 86 F.T.C 1106, 1179 (1975).

[6] <http://www.ftc.gov/os/fedreg/2010/october/101028businessopportunitiesstaffreport.pdf>

[7] <http://www.ftc.gov/os/2006/04/R511993BusinessOpportunityRuleNoticeofProposedRulemaking.pdf>

[8] See <http://www.ftc.gov/reports/consumerfraud/040805confraudrpt.pdf>, at 81.

[9] See Letter dated June 5, 2013 from Congresswoman Linda T. Sanchez to Commissioner Edith Ramirez, <http://lindasanchez.house.gov/index.php/press-releases/820-linda-sanchez-calls-for-investigation-of-herbalife>; Letter dated August 29, 2012 from Alma Morales Rioja, President and CEO of MANA, http://www.hermana.org/sites/default/files/MANA_FTC_Herbalife.pdf; Letter dated May 17, 2013 from Jose Calderon, President of the Hispanic Federation, <http://www.businessinsider.com/hispanic-fed-asks-ftc-to-probe-herbalife-2013-5>; Letter dated September 5, 2013 from Tito Jackson, Boston City Councillor, <http://www.valuwalk.com/2013/09/ftc-to-investigate-herbalife/> See also http://directsellingnews.com/index.php/view/the_new_american_heritage_tapping_the_hispanic_market_segment#.UkbLNUbD-0E (discussing various MLM firms’ strategies for targeting the Hispanic market). According to the Commission’s 2011 survey, African Americans and Hispanics are more likely to be victimized by “Income-Related Fraud” than non-Hispanic Whites. Consumer Fraud in the United States, 2011 Survey, at p. 52, <http://www.ftc.gov/os/2013/04/130419fraudsurvey.pdf>

[10] Vaca, Monica and Carter, Thomas B., “How the Federal Trade Commission and Advocates Together Can Benefit Low Income Consumers,” 45 Clearinghouse Review 457, 458 (March-April, 2012). The authors note that with scams targeted at immigrant communities, “locating injured consumers and

persuading them to cooperate with federal authorities can be hard. To come forward, consumer-victims may have to overcome language barriers and unfamiliarity with U.S. laws and customs. Moreover, consumers whose legal status in this country is uncertain may be wary. Even consumers who have clear legal status may be apprehensive about participating in public court proceedings.” Id. at 460.

[11] The petition states as follows: “We, the People, call on Congress and the Obama Administration to end the neglect of consumer protection and the failure of law enforcement regarding pyramid scams and Ponzi operators.

We respectfully request a Congressional Investigation of the FTC and SEC regarding enforcement of laws against Pyramid Selling Schemes, Multi-level Marketing Scams, Ponzi Investment Frauds, Bogus “Business Opportunity” and “Work from Home” schemes.”

See <http://www.pyramidschemealert.org/ConsumerPetition.php>.

[12] In a 1998 seminar presented for the International Monetary Fund, the Commission’s General Counsel stated that “[a]s we continue to pursue pyramid schemes, we would be delighted to coordinate our efforts with law enforcement in your countries. It is only too evident that the expansion of fraud across borders and on the World Wide Web means that no one agency or country can work effectively on its own. We must be collectively vigilant in order to protect the integrity of our marketplaces and the pocketbooks of our consumers.” Prepared Statement of Debra A. Valentine, <http://www.ftc.gov/speeches/other/dvimf16.shtm>.

[13] We do not claim that all MLM firms engage in all of these practices, but that they are prevalent in the industry. We note that one large direct seller, Tupperware, recently left the DSA. Tupperware’s CEO told the Wall Street Journal “[w]e didn’t leave direct selling ... Direct selling left us, because the industry became dominated by buying clubs and what look like pyramid schemes.” <http://online.wsj.com/article/SB10001424127887323689604578221430526328400.html>

[14] These expenses can be substantial. Herbalife, in Item 7 of its 2011 Form 10-K, stated to its investors that “If a distributor wants to pursue the Herbalife business opportunity, the distributor is responsible for growing his or her business and personally pays for the sales activities related to attracting new customers and recruiting distributors by hosting events such as Herbalife Opportunity Meetings or Success Training Seminars; by advertising Herbalife’s products; by purchasing and using promotional materials such as t-shirts, buttons and caps; by utilizing and paying for direct mail and print material such as brochures, flyers, catalogs, business cards, posters and banners and telephone book listings; by purchasing inventory for sale or use as samples; and by training, mentoring and following up (in person or via the phone or internet) with customers and recruits on how to use Herbalife products and/or pursue the Herbalife business opportunity.” Herbalife and other MLM firms have recently begun making generalized disclosures concerning business expenses. For instance, Herbalife currently advises prospective distributors that “[s]uch business expenses can vary widely. They might include advertising or promotional expenses, product samples, training, rent, travel, telephone and internet costs, and miscellaneous expenses.” <http://opportunity.herbalife.com/Content/en-US/pdf/business-opportunity/StatementAverageCompensation2011EN.pdf> This generic disclosure is utterly inadequate and incomplete and fails to provide the prospective distributor any means to estimate the amount of expenses they can expect to incur.

[15] Many high level MLM distributors sell collections of promotional materials, sales leads and marketing techniques to other distributors. Herbalife refers to these materials as “lead generation systems.” The cost of purchasing leads and sales materials represents one of the many undisclosed expenses of operating an MLM distributorship. For many years Herbalife permitted and encouraged its high level distributors to sell lead generation systems to their downline distributors. Recently Herbalife has apparently restricted these activities. See <http://nypost.com/2013/08/17/death-of-a-dream-top-herbalife-pitchman-takes-his-own-life/> . The use and impact of similar systems in Amway, the largest MLM seller, has been documented in several books. See Carter, Ruth, *Amway Motivational Organizations: Behind the Smoke and Mirrors* (Backstreet Publishing, 1999); Scheibeler, Eric, *Merchants of Deception*, available at <http://archive.org/details/MerchantsOfDeception>. These writers demonstrate how high level Amway distributors made more money selling lead generation systems to their downlines than they made in the commissions paid by Amway.

[16] Most MLM firms require distributors to sign a pre-printed agreement which is typically one or two pages long. The brevity of these agreements is deceptive, however, because they typically incorporate by reference a lengthy set of additional terms and conditions, often referred to as a policy and procedures manual. For instance, Herbalife utilizes a two page “Application for International Distributorship” which

incorporates by reference “the Rules of Conduct and Distributor Policies, the Sales and Marketing Plan, Ordering Procedures and Sample Forms”, which collectively comprise 124 pages. The Herbalife agreement provides that it may change or add to these Rules at any time “in its sole and absolute discretion,” raising a question as to whether it is an enforceable contract. See *Day v. Fortune Hi-Tech Marketing, Inc.* Nos. 12-6305, 12-6305 (6th Cir., decision dated September 12, 2013) (holding arbitration clause in MLM distributor agreement unenforceable because agreement gave MLM company right to modify the agreement and policies and procedures at any time).

[17] See Taylor, Jon M., *Multi-Level Marketing Unmasked* (Chapter 7), available at <http://mlm-thetruth.com/research/case4and-against-mlm/>; Fitzpatrick, Robert L. “The Myth of ‘Income Opportunity’ in Multi-Level Marketing,” available at <http://pyramidschemealert.org/PSAMain/news/MythofIncomeReport.html>

[18] For instance, in its 2005 Form 10K Herbalife reported that for the twelve month period ending in January 2005 “approximately 60 percent of our supervisors did not re-qualify and more than 90% of our distributors that are not supervisors turned over.” Since 2005 Herbalife has not reported the attrition rates of its entry level distributors.

[19] The claims administrator’s declaration is available at <http://www.ftc.gov/os/comments/businessopprule/522418-10572.pdf>

[20] See, e.g. *Webster v. Omnitrition International, Inc.*, 79 F.3d 776 (9th Cir. 1996), cert. den. 519 U.S. 865 (1996) (adopting FTC pyramid scheme case law to define pyramid scheme in securities fraud action).

[21] 86 F.T.C. at 1181.

[22] Several commentators have noted apparent inconsistencies and contradictions in various pyramid scheme definitions. See Craig, Bruce “An Investor’s Guide to Identifying Pyramid Schemes,” available at <http://seekingalpha.com/article/918831-an-investors-guide-to-identifying-pyramid-schemes>; Keep, William, “Publicly Available Lessons Regarding Pyramid Schemes: What Should We Think About Herbalife?,” available at <http://seekingalpha.com/article/1244531-publicly-available-lessons-regarding-pyramid-schemes-what-should-we-think-about-herbalife>; Fitzpatrick, Robert “Recognizing Pyramids Without a Lawyer, an Economist or the FTC,” available at <http://seekingalpha.com/article/1107821-recognizing-pyramids-without-a-lawyer-an-economist-or-the-ftc>; Taylor, Jon M. *Multi-Level Marketing Unmasked* (Chapter 10), available at <http://mlm-thetruth.com/research/case4and-against-mlm>

[23] 86 F.T.C. 1106, 1186 (1975) (emphasis supplied).

[24] 86 F.T.C. 1106, 1184 (1975).

[25] 86 F.T.C. 1106, 1180 (1975).

[26] 93 F.T.C. 618, 646, 667-68 (1979).

[27] 79 F.3d 776, 783 (9th Cir. 1996).

[28] *Federal Trade Commission v. Burnlounge, Inc.*, Case No. CV 07-3654-GW (C.D. Cal., Western Division, Amended Final Order dated February 29, 2012) (appeal pending).

[29] See <http://www.mlmlaw.com/FTCinternalconsumptionletterkohm.pdf>

[30] 86 F.T.C. 1106, 1181-82.

Appendix 11B

Challenges for legal, financial, and market analysts – and for regulators

(Article originally titled: “Herbalife, MLMs and the FTC: Some Questions and a Challenge for Market Analysts and the Financial Press,” seekingalpha.com web site, Jul. 28, 2015)

By Bruce Craig, former assistant to Wisconsin Attorney General

Summary

As a former consumer fraud prosecutor, my interest in the issue of pyramid schemes in general is focused on the victims.

It has been troubling to me that the issues framed by the dispute have not seemed to merit a more thorough analysis by market professionals or the financial press.

I also believe that the academic legal community owes an objective and extensive analysis of a matter of this economic magnitude.

As a former consumer fraud prosecutor, my interest in the current Ackman - Herbalife (NYSE:[HLF](#)) dispute, and the issue of pyramid schemes in general, is focused on the victims, here and abroad, who number in the millions and face a [99% failure rate](#) and a business life of less than two years. Current annual MLM revenues exceed \$30 billion in the US and \$150 billion worldwide.

With that in mind, it has been troubling to me that the structural and legal issues framed by the Herbalife dispute have not seemed to merit a more thorough analysis by the market professionals in the field and the financial press that provides external, and independent, comment.

I am certainly not an expert in the area of financial analysis and reporting, but it has been my impression that, at elite levels, these highly educated, and paid, professionals serve the general public purpose of providing relevant, and accurate, information, derived from admittedly complex data, for the general public, individual investors, retirement and mutual funds, government regulators, and corporations seeking data of value in making their business decisions. The financial press has the added responsibility

of informing the public about areas of concern, not only from the standpoint of those who may be involved in the market in one way or another but also from the perspective of those who may be personally, and adversely, affected by business practices which face scrutiny for possible illegal and financially damaging activity. Madoff and Enron come to mind - as does the current Ackman - Herbalife dispute. Because of some intricate legal issues, I also believe that the academic legal community owes an objective and extensive analysis of a matter of this economic magnitude. I have asked several top legal academics to consider this option but, to date, with no success.

Pyramid schemes

Those analyzing and reporting on these issues have a difficult task. The legal standards applicable to pyramid style schemes and the enforcement responses of the Federal Trade Commission have been ambiguous at best and certainly vague enough to permit this \$150 billion/yr industry to continue, and expand, essentially unhindered for the past 35 years. Even the Federal Trade Commission confesses it doesn't really know what a pyramid is: "There is no bright line disclosure that would help consumers identify a fraudulent pyramid from a legitimate MLM."

I discussed this troubling and astounding conclusion in a recent [letter to the Chairman of the FTC](#). This issue was also brought to the foreground by one member of the press, Joe Nocera of the New York Times, who wrote an [opinion piece on the Herbalife issue](#). When he contacted the FTC on the matter, he states:

"I called the agency and asked what distinguished an illegal pyramid scheme from a legal direct-selling company. . . A few hours later, I received an email from an F.T.C. public relations staffer. "I'm sorry," it began, "but we won't be able to offer you any on (or off) record assistance."

A response such as this presents a real challenge for analysts and the press, but it also makes it even more critical that this challenge be met and that formal inquiry be made of the FTC to the extent necessary to adequately inform those in the market and the public in general - particularly those who might be considering participating, or investing, in one of these offerings - as to just what is going on with an offering which the FTC, in its 1975 case against Koscot Interplanetary, described as "[inherently deceptive](#)."

This is not a minor matter. As stated, MLM/pyramid style operations now operate worldwide, with annual revenues of \$150 billion, participant loss ratios of 99%, and, as an indicator of '[saturation](#)' - the fact that 80% of current MLM business is done outside the US, its home country. Even more critical is that no one seems to know what is really going on.

An example of this phenomenon was evident in a recent [Barron's blog](#) by Ben Levisohn. The topic was a statement by Sterne Agee's April Scee:

"Sterne Agee CRT's April Scee contends that Herbalife isn't a pyramid scheme-but it's not worth buying either. She explains why:

We believe Herbalife's business practices contain no elements of a pyramid scheme. Herbalife has also put many protections in place that make its business model far more consumer/rep-friendly than peer MLMs (and peer bricks and mortar peers). Herbalife has very low start-up costs, protections against financial losses, a strong compliance function, and clear earnings potential disclosures. In our view, neither the consumer nor the representative is harmed suggesting there is no reason for the FTC to find against the company. Despite this, timing remains a concern and there is potential that the FTC could change the rules. We think it's unlikely Herbalife could be fined retroactively, but could incur costs to transition business..."

Levisohn adds: "Scee even argues that Herbalife looks good compared to peers Avon Products (NYSE:[AVP](#)) and Nu Skin (NYSE:[NUS](#)) on a margin, capital-intensity and growth basis." So why does she only rate it Neutral? Because Herbalife has gained 40% so far this year. "[Given] recent strong stock performance, we would wait for a better entry point," Scee writes."

Scee focuses on the central issue buried under countless discussions, on this web site and others, about the existence, meaning, and reliability of "protective" standards of conduct claimed by those marketing MLM to legalize their offerings. Specifically, she states "Herbalife has also put many protections in place . . . very low start-up costs, protections against financial losses, a strong compliance function, and clear earnings potential disclosures."

- Just what are these "protections" and where is the proof of their efficacy?
- What are the actual start-up costs for those who seriously want to pursue this business?
 - What are the actual protections against financial losses, and where is the substantive evidence proving that refund programs actually prevent serious financial injury, given a documented 99% failure rate?
 - What is a "strong compliance function"?
 - Have these protective functions ever been documented, with verified and public data, either for market analysts, the financial press or, most importantly, the Federal Trade Commission?
 - Why couldn't David Einhorn get a simple answer from Herbalife to his question as to the existence and number of actual retail customers?

Corporate claims of protection and that the vast majority of participant inventory purchases are for personal consumption, as claimed in a Herbalife sponsored study, deserve, from a skilled analyst or member of the press, more than simple acceptance. Verification of claims is at the very heart of these professions, particularly with the significant stakes at play in this particular matter.

The Amway case

The issue of 'protective' elements in a MLM/pyramid style is a direct result of the

FTC's [decision in the Amway case](#), which essentially said that if you were a pyramid (as Amway had been charged) and had "rules" which actually 'protected' participants from the economic damage expressed as inherent in the FTC's prior, and still operative, Koscot case, then you're not a pyramid. Essential to this ruling was the fact that Amway 'proved' that its rules were in existence and prevented the kind of participant injury spelled out in the [Koscot case](#).

This was quite a leap for the Judge deciding the Amway case, James Timony - in his first case as an Administrative Judge, (he was appointed Judge in 1976, after the Amway case had already started) particularly because the proof of the protective value, and enforcement, of these "rules" came from the company officers and employees (sound familiar?) and was, as far as the court record is concerned, without any documentation or proof of the actual protective value of these internal rules. A formal request, in 2000, asking that the efficacy of these rules be re-evaluated by the FTC was functionally denied.

The shift from a virtual outright prohibition to one of tolerance if certain rules were, purportedly, in effect is at the heart of all current controversy. In the opinion of MLM expert, attorney Jeffrey Babener, [Amway created the MLM industry as we now know it](#):

"Had Amway lost, MLM history after 1979 may have been nonexistent. Amway's victory paved the way for hundreds of MLM companies that would follow. So significant was the decision that the FTC during the next 20 years focused on "deceptive" practices of MLM companies such as earnings representations or medical claims rather than attacking the "structure" of MLM programs. The industry owes Amway a debt of gratitude."

The MLM industry had 20 (now 35) years of minimal enforcement oversight by the FTC, giving it the time and money to establish a formidable political effort and regulatory influence.

How is the efficacy of these "protections against financial loss" evaluated in such a

manner that the public has proof that it is actually protected from the abuses spelled out in the Koscot case?

"such plan is contrary to established public policy in that it is generally considered to be unfair and unlawful and is by its very nature immoral, unethical, oppressive, unscrupulous, and exploitative. Therefore, such plan was and is inherently unfair and the operation of the Koscot marketing plan by respondents, having caused substantial injury to the participants therein as well as to other members of the public, constitutes an unfair and deceptive act and practice."

Keep in mind that there are [hundreds of MLM companies](#) and the substantive evaluation of the continued efficacy of rules which purportedly protect participants and which are, essentially, against the economic interests of the promoters, such as a refund program, is a massive, critical, and continuing, enforcement task.

My position is that the Amway decision was, for these very reasons, irrevocably flawed.

First, the FTC or anyone else faces a virtually impossible task in determining, from hundreds of company internal records, whether participant injury has actually been, and will be, avoided.

Second, this determination will always be after the fact - after the injury, if any, has already occurred and money possibly lost, perhaps at the hands of a company based, say, in the Cayman Islands.

Third, the substantial risks outlined in Koscot are still in play and, given 99% loss rates, the value of allowing these companies to continue is questionable.

Fourth, once an agency such as the FTC faces such a formidable task, created by its own faulty legal decision in Amway, what are its options other than to play down the problem and avoid admitting its error and the substantive and expensive and ongoing process of actual verification of rule compliance?

Fifth, the creation of a heavily funded industry lobby, to deliver its benign message to the FTC and to Congress is also a significant factor.

This is what I believe what has happened and part of this is the direct result

of highly paid, and well educated, financial analysts - and their counterparts in the investigative financial press - failing to demand relevant information from the major players and meaningful investigative procedures from the agency responsible for preventing consumer, and investor, injury, the Federal Trade Commission. Not your job? I disagree.

Effort by the financial press has been expended in discussing the foibles of various hedge fund managers involved in this matter, such as William Ackman, [here](#), [here](#), and [here](#), but that, to me, has essentially served to trivialize the importance of possible significant losses, both in the market and by the victims of this \$150 billion/yr behemoth existing as the result of a single flawed decision made by the Federal Trade Commission by a rookie Judge and confirmed by former FTC Chairman, and [Emeritus Dean at Georgetown Law](#), Robert Pitofsky.

In this context, it would be worthwhile to review Herbalife's "protections against financial losses, [and] a strong compliance function" Ms. Scee has cited with confidence as a representative of Sterne Agee.

Herbalife has its own version of the "Amway Rules" as set forth in its [Sales and Marketing Plan](#) at pp. 70-71:

*Rule 18-B: The 10 Retail Customers Rule: A Distributor must personally make sales to at least ten (10) separate retail customers in a given Volume Month to qualify for and receive Royalty Overrides, Production Bonuses, and other bonuses paid by Herbalife. For the purpose of fulfilling the certification requirements of this Rule, a Distributor may count any or all of the following each Volume Month. • A sale to a retail customer; • A sale to a first-line Distributor with up to 200 Personally Purchased Volume Points (and no downline Distributors) may be counted as a sale to one (1) retail customer; and • *A Nutrition Club member who consumed products during ten (10) visits to a Nutrition Club within one Volume Month may be counted by the Nutrition Club operator as a sale to one (1) retail customer. If the Distributor fails to timely certify to Herbalife that they have sold to at least ten (10) retail customers in a given Volume Month, Royalty Overrides, Production*

Bonuses, and other bonuses will not be paid to the Distributor.

*Rule 18-C: The 70% Rule: In order to qualify for and receive Royalty Overrides, Production Bonuses, and other bonuses paid by Herbalife, at least 70% of the total value of Herbalife products a Distributor purchases each Volume Month must be sold or consumed that month. For the purpose of fulfilling the certification requirements of this Rule, a Distributor may count any or all of the following: • Sales to retail customers; • Sales at wholesale to downline Distributors; and • *Product consumed at Nutrition Clubs. If the Distributor fails to timely certify to Herbalife that they have sold or consumed 70% of the product purchases made that Volume Month, Royalty Overrides, Production Bonuses, and other bonuses will not be paid to the Distributor.*

Rule 18-E: Maintenance of Records Distributors must maintain records of all their product distribution for a minimum of two (2) years. The records must contain the name, address and telephone number of the customer or Distributor to whom products were sold, complete information on products bought, and amount and method of payment. These records must be provided to Herbalife immediately upon request. Herbalife maintains the right to contact retail customers and downline Distributors to confirm these transactions and the level of service provided by the Distributor"

The HLF "Gold Standard" for refunds:
Herbalife Stands Behind All Of Our Products With A 100% Money-Back Guarantee. If membership is canceled for any reason, we offer a fully refundable, 90-day money-back guarantee for the cost of your Herbalife Member Pack - which you are not required to return. Furthermore, there is a 100% refund guarantee on all products in re-saleable condition that were purchased within the prior 12 months. Herbalife will pay the cost of return shipping.

Note that Herbalife requires these records to be immediately available for Herbalife review:

The records must contain the name, address and telephone number of the customer or Distributor to whom products were sold, complete information on products bought, and amount and method of payment. These records must be provided to Herbalife immediately upon request.

Herbalife maintains the right to contact retail customers and downline Distributors to confirm these transactions and the level of service provided by the Distributor"

This reaches the bare bone of the issues involved in the Herbalife dispute and the question of the accuracy of claims of 'protection' made by Sterne Agee.

Did Sterne Agee rely solely on statements of, 'protection' made by corporate officers or printed materials?

Did it ask for any documentary evidence, which "must be provided to Herbalife immediately upon request" that these rules were actually complied with? The amount and number of refunds to the 99% failed distributors for instance?

Did it ask whether, even assuming compliance with providing rule data, whether the questions asked and answers given accurately provided data which would enable the public, and the FTC, to determine whether the victim damages predicted in the Koscot case were actually prevented, i.e. the participants were 'protected'? Einhorn's experience indicated that there was no Herbalife documentary evidence of the amount and nature of Herbalife's 'retail sales,' even though that is a central issue in current legal discussion.

Did it, or the financial press covering the matter, e.g. Barrons, ask the FTC whether it had sought the extensive and fully documented data required by the Herbalife rules? Data which unquestionably would bear on the legal and factual issues at the heart of this matter.

Did they ask the FTC whether this data even exists in meaningful amounts or accurate responses and whether the FTC had made any substantive analysis of the very issues which legalized Amway and not Koscot, the existence of bona fide 'retail sales' for instance?

Just to clarify the issues faced by Amway during its 1979 case, and which are directly relevant in the present instance, here are some of the findings and conclusions reached in Amway by Judge Timony.

72. Amway, the Direct Distributor or the sponsoring distributor will buy back any unused marketable products from a

distributor whose inventory is not moving or who wishes to leave the business. (RX 331, p. 17-B to 18-B; CX 847; CX 1076) The buy-back rule has been in existence since Amway started. (CX 1041- J) Amway enforces the buy-back rule. (CX 847; Brown, Tr. 5012-13; Bortnem, Tr. 686, 690; Soukup, Tr. 913).

"73. To ensure that distributors do not attempt to secure the performance bonus solely on the basis of purchases, Amway requires that, to receive a performance bonus, distributors must resell at least 70% of the products they have purchased each month. (RX 331, pp. 16-B to 17-B) The 70% rule has been in existence since the beginning of Amway. (S. Bryant, Tr. 4086) Amway enforces the 70% rule. (Lemier, Tr. 192-93; S. Bryant, Tr. 4056-59; Halliday, Tr. 6497)

74. Amway's 'ten-customer' rule provides that distributors may not receive a performance bonus unless they prove a sale to each of ten different retail customers during each month. (RX 331, pp. 1-B and 17-B) The Direct Distributors have the primary responsibility for enforcing the ten-customer rule in their own group. (S. Bryant, Tr. 4061-62) The ten-customer rule was started by Amway about 1970. Prior to that, there was a 25 sales rule which required the distributor to make 25 retail sales a month without regard to the number of customers. (S. Bryant, Tr. 4085-86) The ten-customer rule is enforced by Amway and the Direct Distributors.

75. The buy-back rule, the 70% rule, and the ten-customer rule encourage retail sales to consumers. (Van Andel, Tr. 1999-2000, 2010; Halliday, Tr. 6231-33; Lemier, Tr. 176; Cady, Tr. 5795-97) [27]."

144. The Amway Sales and Marketing Plan provides incentives for sponsoring which are based on sales of products to consumers. (Van Andel, Tr. 1823-24; Granfield, Tr. 2951-52; Patty, Tr. 3092-95; Cady, Tr. 5779-81; Max, Tr. 5995- 97) It is not a pyramid sales plan.

Note the conclusion that "Amway enforces" it rules. In other words Amway, sued as a pyramid by the FTC was able, through its testimony, to meet its burden of proof that its rules protected its distributors.

The burden of proof

This brings us to one of the most critical, and publicly unanswered, legal

issues arising from the "Amway Rules" and its part in subsequent enforcement against pyramid style companies (MLMs) who claim to have their own version of these rules or comparable 'protective' procedures.

The explicit ruling in the 1999 case [US v Gold Unlimited](#), 177 F.3d 482, made it abundantly clear that the obligation of proving the existence of protective corporate provisions or 'rules' and their efficacy, in the context of the Amway ruling, rests solely with a defendant.

Here is the "burden of proof" legal standard referenced in Gold Unlimited:

"Given the district court's instruction that a pyramid exists when a program's rewards relate to recruitment, not product sales, the jury necessarily found the possibility of saturation when it found that the defendants ran a pyramid scheme: "[T]he presence of this second element, recruitment with rewards unrelated to product sales, is nothing more than an elaborate chain letter device in which individuals who pay a valuable consideration with the expectation of recouping it to some degree via recruitment are bound to be disappointed." Omnitrition, 79 F.3d at 781 (quoting Koscot).

We find it more appropriate, however, that a defendant carry the burden of establishing that it has effective anti-saturation programs. Given the grave risks imposed on investors in illegal schemes, the government should have to do no more than prove that the program satisfies the definition of Koscot. See, e.g., Amway, 93 F.T.C. at 699 ("There is little doubt that a pyramid distribution scheme should now be condemned even without the demonstration of its economic consequences. The Commission has studied the effects of such 'entrepreneurial chains' and seen the damage they do and a per se rule should be used.") (initial decision, affirmed by the FTC opinion, 93 F.T.C. at 735); Koscot, 86 F.T.C. at 1182 ("To require too large an evidentiary burden to condemn these schemes can only ensure that future generations of self-made commercial messiahs will dare to be great and dare anyone to stop them."). The alternative-placing the burden on the government-

forces the government to wait until after the collapse, as that alternative permits operators to maintain that the absence of collapse proves the success of the anti-saturation policies.

It is hard to be any more explicit than that, and it is exactly the legal burden and standard that was applied to Amway during its trial. There is no reason for different treatment on the part of Amway's modern counterparts. Some recent case law has made some of these 'protection' standards more ambiguous than those that existed 35 years ago, but that makes the data available from these "rules", such as Herbalife's, even more critical - so that this explicit data can be used to fine tune the reality of retail sales restrictions and refund programs to the extent that it can be known whether current participants are being protected.

The Federal Trade Commission

From an enforcement standpoint, an area with which I have some 30 years of experience, I am genuinely concerned that the Federal Trade Commission, in respect to pyramid schemes, has placed itself in an untenable position, one which permits only infrequent and often inefficient enforcement efforts - ultimately perpetuating, or virtually endorsing, the continued viability of the MLM industry - regardless of what happens to Herbalife, who can easily fit under the bus - perhaps with a flesh wound to the wrist.

The reason for this is based in the Amway decision and the manner in which it has been treated for the past 35 years. Essentially, after Amway, the general premise, reflected in Attorney Babener's quote, above, is that all pyramids who adopted, as did Herbalife, their version of the Amway Rules were treated as presumptively legal. In other words, relieving the FTC of the significant burden, created by Amway, of examining all MLM 'rules', on a periodic basis, to determine whether they meet the Amway test, in fact - not on paper - an impossible task.

Some FTC cases would be brought, either on technical grounds, or against select violators, ([FHTM](#) was sued by the

FTC in 2013, ten years after commencing operations, leaving over 350,000 victims and \$7.5 in restitution - or \$22 per victim) and the implication after FHTM was that those not sued were legal - or at least not illegal. This ongoing presumption of legality opened MLM to other countries, including China, to the extent that the US has \$30 billion annual revenues and worldwide revenues now total in excess of \$150 billion. It also opened the doors to US stock markets, where a large number of MLM offerings are listed and legality is presumed.

To my knowledge, and because of the massive task of validating 'rule compliance' of the hundreds of MLMs in operation, the FTC has not based any of its cases on data obtained from a MLM's version of the Amway Rules - either to prosecute as a pyramid, or perhaps even more informatively, to exonerate the MLM - as was Amway. I am unsure whether the FTC has ever asked for this information, at least in meaningful quantities. This would open a door which the Commission could not close. So much for the, positive, value of the Amway decision.

These issues and inquiries should not be limited to MLMs which are subject to enforcement concern. As stated, such efforts are already after the fact. If the FTC is serious about the Amway ruling then it should, on a routine basis, be examining the "rules" of all MLMs entering the field, so that those without adequate safeguards can be screened out before the damage has been done (and investors find themselves with worthless stock).

Again, these general policy procedures, concerning the validation of protective rules, ought to be of significant interest to market analysts and the financial press. Not the specifics of a particular ongoing investigation but the enforcement policies currently being implemented by the Commission.

Of particular significance in this respect is the [BloombergBusiness article by Matt Stroud](#) which concerns long-time FTC pyramid expert Dr. Peter Vander Nat, now retired. The article deserves to be read in its entirety. In summary, it indicates that the development of an FTC pyramid case is based not on recorded data but on the "square zero" approach of Commission

acquired data then processed by Dr. Vander Nat in an expensive and time-consuming manner - he was required to re-invent the wheel for each subsequent case. This guarantees those not subjected to this process will have a number of years before even the risk of prosecution exists - with essentially a presumptive label of legality and a significant window of opportunity to increase revenue and profits in the interim.

In Dr. Vander Nat's words:

"It is a process in which the prosecution takes so long that the deterrent effect is insufficient," he says, comparing it to people speeding on the highway. "A police officer can only stop one speeder while all the others race by."

In the context of this functional immunity enjoyed, at least by the top-level US based MLMs, is the fact that over 80% of their business is presently conducted overseas. Aside from evidence of saturation in this figure is the question whether cosmetic reforms in the US, regarding rule enforcement, which could well gain at least a pause in FTC enforcement interest, will be implemented in the other 80% of the customer countries where these companies operate, such as [Cambodia](#), with its obesity problems, or be used to enhance foreign status without any functional implementation of the rules in overseas venues.

China is a separate and critical package. Recent developments there raise risks of [government involvement](#), concerning pyramids, which would affect a substantial percentage of the foreign market. As a footnote to this situation, I note that [Harvard University has associated with Amway in respect to its China operations](#) also [here](#). There is no question that the Harvard association lends credence and endorsement to Amway in places other than China. I wrote President Faust and Dean Ellwood of the Kennedy School and asked whether any due diligence had been conducted in respect to the legality of the Amway program in the United States prior to this endorsement. I did not receive a substantive response and understood that to mean that a due diligence inquiry of Amway legality in the US had not been conducted. I understand Harvard receives about \$1 million/yr for its efforts.

Conclusions

It is my belief that the FTC faced such a substantial enforcement burden once the Amway ruling was decided - essentially requiring the physical examination of the internal records, "rules" of hundreds of MLM companies on a regular basis in order to determine that the millions of persons who join these offerings are adequately 'protected' that it has created an ambiguous and grossly ineffective enforcement posture - one that relieves it of this enforcement burden and essentially presumes MLMs to be legal unless the FTC chooses to prove otherwise. This is notwithstanding the "burden of proof" principle previously cited.

This posture is implemented by indicating

That there is no 'bright line' to define a pyramid, leaving all in a zone of presumed legality

That, as Dr. Vander Nat has indicated, making each pyramid prosecution a complex process guaranteeing an absence of public comprehension and the resultant delay -essentially immunizing the balance of the industry for several years. **"A police officer can only stop one speeder while all the others race by."**

That MLM/pyramid marketing is in a benign enough category that it warranted [exemption from the Commission's Business Opportunity Rule](#) even though there are few, non-franchise, business opportunities other than MLM and an abundance of documented victimization of MLM participants.

[Not even listing pyramid/MLM](#) issues as one of the top five priorities of the FTCs Consumer Bureau.

35 years after the fact, it is time for professional market analysts and the financial press to look into the enforcement deficiencies expressed here.

As I indicated, aside from the victims of these schemes and the diversion of entrepreneurial talent from an offering with a 99% failure rate, MLM/pyramid style offerings have structural elements of an endless chain - which, like a Ponzi, will eventually result in full saturation. In this eventuality, think Madoff or Enron, millions of citizens who own these MLM offerings will want to know why those who advised them, or their retirement fund, to purchase or retain this type of stock did not give adequate warning.

Readers of the financial press will ask why discussion of these matters, with some exceptions, has centered of the personalities of those involved in shorting or supporting a particular MLM stock rather than the somewhat more substantive issues raised in this article.

Another group, briefly mentioned, are legal academics. If any topic deserves to be examined by skilled, and objective, legal analysts not involved in the adversarial process currently in play it is this one. The victims have no organized group to speak on their behalf, they are politically invisible. This area, given its \$150 billion price tag, deserves a thorough legal analysis, for the benefit of the public in general. Sifting through the ashes, as with Madoff and Enron, will produce little professional reward.

I feel I should mention, and credit, William Ackman, who brought this to the surface after 33 years of functional dormancy, Michelle Celarier of the NY Post who has taken up the cause, Joe Nocera, who at least has recognized the relevant issues and mentioned them publicly, and others, such as Matt Stroud, who have dealt with discrete issues within this area. Also the many writers on Seeking Alpha who have expressed their concerns, not without resultant critical comment, and Seeking Alpha itself for providing a forum for matters such as this.

Appendix 11C

Keynote Remarks of FTC Chairwoman Ramirez at DSA Business & Policy Conference in Washington, DC – October 25, 2016

(footnote references at the end)

Direct selling, a \$36 billion industry, plays a robust role in the marketplace and has the capacity to provide consumers with valuable goods and services and an opportunity to try an entrepreneurial experience. The Federal Trade Commission, as you know, has been active in this area for decades.

We hear often from members of the direct selling industry, and one of the frequent themes is the negative public perception about how the industry operates. Multi-level marketers have a tremendous opportunity to address these concerns by enhancing transparency and fostering credibility across the industry. There are three important facets to this that I would like to address this morning: self-regulatory initiatives to improve compliance and level the playing field; realistic and candid communication about the limited nature of the earnings potential; and practices showing that MLM companies are making real sales to real customers.

I. Self-Regulatory Initiatives

The Direct Selling Association works persistently as the voice of self-regulation in this market. And, as DSA president Joe Mariano has emphasized, the DSA Code of Ethics can play an important role in modeling behavior for its members. I want to commend the DSA for the willingness it has shown to continue to work on and improve the Code Changes were made most recently in 2015 and 2016. Among other things, the DSA established a mechanism to handle complaints about the practices of member companies – and for the DSA to publish reports about those complaints – and included lifestyle representations in the definition of earnings claims

.And, as Mr. Mariano noted, the DSA plans to take further steps next year to bring greater transparency to the industry. It is encouraging to see both the steps that have been taken so far and the recognition that this work is far from finished. This activity also reflects that the DSA has heard, and is open to hearing, concerns from the FTC.

I would like to use the majority of my time to address two areas where multi-level marketers need to take effective action to halt the practices that understandably damage the credibility of the whole industry. One is misleading income representations; the other concerns business structures that are unfair or deceptive because they are not focused on real sales to real customers.

II. Legitimate MLMs Must Accurately Represent Business Opportunities

I will start with misleading income representations. Earnings claims, regardless of whether they are express or implied, are highly relevant to consumers in making

their investment decisions. In fact, we find that earnings claims are often the single most decisive factor in those choices. So it should be no surprise that the FTC takes earnings misrepresentations very seriously.

False and unsubstantiated earnings claims are deceptive and unlawful under Section 5 of the FTC Act. Unfortunately, however, our law enforcement experience shows that many MLMs continue to misrepresent the amount of money participants are likely to earn. In fact, in all of our cases against multi-level marketers, the FTC has alleged that the defendants made false earnings representations. These misrepresentations cause real harm to consumers, and they need to stop.

A legitimate multi-level marketer must accurately represent its business opportunity and what a participant is likely to earn. These representations must be truthful, non-misleading, and substantiated. Practically speaking, this means that multi-level marketers should stop presenting business opportunities as a way for individuals to quit their jobs, earn thousands of dollars a month, make career-level income, or get rich because in reality, very few participants are likely to do that. Although it may be true that a very small percentage of participants do have success of this type, testimonials from these rare individuals are likely to be misleading because participants generally do not realize similar incomes.

The fact that most MLM participants do not earn substantial incomes is not new. The low incomes received by most MLM participants is something that the DSA itself acknowledged more than a decade ago. In 2006, when commenting on the FTC's Business Opportunity Rule the DSA cited a 2002 National Salesforce Survey showing that the majority of direct sellers made less than \$10,000 per year from direct selling, with a median annual gross income of about \$2,400 or only \$200 per month.¹

Just last month, Mr. Mariano noted that the majority of multi-level marketing participants do not earn more than very modest incomes. I commend him for emphasizing that MLMs "must increase [their] efforts to ensure prospective distributors are fully aware...that for most, direct selling can [only] provide supplemental income. Most distributors will not realize replacement income, let alone a lavish lifestyle."²

It is time that MLM income representations matched the income reality of the majority of multi-level marketing participants. This means both explicit statements about how much a participant is likely to earn, as well as implied claims and lifestyle claims.

We all know examples of the obvious types of lifestyle claims that can be misleading: representations that participants can be "set for life" or "make more money than [they] ever thought possible" and images of expensive houses, luxury cars, and exotic vacations. But there are also problematic claims that are a bit more subtle, like claims that you can quit your job, "fire our boss," become a stay-at-home parent, travel the world, or

have the time and money to enjoy the “finer things in life.” These lifestyle claims – whether made through statements or images – are deceptive when made to a general audience because participants are unlikely to achieve them.

Now, some of you may be thinking that what I am saying does not apply to you because you do not make income misrepresentations and you prohibit your distributors from making income misrepresentations. However, simply prohibiting your distributors from making income misrepresentations is not enough. MLMs must take reasonable steps to monitor and ensure that participants are not misleading others about the business opportunity. In addition, MLMs should provide sufficient information and training to participants to ensure that they will adequately understand the business and will not be misled by others.

This message is consistent with the DSA’s Code of Ethics, which states that member companies must comply with and ensure that their independent salespeople adhere to the Code’s guidance on earnings representations. As you know, the Code prohibits false, deceptive, misleading and unsubstantiated earnings representations. And, as the Code acknowledges, FTC case law provides ample guidance on the subject. I urge you to review FTC precedent and ensure that any income claims you and your distributors make accurately and truthfully reflect distributors’ likely earnings.

III. Legitimate MLMs Must Be Driven by Real Sales to Real Customers

Let me now turn to the second main problem we see in the MLM industry, namely, that many MLMs have structures that are unfair or deceptive because they are not focused on real sales to real customers.

A legitimate multi-level marketer must be focused on, and must pay compensation that is based on, real sales to real customers, not wholesale purchases by its sales force. This is a familiar concept, but I want to spend a few minutes breaking it down and showing how it animates FTC enforcement efforts. You can find the concept embodied in Commission decisions reaching back more than forty years, like the 1974 Holiday Magic opinion, which stressed the importance of basing multi-level compensation on actual product sales rather than on purchases by recruits.³ And, as the Ninth Circuit’s decisions in *Omnitrition*⁴ and *BurnLounge*⁵ made clear, MLMs that pay compensation for product purchases by recruits, rather than for actual sales to customers, are facially unlawful.

As a practical matter, what does it mean for a multi-level marketer to base compensation on real sales to real customers? There are four aspects of this core principle that I want to emphasize:

- First, a legitimate MLM must be focused on real customers;
- Second, a legitimate MLM opportunity must be based on sales that are both profitable and verifiable;
- Third, a legitimate MLM should not use targets or thresholds that are met by mere product purchases; and
- Fourth, the compensation paid by a legitimate MLM must be tied to retail sales.

I will start by explaining what we mean by “real customers.” Simply put, products sold by a legitimate

MLM should be principally sold to consumers who are not pursuing a business opportunity. For good reason, the law has always taken a skeptical view of paying compensation to someone based on the presumed “internal consumption” or “personal consumption” of recruits who are pursuing a business opportunity.⁶ When a product is tied to a business opportunity, experience teaches that the people buying it may well be motivated by reasons other than actual product demand.

One of the more vivid examples of this comes from the *BurnLounge* case. The activities of the *BurnLounge* defendants included selling packages of music-related merchandise. Before the FTC brought its enforcement action, anyone who wanted to participate in the business opportunity was also required to buy a package. *BurnLounge* had monthly revenues of over \$475,000 from package sales, but those revenues did not reflect consumer demand for *BurnLounge*’s merchandise.⁷

After the FTC filed suit, charging that *BurnLounge* made deceptive income representations and paid compensation that was tied to recruitment rather than the sale of merchandise, the court entered a preliminary injunction that radically changed *BurnLounge*’s operations. Under the preliminary injunction, distributors could still buy *BurnLounge* products if they liked the merchandise, but they could no longer advance in the business opportunity. What happened to sales? In only two months, they plummeted from over \$475,000 to less than \$11,000.⁸ As it turned out, at most, only a small minority of sales had been motivated by actual product demand, whether internal or external.

So, what does an MLM organized around real customers look like? You can see one approach laid out in the recent consent order we obtained in the *Herbalife* case.⁹ The order identifies two classes of people who are not pursuing the business opportunity: “retail customers” who simply buy product from *Herbalife* distributors and do not have any direct connection to the company; and “preferred customers,” who have registered with *Herbalife* as customers and do not participate in the *Herbalife* business opportunity.¹⁰ Under the order, there

are a number of requirements that are intended to ensure that preferred customers represent a genuine class of discount buyers and are not simply business opportunity participants under another name. Preferred customers, for instance, are not permitted to resell product, recruit, or receive multilevel compensation.¹¹

The *Herbalife* order also reflects the law’s justified skepticism of compensation based on the presumed “internal” or “personal” consumption of recruits who are pursuing a business opportunity. To address this issue, the order incorporates a number of provisions that impose reasonable limits on the compensation paid for the consumption of products by business opportunity recruits. I will highlight one in particular: at least two-thirds of the compensation paid by *Herbalife* must be based on sales to retail customers or preferred customers, not on consumption by business opportunity participants.¹²

The second issue I want to highlight concerns the meaning of “real sales.” “Real sales” are sales that are both profitable and verifiable.

To a certain extent, this is just simple logic. An MLM that pays compensation based on claimed sales that do not generate a net profit for the individual making the sale, or that cannot be verified as sales, cannot reasonably be characterized as based on “retail sales.” And, of course, decisions like *Omnitrition* and *Holiday Magic* have long recognized that compensation should be based on “actually consummated sales” to consumers.¹³

The *Herbalife* order also shows how these principles can play out in the operations of an MLM. It requires that retail sales that generate multi-level compensation for a participant, or that advance a participant in the business plan, must be both profitable and verifiable. Herbalife is required to collect verification information for every claimed retail sale and take all reasonable steps to verify that these sales both occurred as reported and represent genuine purchases by a true customer.¹⁴

Third, a legitimate MLM should not use targets or thresholds to satisfy eligibility for compensation or rewards that are met by mere product purchases. Because the focus of a legitimate MLM, and the basis for the compensation it pays, must be real sales to real customers, business opportunity participants should buy product only in response to actual consumer demand. For this reason, any requirements or incentives that participants purchase product for reasons other than satisfying genuine consumer demand – such as to join the business opportunity, maintain or advance their status, or qualify for compensation payments – are problematic. As you will recall from the *BurnLounge* example, these incentives can be powerful. There the defendants were selling nearly a half-million dollars of merchandise every month and almost all of those purchases were driven by the desire to get ahead in the compensation plan rather than by genuine product demand.

Under the *Herbalife* order, the company is prohibited from imposing any requirement that a business opportunity participant purchase a minimum quantity of products. It also prohibits business opportunity participants from joining an automatic-shipment or similar program involving standing orders of product. And, targets or thresholds are permitted only if they are met exclusively through sales to retail customers or preferred customers.¹⁵ These provisions underscore that an MLM should always be focused on making sales to real customers who are not pursuing a business opportunity. MLMs should not contrive ways to get their business opportunity participants to make purchases for reasons other than actual retail demand.

The fourth point I want to highlight is that compensation paid by a legitimate MLM must be tied to real sales to real customers. If an MLM’s participants buy product that does not result in real sales to real customers, this revenue should not be used to fund compensation.

It goes without saying that a legitimate MLM should not pay compensation solely for enrolling or recruiting a new participant. This means there should be no headhunter fees, recruitment bounties, or anything else of the sort.

For example, in *Herbalife*, we are requiring the company to track the percentage of wholesale revenues earned from product that is (i) sold to a retail or preferred customer, or (ii) within the limits established for compensating reasonable personal consumption by

business opportunity participants. If at least 80% of Herbalife’s wholesale revenue is not accounted for within these categories, the order imposes a cap limiting the total amount of compensation Herbalife can pay to its participants.¹⁶

What does this mean in practice? If, hypothetically, half of the product that Herbalife sells wholesale results in verifiable retail sales as defined by the order and half does not, the total rewards that the company can pay are limited to the 50% that consists of verifiable sales to customers. On the other hand, if the vast majority of product purchases are genuine retail sales, total compensation can be higher. And if they are not, then the total compensation will be much lower.

All of the points I have highlighted are intended to operate in combination to provide reasonable assurance that product purchases will be driven by real product demand. Providing this assurance is both appropriate and necessary; it is not enough for an MLM to simply assume the existence of real sales to real customers.

Finally, I want to note that, although this is less common today, in the past some MLMs have sought to rely on policies similar to those referenced in the Commission’s 1979 Amway decision – specifically, the so-called “buy-back,” “70 percent,” and “10 customer” rules – as a sufficient basis for assuming that their product is purchased by real customers to satisfy genuine demand. This reliance is misplaced. The Commission found those policies were effective given the specific facts in Amway,¹⁷ but neither the Commission nor the courts have ever endorsed those policies for the MLM industry at large.¹⁸ Indeed, the existence of a refund policy and a low refund rate do not necessarily mean that consumers are satisfied with their business opportunity, and both the “10 customer” and “70 percent” rules offer, at best, weak and attenuated evidence of a business focused on real sales to real customers.¹⁹

IV. Conclusion

Let me conclude by thanking you for allowing me to share some of my thoughts about reforms that the MLM industry should undertake in order to operate lawfully and prevent consumer harm. The industry’s self-regulatory efforts to date are steps in the right direction, but more needs to be done.

For our part, the FTC will be issuing further guidance for MLMs, but I believe the principles that I have outlined today should provide an important foundation for structuring business practices in the MLM industry in a way that provides consumers with truthful information and helps prevent customer harm.

Thank you

Footnote references:

1 Direct Selling Ass’n, Comments on the Notice of Proposed Rulemaking for the Business Opportunity Rule at 15 (July 17, 2006), available at https://www.ftc.gov/system/files/documents/public_comments/2006/07/522418-12055.pdf

2 Joseph Mariano, Learning and Building on Collective Experience, DSA News (Sept. 1, 2016), available at

http://directsellingnews.com/index.php/view/learning_and_building_on_collective_experience

3 In re Holiday Magic, Inc., 84 F.T.C. 748, 1042-43 (1974).

4 Webster v. Omnitrition Int'l, Inc., 79 F.3d 776, 782 (9th Cir. 1996) (explaining that an MLM operation is facially unlawful if a participant earns compensation based "on product orders made by [his] recruits" rather than "on actual sales to customers").

5 FTC v. BurnLounge, Inc., 753 F.3d 878, 885-86 (9th Cir. 1996) (citing with approval the issuance of a preliminary injunction against an MLM in which "rewards are received by purchasing product and by recruiting others to do the same").

6 Id. at 886-88 (rejecting claim that business opportunity participants bought product packages for their own use and finding "[t]he merchandise in the packages was simply incidental"); *Omnitrition*, 79 F.3d at 783 (rejecting argument that a business opportunity participant's use of products represents a sale to an ultimate user).

7 See *BurnLounge*, 753 F.3d at 885.

8 Id.

9 See FTC v. Herbalife Int'l of Am., Inc., No. 16-5217 (C.D. Cal. July 25, 2016) (Stipulated Order for Permanent Injunction and Monetary Judgment) [hereinafter *Order*]

10 Id. at Def. I, N.

11 Id. at Def. I, § I.B.

12 Id. at §§ I.A.1.d, I.A.4

13 *Holiday Magic*, 84 F.T.C. at 1043 (compensation must be "based on actually consummated sales of such recruits to consumers"); see also *Omnitrition*, 79 F.3d at 782 (compensation must be based on "actual sales to consumers").

14 See, e.g., Order Def. M, §§ I.C, I.D, I.F.2.

15 Id. at §§ I.F.1.- I.F.3.

16 Id. at § I.A.4.

17 In re *Amway Corp.*, 93 F.T.C. 618 (1979)

18 See, e.g., *Omnitrition*, 79 F.3d at 784 (observing that holding in *Amway* was no broader than specific factual findings of that case).

19 See *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1098 (9th Cir. 1994); *Omnitrition*, 79 F.3d at 783.

Appendix 11D

How to Start a Pyramid Scheme that Is Very Profitable for the Founders – and Get Away with It

By Jon M. Taylor, President, Consumer Awareness Institute

Given the current passive regulatory environment and DSA-promoted weakening of laws against pyramid schemes, it is interesting to see what a person motivated to create and profit from a pyramid scheme might do. One could very deliberately accomplish this and get away with it by following these steps:

1 Decide on a compensation system (binary, breakaway, matrix, etc.) that would operate in pyramid fashion using products as a vehicle for getting people to pay into the pyramid. Offer a complex system of incentives for progressing to higher and higher levels through intense recruiting, with upline participants getting as much or more per sale as the person actually selling the products – to fuel recruitment into an expanding pyramid of participants. The income to those at the top of their respective pyramids will be huge from leveraging the efforts and purchases of hundreds or even thousands of downline participants. Everyone will recruit like crazy to get to the top level. *[Beautiful!]*

2. Develop a product that has emotional or mystical appeal, is too unique to be compared with something that could be purchased at retail outlets, and is highly consumable. For simplicity, hire a qualified nutritionist or herbalist to search the scientific journals for some newly-discovered substance that has been shown (even if only minimally) to help prevent cancer, minimize heart disease, slow aging, enhance sexual function, and/or stimulate energy and brain cells. It is best if this substance comes from some exotic rain forest or other remote location. *[Many consumers will think anything this exotic with such magical benefits must be perfectly OK even if health consumer advocates warn against it.]*

3 Then combine this exotic substance with proven ingredients found to be effective for combating certain ills and arrange to have it manufactured by any of a number of formulating companies that do this routinely. But make certain it is unique enough that it cannot be compared with existing off-the-shelf products. This will enable you to price it well above any competitive products sold in standard retail outlets.

4. Give your program a name that has a ring of success attached to it, such as “Wealth Plus.” Then give your product a magic sounding name, such as “Health Plus.”

5. Price all of the variations of the product at a price that allows plenty of margin to support the distributor network that will sell it, with a nice profit margin for your firm. *[This margin would be large enough that it could be considered the pyramid premium contribution to your pyramid scheme. But don't tell anybody.]*

6. Since the product cannot be compared exactly with any existing product, you may produce it for \$3 or \$4 a bottle, while listing it for sale to consumers for \$60-70 a bottle. Of course, participants in your scheme would be able to buy it wholesale for about \$40. *[What a great way to fool the regulators! Participants may actually be paying \$20-\$30 a month from the pyramid premium portion of the price—or large multiples of that amount— into the pyramid, but because of the “legitimate product” disguise, this can be done over and over ad infinitum without detection and appear perfectly legal – especially if purchased “for personal use or consumption” (Some DSA-initiated state legislation allows this).]*



7. Prepare literature touting your formulation as one of the greatest advances in nutrition, and offer it in conjunction with a compensation system that is "truly a revolutionary money-making program," one destined to make those persons who "get in on the ground floor" an obscene amount of money – or at the very least, a nice "residual income" for the rest of their lives. Promise them an early retirement with the money to travel or pursue their favorite interests if they will get in early and build "an organization." Even students and financially strapped prospects will see the MLM as their chance to enhance their income. *[But we won't tell anyone that a participant has to work his tail off recruiting a large downline to realize any actual profits after expenses.]*

8. Set up your compensation plan so as to create the illusion for recruits that they can achieve success. *[Hire a statistician to hide the numbers so that new recruits and enforcement agencies will not realize that this "great opportunity" will be profitable primarily to you and the participants at the top of the pyramid.]*

9. Set up minimum purchase requirements and volume incentives to qualify for progression into ascending distributor payout levels. Make these volume requirements high enough that participants will be on a continual treadmill trying to achieve that "next level." Remember, purchases by participants is the engine of any product-based pyramid scheme. *[In some states with statutes influenced by the DSA, an MLM is not a pyramid scheme as long as it has an inventory buyback provision – or (in other states) as long as purchases are for personal consumption by any one (including participants).]* Of course, to comply with the FTC's "Amway rules," it would be best to write into your "Policies and Procedures" manual the requirement that 70% of the products must be sold at retail to at least ten actual (non-participating) customers to give credence to your claim to be a direct sales company. *[Fortunately, you know that you won't need to enforce the rule, as no one in law enforcement will check up on you.]*

10. Join the Direct Selling Association (DSA). If you encounter any suspicion that your actual customers are participants stocking up on products, enlist the help of the DSA to make the case that you are a legitimate direct seller. *[Of course, with DSA-influenced legislation in place, there is really no need to sell products outside the network of participants,, except for a few "preferred customers" to give the appearance that you are doing legitimate direct selling. These could be close family members of participants - who may actually be funded by participants. Your newly recruited participants will be your primary customers. The sellers are the buyers and the buyers are the sellers. Who cares?]*

11. Put together a starter kit of sales materials, and enough products to get started. But check out local state laws regarding pyramid schemes to make certain the charge for the kit and products fall within what is legally acceptable. *[This is not hard to do. The impression of "legitimate products" is easy to satisfy. You may not even need an attorney will keep you out of hot water. You can conduct your pyramid*

scheme with impunity – so long as you sell products “for actual use or consumption.”]

12. Begin selling this pre-launch “ground-floor opportunity” to MLM enthusiasts and through MLM publications, announcing a launch date when all who enter can expect to prosper beyond their wildest dreams. Set up a web page and promote it heavily to those seeking an inside track on a “pre-launch opportunity.” *[They will scramble to be the “first ones in.”]*

13. Train the “ground floor” participants in how to recruit, advertise, hold opportunity meetings, etc. *[and most of all – to stock up on products to “build their downline.” Better yet, promote monthly product subscriptions to qualify for commissions. This avoids the charge of front-end loading.]*

14. Pump up new recruits with promises of huge paychecks soon to come. They will even pay to attend weekend retreats and “sales training” programs *[actually recruiting programs]*—and for tapes, books, company T-shirts, web sites, and all the other programs and paraphernalia that will help them to be “successful.” *[This can become a separate “ success tools” business, or a pyramid within a pyramid” – expanding the income of the top people – so you won’t have to reward and motivate them solely on product sales to participants.]*

15. Build your infrastructure as you go, developing new products and geographical divisions as needed to continue the illusion of a “ground-floor opportunity.” *[Or – If the “first wave” is successful—you can take your money and run as soon as market (de facto) saturation causes sales (to recruits) to level off.]*

16. Spend some of your abundant supply of money supporting the political party in power. Donate to the campaigns of all likely candidates for Attorney General, regardless of party. *[They will then be obligated to indefinitely delay action should any zealous investigators suspect you are conducting a disguised pyramid scheme.]*

17. Donate to university scholarship funds and popular charities, making certain

that timely press releases accompany all such giving. Support local athletic programs, with priority to highly visible scoreboards and other showy paraphernalia. *[Enforcement agencies will not get popular support for going after an MLM that is doing so many good things, if your largesse is well placed and very noticeable.]*

A reader, Numa Roch suggested the following additions, which I’ve paraphrased:

Master the art of entertainment, seduction and rhetoric to use in meetings with prospects. Assure them that it is easy to attract new recruits. Use selective honesty right from the start by telling them that success requires hard work. Once they have signed up, change your discourse slightly and educate them to work hard. “If you really want and work hard, you can do it.” You might even create an atmosphere of exclusivity: “Only a few privileged make it through.” Draw parallels to the real world. “Only a few become tennis stars,” etc.

Anticipate the employee turnover by convincing your organization that willpower is the only variable for success or failure and that there are no other variables. “You and only you are responsible if you succeed or fail.”

Steal the thunder of critics by mimicking them. Give yourself the aura of sound morality by publishing guidelines for protection from unethical individuals or organizations. Repeat your main points endlessly. Use NLP, hypnosis, seduction, subtle manipulation, brainwashing, etc. The ends justify all means.

NOTE: After you’ve proven that you can build and profit from – and get away with – starting a pyramid scheme, please donate the profits to charity – or to exposing MLM fraud. These instructions are given merely to illustrate a point. Unfortunately, in the current regulatory environment, one can generally initiate and profit from an exploitive product-based pyramid scheme with impunity.

Chapter 12

IS MLM A MORAL AND ETHICAL BUSINESS MODEL?

This question can be answered in one word –

No!

(over)

Is MLM a moral and ethical business model? (continued from page 1)

If one has read the prior chapters, the answer to the question posed in the chapter title is all too obvious. From decades of analysis of packaged home business opportunities, it is clear to me – and should be to anyone who reads this book with an open mind – that MLM is the most unfair and deceptive of them all. In fact, it would be difficult to conceive of one to top it.

All recruitment-driven MLMs⁶¹¹ (which are virtually all MLMs) are built on endless chains of recruitment of participants as primary customers. As such, their compensation plans assume an infinite market, which does not exist in the real world. They also assume virgin markets, which don't exist for long – which means they either collapse or re-pyramid into new markets. They are therefore inherently flawed, deceptive, and unprofitable except for the founders and those at or near the top of a pyramid of participants – which are often those who got in at the beginning of an endless chain of recruitment. Worldwide feedback also convinces me they are also extremely viral and predatory, defrauding millions of victims in vulnerable populations that can least afford to suffer losses.

In fact, my research shows that MLM is the most harmful category of pyramid schemes. With a much higher loss rate and promoted with typically far more misrepresentations, MLM is more unfair and deceptive than classic no-product pyramid schemes, which are treated as illegal by the FTC on the grounds that they are inherently unfair and deceptive.

Since MLM as a business model is fundamentally flawed, unfair, and deceptive, the answer to the question of whether or not MLM is a moral and ethical business becomes self-evident.

If someone wants to explore further the moral and ethical issues relating to MLM participation, they may want to read Dean VanDruff's classic article "What's Wrong with Multi-level Marketing." Go to – www.vandruff.com/mlm.html

In 1997, I completed a more thorough ethical analysis in my self-published book *The Network Marketing Game: Gospel Perspectives in Multi-level Marketing* (1997). The book describes my experience with a major MLM company (as told in Chapter 1 of this book) and my subsequent treatise called "The principles of True Wealth," drawn from "sages of the ages" – quotes from scriptures and some of the greatest books of all time. MLM is then compared with these principles, and a final score is given. The book was directed primarily to an LDS (Mormon) audience, which has been particularly vulnerable to MLM for a variety of reasons, which are examined; so many of the quotes are from LDS sources. Inquiries about the book can be sent to the contact address on my web site – mlm-thetruth.com. For a summary of some of the concepts in this book, see Exhibit 12a.

Another book on the ethics of MLM which was published the same year is *False Profits – Seeking Financial and Spiritual Deliverance in Multi-level Marketing and Pyramid Schemes*, by Robert L. FitzPatrick and Joyce K. Reynolds. To obtain copies and related reports, go to the author's web site – pyramidschemealert.org.

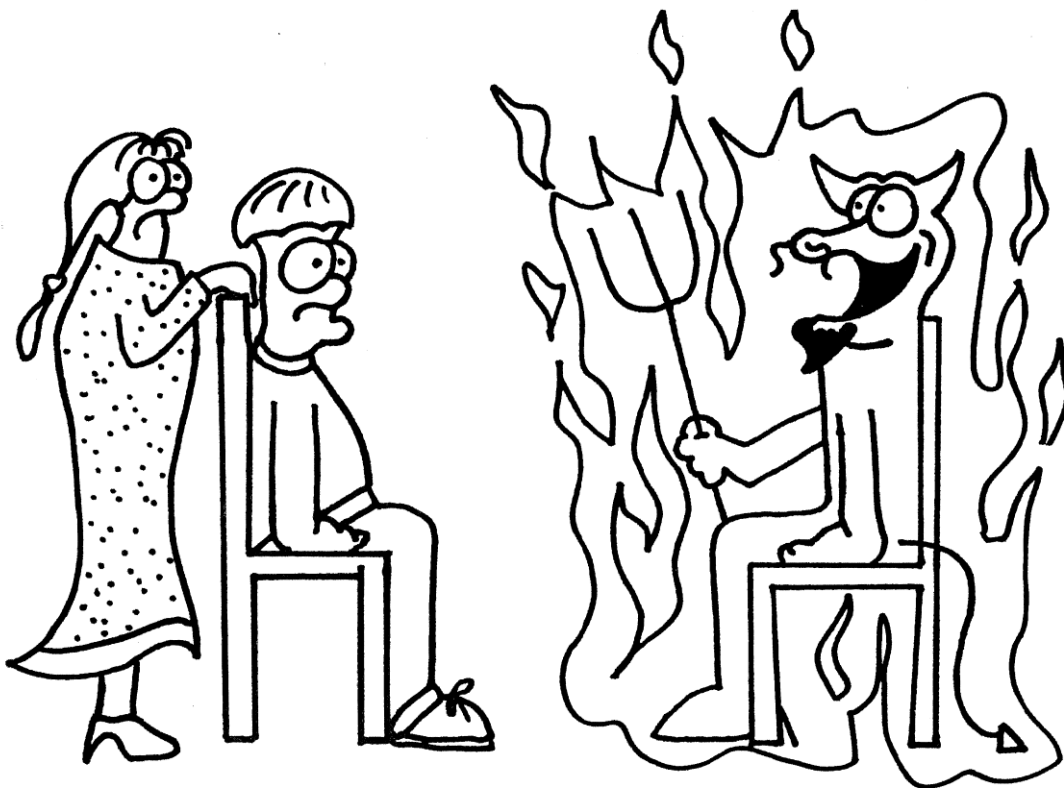
⁶¹¹ The compensation plans of all of the over 600 MLMs I have personally analyzed are recruitment-driven, based on the four causative and defining characteristics of product-based pyramid schemes, or recruitment-driven MLMs. (See 5-step do-it-yourself evaluation on the independent research-based web site – mlm-thetruth.com).

The only possible exception to this is the party plan model, which depends at least in part on sales to non-participants. However, even for party plans, the top levels of the compensation plan must be analyzed closely to see if they are recruitment-driven and top weighted.

Exhibit 12A

The promises of MLM do not equate to a moral and ethical way of life.

How MLM is typically promoted	A more moral and ethical approach
This MLM offers a truly unique path to the riches you deserve. Get in on this great opportunity and earn a lifetime of residual income, so you will never have to punch a time clock again.	There are literally thousands of ways to earn a comfortable living. Find out what interests you and where you can make a valuable contribution, and in addition, where you can be successful without deceiving or defrauding others.
In MLM, the income potential is huge. We have high level distributors who are making millions, and you could be one of them. <i>(No matter how much money you make, to do so at the expense of a multitude of downline victims losing money is immoral.)</i>	The huge income potential is only for those who got in early, The emphasis on income potential is like worshipping a golden calf. Be satisfied with earning what you need from honest work. Spend your spare time serving others and & enjoying friends & family..
By succeeding in MLM, you will win the respect and admiration of others. People who are rich are certainly more respected than people who are poor.	People who care about other people, who are honest in their dealings, and who contribute to society deserve our respect and support more than those who get rich by questionable means.
Slaving at a dead-end 9-to-5 job is foolish. You don't need to be at the mercy of your boss, trading time for money.	There is nothing wrong with an honest day's pay for an honest day's work. Work is respectable. We can work and save and plan ahead for a comfortable future through wise use of our resources.
Riches will make you happy. The more money, the better. A prosperous life is a good life.	There is little correlation between riches and happiness. Contributing our time and talents and efforts to society and to serving others does yield happiness and satisfaction.
You can take pride in what this MLM will bring to you – nice cars, plush living quarters, world travel – money for whatever you want.	Truly caring people will seek the well-being of others as well as the finer things of life for themselves. (Pride and vanity are not qualities to be admired.)
Learn our system (which includes a litany of deceptions), and you will not fail.	Living by principles of honesty and integrity pay off in the long run.
If you will just believe (in this MLM), you can achieve.	Believe and trust in God and love your fellow man.
Recruit a large downline of friends, family, and others to get ahead	There are many ways to earn an honest living without exploiting friends and family – and others.
Prioritize your time to build a downline so that you can enjoy residual income for the rest of your life.	When building a fortune becomes our primary focus, we lose something of our humanity.
It is better to make 1% off of the efforts of 100 people than to make 100% on your own efforts.	Take satisfaction in whatever service you provide to others, whether you own a large company, are employed by others, or work for yourself.
The gold rule.	The golden rule.



It's a *great* program - you'll love it. First, you sell me your soul. Then you get five distributors to sell me their souls. Then each of them gets five distributors . . .

- Cartoon by my son Kristopher Taylor when he was in his teens

Chapter 13: ACTIONS NEEDED – How to protect oneself from MLM abuse, how MLM victims can recover losses, how families can deprogram loved ones victimized by MLM, and what regulatory agencies, the media, and academia can do protect consumers

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Introduction and summary

Why are MLM companies successful in defrauding millions of victims of tens of billions of dollars every year and in evading actions by law enforcement? A primary reason is the lack of determined action by participants and family members impoverished and confused by these schemes. To understand why MLM victims seldom file formal complaints with law enforcement or with the Better Business Bureau, read Chapter 9.

However, with determined effort, you can often recover much if not all of your losses and in the process alert others and law enforcement of the ongoing fraud in MLM. So please – speak up and act! Below are 15 concrete actions you can take.

Get Informed.

You are off to a good start reading this book. Most participants who lose money in MLM's drop out without knowing what went wrong. They typically blame themselves for not "working the system," or they may fear consequences to or from their upline or downline – often close friends or relatives.. So they don't file complaints. Also, they often believe that if the program were illegal, it would have been stopped by authorities – who simply don't have the resources to stop the abuses, and who won't act without a highly vocal group of complainants.

So get informed by reading this book or the MLM consumer guides and MLM research posted on the research-based web site – www.mlm-thetruth.com – and others recommended there. And if you know an MLM victim who is wondering why MLM has not worked for him/her, see if you can't get them to go through our "12-step Program for Deprogramming MLM Victims." (Appendix 13C)

Complain – and loudly!



1. File a Complaint with the [FTC](#). If you want timely action, don't hold your breath waiting for the Federal Trade Commission to act – even though it has the primary responsibility for protecting fair trade on a national level. Part of the problem is the 1979 FTC ruling that Amway was not a pyramid scheme, conditioned on certain "rules" which are almost impossible to police and are generally disregarded. So the FTC has egg on its face on this issue. But if enough people place pressure on the agency to demand action, they have been known to take some constructive steps, as they did in conjunction with some states to shut down a handful of MLMs.

However, for every one product-based pyramid scheme (MLM) the FTC has acted against, there are at least 100 that escape FTC attention. The FTC has become corrupted by cross-fertilization between agency personnel and representatives of the DSA/MLM cartel (my term). The latter quickly offer lucrative positions to former FTC personnel to lobby their former agency. And the Bush administration rewarded Amway for its generous political contributions by appointing MLM supporters to key posts at the FTC.

The Obama administration was distracted by a faltering economy and other serious problems and did not get to the issue of widespread MLM fraud before the Republicans regained control of the House in 2010. Consequently, the FTC has done very little to prosecute product-based pyramid schemes in the past 10 years. Still, even though other avenues of redress are likely to be more effective than the FTC, official complaints need to be filed with them, so the FTC is denied the excuse that they are getting few complaints about MLMs.

Important note. The FTC recently issued its Business Opportunity Rule requiring sellers of business opportunities to disclose certain information that would help prospects make a good decision. Unfortunately, the FTC yielded to pressure from the DSA/MLM lobby to exempt MLM from the ambit of the Rule. Although their efforts were successful, the FTC pledged to use Section 5 of the FTC Act to go against MLMs if they are engaged in "unfair and deceptive acts or practices."

So that is your justification for filing a complaint with the FTC against the MLM that has misled and defrauded you. Insist that the FTC make good on their promises to take action against such schemes if you have been hurt by one of them. You should find the information in this book helpful in preparing your complaint.

The FTC's promise (to act against violators of Section 5 of the FTC Act) is your justification for filing a complaint with the FTC against the MLM that has misled and defrauded you. Insist that the FTC make good on their promises and responsibility to take action against such schemes if you have been hurt by one of them.

2. File a complaint with the [SEC](#).

If the MLM is a publicly-traded company, the Security and Exchange Commission should know about it. They may do very little, as their resources for pursuing such small claims is limited. But it will make the MLM officials squirm a little.

3. File a complaint with the FDA (Food and Drug Administration).

If you suspect an herbal remedy (classified as a "dietary supplement") sold by your MLM has caused you or someone you know to suffer ill effect, the FDA should be informed about it. Also, if your MLM makes any claims that its product diagnoses, treats, prevents, or cures any ailments, the FDA needs to know because such claims can only be made of drugs, which the FDA does regulate.

4. File a complaint with your state's department of labor.

Report any possible labor violations. Even though MLM executives don't want participants classified as employees, they often treat them as such by exercising undue control, such as not allowing them to sell competing products or to sell at retail outlets or on eBay, etc. Report possible misclassification of employees as independent contractor, or at least ask for a determination.

5. File a Complaint with Your State's Office of Attorney General and/or Office of Consumer Protection. Regulators in only a few states have the resources and the will to take action, and typically they will only act when a large number of complaints come in. Fraud inherent in a compensation plan seldom draws attention by itself. However, by all means, file a complaint with your state's Consumer Protection Agency and/or Attorney General, even if only for the benefit of victims who are likely to be affected later.

Feel free to use any of the information in this book to help you in filing your complaint. Many state regulators are new or may lack fundamental information on the fraud inherent in the compensation plans of MLMs, or product-based pyramid schemes.

6. File complaint of tax fraud with the IRS and your state's Dept. of Revenue. If you believe the MLM is avoiding taxes by promoting the MLM as a tax write-off – though the odds of profiting are far less than gambling, which can only be written off to the extent of winnings – it would be useful for the appropriate tax authorities to know that.

7. File a Complaint with the Better Business Bureau. Remember that many if not most MLM's are members of the BBB. And their bulletin on "multi-level marketing" reads as though it had been written by the DSA (Direct Selling Association), which has become the MLM industry's lobbying arm and a powerful cartel protecting MLMs unfair and deceptive practices.

I should warn you that the DSA and leading MLMs are "corporate partners" of the BBB, which of course compromises their objectivity. But MLMs who recruit aggressively are not going to be happy with a record of unresolved complaints against them. So at the very least get on their list of complaints against an MLM whose representatives have defrauded you. And don't accept their resolution of the problem by sending you free products or some other tiny peace offering.

8. Write your Senator and/or Congressman. If you believe many of his/her constituents have been similarly ripped off, you could encourage an investigation and discourage MLM-friendly

legislation promoted by the DSA/MLM lobby. It wouldn't hurt to also contact your state legislators for the same reason.

9. File a Complaint with the Direct Selling Association. The DSA claims to act on complaints of violations of its so-called "Code of Ethics." If you think about it, though their MLM members routinely deceive and defraud participants in their programs, the DSA is eager to be accepted as an organization of legitimate direct sellers. Hold them to their pledge to regulate themselves with their own Code of Ethics.

10. File Complaints with all of the above – plus a letter to the president of the MLM company informing him or her of your actions. You dramatically increase your chances of some satisfaction if you do all of the above, simultaneously or in sequence. Be sure to write the president of the company and let him know what you are doing. But act quickly and firmly. This is not a time to hold back your feelings of outrage for being deceived and defrauded of your time and other resources.

One determined lady who lost almost \$7,000 in a prominent MLM did this very successfully. Having listed all the deceptions used in recruiting her, she wrote the FTC, the BBB and AG office (in her state and the state in which the MLM was headquartered), the DSA, and the president of the company, demanding payment in ten days. A check was sent by Federal Express for the full amount by the date specified.

11. If your purchases from the company are recent and you have the bank records, you may be able to get a refund by contacting the fraud or disputes department of the credit card company or bank you used to pay the company. If you have contacted the company first and gotten no satisfaction, you can contact the bank or credit card company you used to pay for purchases from the company. Explain how you have been defrauded, supply the documents (or ask them to pull them up electronically), and insist that they contact the company for a full refund. Many victims of various schemes have gotten refunds in this way.

Take legal action.

1. Pursue a Class Action Lawsuit.⁶¹²

This is a long process, but it sometimes gets better results in actions against MLM's than filing complaints with consumer protection agencies. Look for plaintiff attorneys with experience in business opportunity fraud.



2. File a Claim with the Small Claims Court in Your Area.

Your local small claims court could be an effective remedy in cases of blatant misrepresentation – which is common with MLMs. For this type of action, you do not need to hire a lawyer or go through a long and costly trial proceeding. Just state your case before the judge in your nearest Small Claims Court and include as much documentation as you can – promises made and broken, etc. You may be awarded an amount up to a limit of a few thousand dollars to recoup at least some of the losses you can prove. Use the information in this book – and on the web sites of those of us who advocate for consumers on this issue – to help you make your case.

You may find it easier to sue those TOPPs (top-of-the-pyramid promoters) in your upline who misled you with phony promises and misrepresentations than it is to sue the company itself, which likely has a team of attorneys. Upline participants seldom have sufficient assets to mount a serious challenge to such a claim, unless they are at or near the top of the pyramid of participants. At the very least you will find out how phony were the claims of wealth that were being made. In your effort to recover damages, it may pay you to name more than one upline recruiter who misled you, as well as the company itself in your claim.

3. Consider with your attorney filing RICO charges against the leaders of an MLM.

The Racketeer Influenced and Corrupt Practices Act⁶¹³ is a federal law that provides for extended criminal penalties and a civil cause of action for acts performed as part of an ongoing criminal investigation. While its' intended use was to prosecute the Mafia as well as others who were actively engaged in organized crime, its application has become more widespread.

Since MLMs often break both state and federal laws, the provisions of RICO could be applied. One of the most attractive features of the law is that if an individual harmed by the actions of such a “racketeering activity” (as MLM fraud) is successful, they can collect treble damages.

One determined lady (who had lost \$7,000) wrote the FTC, the BBB and AG office, the DSA, and the president of the company, demanding payment in ten days. A check was sent by Federal Express for the full amount by the date specified.

Support good legislation – and fight bad legislation or rules

Support good legislation against product-based pyramid schemes – as opposed to what the DSA – is promoting.

Be aware that many statutes are adequate as they stand, assuming they are understood and applied.⁶¹⁴ Even when product-based pyramid schemes manage to avoid prosecution as pyramid schemes (for reasons cited on the law enforcement page), they routinely engage in deceptive marketing practices, which may be easier to prosecute.

⁶¹² For a more complete discussion of class actions, See Chapter 10.

⁶¹³ RICO was enacted by section 901(a) of the [Organized Crime Control Act](#) of 1970 ([Pub.L.](#) 91-452, 84 [Stat.](#) 922, enacted October 15, 1970). RICO is codified as Chapter 96 of [Title 18 of the United States Code](#), 18 U.S.C. § 1961–1968.

⁶¹⁴ Review state statutes in Appendix 10G.

In any event, you would be doing yourself and other consumers a favor by resisting any moves by unwitting legislators to sponsor DSA-initiated legislation to "improve" laws against pyramid schemes, which in any way exempt MLMs that have legitimate products to offer. Remember, product-based pyramid schemes have been found to have the highest lost rates and to do the most aggregate damage of all the pyramid schemes. (See Chapters 7 and 10.)

Other actions you can take

1. Copy and E-mail a descriptive bulletin about this book and our web site to your favorite people. Another way you can help prevent losses by friends and family members is to share an important bulletin with them about the research and consumer guides on our web site – anyone who may at some time be confronted with a "once in a lifetime" MLM "opportunity." Copy and paste the bulletin into a message from you, and send it to everyone on your e-mail list of favorite people. Please be sure to add your personal recommendation that they likewise pass it on to friends and family on their e-mail lists - and that they do the same. See Appendix 13A for the "Pass-it-on Bulletin from Someone Who Cares."

2. Print and use "Answer Cards" to warn 5 people, ask them each to warn 5 more, and they each 5 more, etc. When someone attempts to recruit you or those you care about, refer each of them to this site and to other recommended links. Print on card stock and use the answer cards provided in Appendix 13B.⁶¹⁵

Aggressively promote an endless chain of truth-telling – as opposed to an MLM's endless chain of recruitment for gain. You can print copies of the suggested Answer Cards to distribute when people attempt to recruit you into any MLM – or whenever the topic comes up. If you or your family are besieged with MLM offers, you might try posting a notice on your doorway and/or on your car's license plate holder, such as: "We don't do drugs, porn, or MLM."

Warn 5 people, ask them to each warn 5 more, and they each 5 more, etc. Aggressively promote an endless chain of truth-telling – as opposed to an MLM's endless chain of recruitment for gain.

3. Help deprogram victims of MLM abuse. Apply the suggestions in Appendix 13C for deprogramming victims of an MLM.

If someone you care about has been victimized by MLM, you may wish to approach them with kindness and whatever else it takes to get them to proceed through the steps below. This information is especially useful because it is based on extensive independent research, rather than mere opinions. Effective deprogramming will be helped by rigorous study of these reports – especially in helping someone who has been powerfully indoctrinated with MLM propaganda, laced with a complex web of deceptions. If as a result of all this reading, you help them recover their perspective (and possibly some of their losses) and pursue a more ethical income source, it will have been worth it.

Of course this may not help with an "MLM junkie"; i.e., someone who has been brainwashed or "hooked" on MLM to the point that they have been in and out of several MLM's, only to fall farther and farther behind financially socially, spiritually, etc. – while stubbornly maintaining that "their time will come." As some wise person once said, "A person "convinced against his/her will is of the same opinion still." But a person who is sufficiently open-minded to read and reflect on this book or the reports on my web site will likely experience a change of thinking about MLM – and a new direction.

To my knowledge, no one who has read even half of the reports on my web site or the information compiled in this book with an open mind has continued to pursue MLM/pyramid/chain selling as an "income opportunity" – or even to regard it as such.

4. Watch – and encourage others to watch the excellent whiteboard video presentation "Pyramid Schemes: a

⁶¹⁵ Or print from a "Action Cards" pdf file from the web site – mlm-thetruth.com.

Primer⁶¹⁶ Although it refers primarily to Herbalife, the video provides a simple explanation of why MLMs like Herbalife are unfair and deceptive, causing almost all new participants to suffer losses.

5. Publish your experience and insights – in a book, in the press, and/or on the web. People have written articles or books about their experience with MLM, and some have gotten considerable attention in articles or on investigative TV news programs. Dozens of anti-MLM web sites are now available to the sincere seeker of truthful information to counter the deceptions in sites sponsored by MLM promoters.

These anti-MLM sites, combined with the bad aftertaste of MLM participation by ex-distributors, may have had more effect on discouraging MLM abuse than has all of law enforcement put together. This is an excellent example of the benefits stemming from the free flow of information on the web. As an example of a whistleblower's efforts, read "Nu Skin Attempts to Discredit its Whistleblower,"⁶¹⁷ which refutes charges Nu Skin circulated to news organizations about me. It includes my rigorous one-year test of the Nu Skin program before reporting my experiences.

A word of caution is in order about making claims or charging the MLM with fraud. Occasionally an MLM company will defend itself with a lawsuit against the complainant! Check out anti-SLAPP statutes in the state where you live to see how much freedom you have to tell your story or charge the company with something the MLM could use to file libel charges against you.

6. For the truly brave – Attend an MLM opportunity meeting and/or interrupt someone who attempts to recruit you or someone you care about. Pose some of the "Embarrassing questions guaranteed to make MLM promoters squirm" in Appendix 13D.

7. someone tries to recruit you into an MLM, you can save yourself the trouble of researching the MLM and doing all this debugging and calculating by asking the person who is recruiting you to show you his

tax returns for the past year. Then ask that others he has recruited in the past couple of years show their tax returns – or some proof that they have earned the promised rewards (less expenses). Be prepared for some blank stares and evasive answers.

Endless chain opportunity selling (MLM) is inherently unprofitable except for those at the top of a pyramid of participants. Almost any income opportunity is better. Read "1,357 Ways to Make More Money than in MLM" – available from on the web site – www.mlm-thetruth.com

Find a better income option

Find a better income option. Endless chain opportunity selling (MLM) is inherently unprofitable except for those at the top of a pyramid of participants. Almost any income opportunity is better. Read "1,357 Ways to Make More Money than in MLM/Network Marketing" – also posted on my web site. It not only lists many categories of income options that are more profitable than MLM, but offers suggestions about how to undertake successful self-employment. Then do a little research on the web and in your local bookstore. There are literally thousands of income options to choose from. Make sure you pick the one that best fits your interests, skills, and personal and financial situation.

Actions needed by law enforcement, the media, and academia

The need for better laws and enforcement of existing laws was discussed in Chapters 10 and 11. The FTC is the nation's "consumer watchdog" and should enact one or more rules to protect consumers from MLMs as a business practice, since it is likely the most unfair and

⁶¹⁶ www.factsaboutherbalife.com

⁶¹⁷ Appendix 1A in Chapter 1

deceptive of any income opportunity operating today. MLM abuse is not confined to specific MLMs. So taking action against MLMs on a case-by-case basis is ineffective, as hundreds of MLMs are operating under the same flawed endless chain business model, and the FTC does not have the resources to prosecute more than a few cases at a time.

Rules by the FTC and the states could require adequate income disclosure, a seven-day waiting period before any investment is made, and strict limits on projecting income possibilities in company literature and web sites. Modifying the Business Opportunity Rule to include ALL business opportunity sellers, including MLMs, would go a long way towards preventing consumer losses.

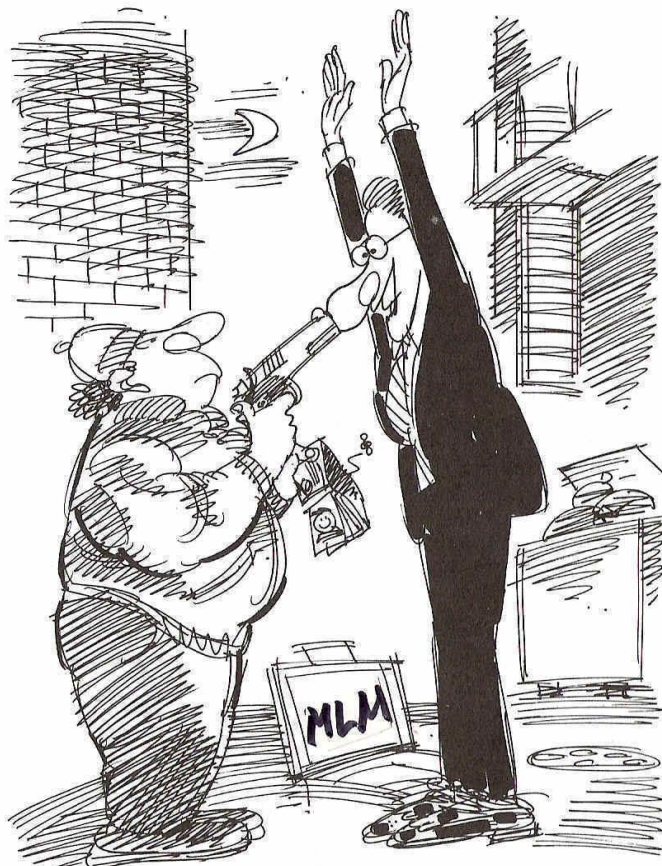
Media personnel could contribute to consumer awareness by becoming better informed on these issues before praising MLM companies or condemning MLM abuses. Hopefully, many will take the time to read this book as part of their research. The same would apply to teachers of personal finance, home economics, entrepreneurship, and related topics.

Conclusions for this chapter

Persons who have suffered losses in an MLM need not go away silently. Taking the decisive actions suggested here will help not only themselves but future victims by establishing precedents of consumer redress. In some cases, they may want to use an attorney to initiate collective action that could benefit thousands of victims. And it is important to promote and support effective laws and rules to protect all consumers.

It is also wise to learn about and pursue more legitimate income options. One need not accept the deceptive dialogue of MLM promoters who proclaim MLM to be the answer to our financial woes. There are better ways to skin the cat.

Law enforcement could provide a great service with better information, rules and regulations to better warn and protect consumers. The media and academia could also inform and warn consumers of the inherent pitfalls of MLM participation.



"What if five robbers were robbing for you and they each recruited five more robbers to rob for you?"

NOTE TO READERS: *Now that you have read some or all of this book, you will be better prepared to respond to those who inquire about or attempt to recruit you into an MLM program. But don't stop there. Please contribute to the well-being of five persons you have any influence over by referring them to this book or the research-based web site – mlm-thetruth.com. Ask each of those five persons to tell five other people about these resources, and that they each tell five more, etc. You can thereby start an endless chain of truth-telling.*

Appendix 13A

Pass-it-on Bulletin from Someone Who Cares

Consumer web site reports on 20 years' research and worldwide feedback – and analysis of over 600 MLM/network marketing programs

For unusually candid and well-researched reports on the MLM industry, go to the research-based web site www.mlm-thetruth.com, where you will find research and consumer guidance regarding MLM/network marketing, prepared with the assistance of top experts over a period of twenty years by Dr. Jon Taylor of the Consumer Awareness Institute. Opinions in publications and on web sites vary widely on MLM's legitimacy.

What is different about this site is that you will find objective research upon which to base analyses on MLM compensation plans and how they relate to success and loss rates, legal definitions, etc. In other words, you will have a basis for deciding whether or not to participate in a particular MLM – or any MLM – or to seek an alternate (and more profitable) income source.

Some of the more interesting features posted on this site include:

- 5-step do-it-yourself MLM evaluation quiz
- Over 600 MLM programs evaluated
- Free download of the eBook *Multi-level Marketing Unmasked*, which summarizes thousands of pages of research and feedback from victims and observers worldwide
- Frequently asked questions – and straight answers about MLM
- "Survey of tax preparers" - Tax professionals as a group know who is and who is not making any money in MLM.
- MLM statistics -The odds of success in MLM, compared with gambling and with no-product pyramid schemes
- "The FIVE RED FLAGS of a Product-based Pyramid Scheme"
- "Twelve Tests for Evaluating a Network Marketing (MLM) "Opportunity" - quoted by both pro and anti-MLM advocates and by consumer protection agencies

- Answer cards hand out to friends, family, co-workers, etc. – who attempt to recruit you
- Actions MLM victims can take to recover losses
- History of MLM and the status of efforts to regulate it

Investigative research and advocacy upon which these reports were based include:

Analysis of over 600 MLM compensation plans, and comparisons with alternative business models to clarify differences and possible harm

- Interviews with and feedback from thousands of MLM distributors and ex-distributors in a wide variety of MLMs
- Interviews with the top experts on pyramid schemes and with consumer advocates, agencies, and university research sources
- Surveys of hundreds of tax professionals where MLM is concentrated - representing thousands of tax returns of MLM participants
- Court records in MLM cases - including IRS income tax records of top distributors in one state
- Household consumer surveys regarding MLM participation
- Surveys of presidents of leading MLMs
- Private and public financial disclosures by MLM companies
- Communications with law enforcement officials at all levels
- Consulting and expert witness services for numerous MLM cases
- Advocating for consumers and encouraging the FTC and state regulators to protect consumers against MLMs' unfair and deceptive practices
- Direct experience with prominent MLMs

Again, to tap into valuable research reports and consumer guides resulting from this research, go to www.mlm-thetruth.com

Appendix 13B: ANSWER CARDS to be given to MLM recruiters

Copy on card stock, clip, and hand out those you find work the best for you.

Notice to all MLM recruiters

Thanks, but my odds are far better gambling in Vegas – and without squandering my social capital!

For more on the numbers for MLM, go to — www.mlm-thetruth.com.

You might want to download the book *Multi-level Marketing Unmasked*.

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

Here is my \$20 tribute payment for allowing me to keep my money and my friends.

Now – for your information, go to — www.mlm-thetruth.com.

You might want to download the book *Multi-level Marketing Unmasked*.

Then tell 5 people to do the same, and ask each of them to tell 5 others, and each of them 5 more, etc., ad infinitum. We can start an *endless chain of truth-telling*.

Notice to all MLM recruiters

Allow me to introduce MY NEW MLM PROGRAM. Go to — www.mlm-thetruth.com

You might want to download the book *Multi-level Marketing Unmasked*.

Then tell 5 people to do the same, and ask each of them to tell 5 others, and each of them 5 more, etc., ad infinitum. We can start an *endless chain of truth-telling*.

Notice to all MLM recruiters

When you achieve a net income (after ALL expenses) from your MLM program, show me your tax return as proof, and then I will look at it. Until then, I suggest you go to — www.mlm-thetruth.com

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

SORRY — but I don't do drugs, porn, gambling, or MLM.

Please do yourself a favor and go to this web site —

www.mlm-thetruth.com.

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

I'll make you a bet. Ask your recruiter to produce the tax returns of ten people showing a profit (who are not at or near the top of his upline, and I will pay you \$100. If you can't do it, you pay me \$100. Fair enough?

For more on the numbers for MLM, go to — www.mlm-thetruth.com

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

Please read the information on this web site – www.mlm-thetruth.com. Be sure to download the book *Multi-level Marketing Unmasked*.

Then go to the recommended [web sites on MLM](#) and read what is posted on each of them. Repeat this suggestion to 3 people you know. Ask each of them to repeat it to 3 more people, and each of them 3 more, etc. Start an *endless chain of truth-telling*.

Notice to all MLM recruiters

Let me spell out my answer: **N O**
Please do yourself a favor and go to this web site –

www.mlm-thetruth.com

You might want to download the book *Multi-level Marketing Unmasked*.

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

Sorry, but I don't need another tax write-off. Oh, and please show me the Schedule C from your tax return.

For more on the numbers for MLM, go to – www.mlm-thetruth.com.

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

I didn't go to school, to peddle Snake Oil to my friends and family.

Now – for your information, go to — www.mlm-thetruth.com

Then tell 5 people to do the same, and ask each of them to tell 5 others, and each of them 5 more, etc., ad infinitum. We can start an *endless chain of truth-telling*

Notice to all MLM recruiters

Didn't the Egyptians bury dead people at the bottom of Pyramids?

Go to —

www.mlm-thetruth.com

Then tell 5 people to do the same, and ask each of them to tell 5 others, and each of them 5 more, etc., ad infinitum. We can start an *endless chain of truth-telling*.

Notice to all MLM recruiters

You think you will make Money at MLM?

By the way, I have some ocean front property in Utah, and if you could just recruit 3 of your friends and family . . . Or even better, I suggest you go to –

www.mlm-thetruth.com

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

If I am going to swindle my friends and family out of their money I want to do it honestly – by playing poker! Please do yourself a favor and go to this web site – www.mlm-thetruth.com

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

A regular job may be like a small life boat but I'd rather be on one that floats than the MLM Titanic that sinks. For the truth about MLM, go to – www.mlm-thetruth.com

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

I would join your MLM to make millions, but someone is supposed to show up at my door any day now with a giant Publishers' Clearing House check. Be smart. Go to – www.mlm-thetruth.com

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

Donald Trump endorses MLM eh! Do you think he's dumb enough to join a pyramid scheme at the bottom level? Please do yourself a favor and go to this web site – www.mlm-thetruth.com

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

Please read the information on this web site – www.mlm-thetruth.com

Then go to the recommended [web sites on MLM](#) and read what is posted on each of them. Repeat this suggestion to 3 people you know. Ask each of them to repeat it to 3 more people, and each of them 3 more, etc. Start an *endless chain of truth-telling*.

This warning should be placed on all MLM products and promotional materials:
DANGER: This MLM program could be hazardous to your wealth!

Go to www.mlm-thetruth.com

Notice to all MLM recruiters

I would rather invest my life savings in a Saudi Arabian water company, than join an MLM. Please do yourself a favor and go to this web site – www.mlm-thetruth.com

Refer this site to 5 people, ask them each to refer 5 others, and each of them 5 more. Help start an *endless chain of truth-telling*.

Notice to all MLM recruiters

Before I consider your MLM offering, please show me Schedule C from your last IRS 1040 tax return.

Go to www.mlm-thetruth.com

Appendix 13C

12 steps for deprogramming victims of MLM abuse

If someone you care about has been victimized by MLM, you may wish to approach them with kindness and whatever else it takes to get them to proceed through the steps below. This information is especially useful because it is based on extensive independent research, rather than mere opinions. Effective deprogramming will be helped by rigorous study of these reports – especially for someone who has been powerfully indoctrinated with MLM propaganda, laced with a complex web of deceptions. If as a result of all this reading, they recover their perspective (and possibly some of their losses) and pursue a more ethical income source, it will have been worth it.

Of course this may not help with an “MLM junkie”; i.e., someone who has been brainwashed or “hooked” on MLM to the point that they have been in and out of several MLM’s, only to fall farther and farther behind financially socially, spiritually, etc. – while stubbornly maintaining that “their time will come.” A person convinced against his/her will is of the same opinion still.” But a person who is sufficiently open-minded to read and reflect on this information will likely experience a change of thinking about MLM – and a new direction. *To my knowledge, no one who has read this information or the reports on my web site with an open mind has continued to pursue MLM/ pyramid/chain selling as an “income opportunity” – or even to regard it as such.*

Step 1. Ask such persons to momentarily close their minds to all MLM propaganda messages and open their mind to some other possibilities. To start, ask them to read the [“Parable of the Missing Children.”](#)

Step 2. Ask them to obtain the compensation plan for the program they are into or are considering. Then have them evaluate the program with the [5-step do-it-yourself evaluation](#). They may find it helpful to read the side notes of explanation for each step and to find their program on the list of product-based pyramid schemes at the end, based on the “5 Red Flags.” For another approach, they may benefit from reading [“Twelve Tests for Evaluation of a Network Marketing ‘Opportunity.’”](#)

Step 3. For a good summary of what they need to know to be better informed, suggest they also read the summary if not the full 44-page report [“5 Red Flags of a Product-based Pyramid Scheme, or Recruiting MLM.”](#) This was prepared for the National White Collar Crime Center. They would also benefit from reading [“Frequently Asked Questions and Straight Answers about MLM.”](#) And if they motivated and curious enough to want to be fully informed, suggest they download and read the eBook [Multi-level Marketing Unmasked](#).

Step 4. Encourage them to track income and expenses to determine if they are actually profiting from the MLM. Show them the [MLM profit tracker](#). Then have them read what **tax preparers** have to say about who

if anyone actually reports profits from MLM participation. You might also suggest that they ask the person who recruited them to show the Schedule C of their latest tax return – which is not likely to show any profit from MLM participation.

Step 5. Challenge them to compare the [odds of success from MLM participation to classic no-product pyramid schemes – and with the odds of winning at gambling](#). These statistical analyses were drawn from analyses of no-product pyramid schemes, from actual reports from the MLM companies, and from casinos in Las Vegas.

Step 6. If they have been sold on the idea that their MLM products are the latest and greatest in “potions and lotions,” have them read [“High prices of MLM Products.”](#) (Do the supplements really work? Are MLM products overpriced? And can they be purchased for less?) They will also benefit from reading some of the many MLM and company and product reports by Dr. Stephen Barrett on his [MLM Watch](#) web site.

Step 7. They may want to know why – if all this is true.– such programs are allowed to exist or are not prosecuted by law enforcement. Refer them to “Frequently Asked Questions” – and to other reports listed on the home page related to law enforcement and how this situation developed following a ruling by the FTC in 1979 regarding Amway – that opened the floodgates of MLM abuse. Have them pay particular attention to why victims of chain selling programs remain silent.

Step 8. They would also be benefited by reading how MLM recruitment is dependent on a whole set of deceptions. *Over 110 misrepresentations are listed in the 8th chapter of the eBook referred to in Step 3.*

Step 9. If they question the information above on the basis of so much research coming from one source, have them go to the consumer-oriented [pyramidschemealert.org](#) web site. Particularly confirming is “*The Myth of ‘Income Opportunity’ in Multi-level Marketing,*” by Robert FitzPatrick, which is available for download from the site. Another classic article is [“What’s Wrong with Multi-Level Marketing,”](#) by Dean VanDruff. Several [other recommended web sites](#) post information and corroborating research leading to the same conclusions.

Step 10. If they ask what they can do to earn as much or more money than they can in MLM, refer them to [“1,357 Ways to Make a LOT More Money than in MLM/Network Marketing.”](#)

Step 11. If they have invested money in products or services sold by an MLM company to “do the business,” have them consider [“ACTIONS you can take when you have experienced losses from MLM participation.”](#) Encourage them to begin now converting from MLM addict to consumer advocate by warning 5 others, and asking each of those to warn 5 others, etc., etc.

Step 12. Then, after their MLM deceptions are debunked and they are fully deprogrammed, lighten their mood with some fun cartoons, humor, and satire to put things into perspective – posted on this web site, such as the all-too-true satirical piece (Please don’t actually do it.) – [How to Start a Pyramid Scheme and Get away with it.”](#)

Appendix 13D

For the bold and the brave – embarrassing questions guaranteed to make MLM promoters squirm

For those of you who are brave enough to challenge MLM promoters at opportunity meetings or in other recruitment settings, here are some sample challenges and questions you could pose – guaranteed to make these promoters squirm:

You claim that many people are profiting from your (MLM) program. What proof can you give to show that most people who put forth effort in your program actually file a profit on their income taxes?

This program you are promoting looks and feels a lot like an illegal pyramid scheme, with pyramid scheme investments merely laundered through product purchases. How can you prove it is not a cleverly disguised pyramid scheme?

It appears that your (MLM) program enriches a few at the top at the expense of a revolving door of recruits like us who buy products to get in on the deal, without any disclosure of the odds of our actually profiting from participation – after all expenses, including purchases from the company. How do you respond?

In major corporations, the country can be covered in four levels of sales managers – branch manager, division manager, regional manager, and national sales manager – and perhaps a fifth level to handle international sales. Why would you need eight (or ten – or an infinite number – or whole breakaway groups), other than to enrich those at the top?

If I as a distributor make a good income for the time spent selling the products, without recruiting a single person, can you give me the names of people who have earned a significant profit after expenses without recruiting anyone?

Would you please provide average net payout by the company (after subtracting product purchases) to all participants who ever signed up (or in the past 5 years, etc.), including those not now active?

How much are we expected to pay out in products, services, training, etc., over the next year, in order to be a serious participant? What percentage of persons who sign up ever earn in commissions enough to exceed purchases?

If – in order to qualify for commissions or advancement - we are expected to subscribe to minimum purchase requirements that are shipped automatically each month and paid for by automatic bank draft, isn't that merely making an investment in a product-based pyramid scheme?

Ask: "I want to be a Blue Diamond. How do I apply?" (Likely response will be laughter – or answer, such as, "You have to earn it.")

Your counter challenge: "You mean I have to recruit others into the program - or buy a whole bunch of products myself in order to advance to that level? Doesn't that make it a pyramid scheme?"

You talk of time freedom. If your top people are making so much money, why are they out recruiting, rather than enjoying the promised life of leisure? What percent of your top "distributors" are no longer actively involved with the company – and never attend opportunity meetings? Can you give me their names?

At other companies, internal conferences and training programs and materials are provided free of charge. Why do you charge for these conferences and for audio and videotapes, etc.? Is this just another revenue source for the company and/or for the upline?

Are the company's wholesale prices low enough to allow a respectable profit when marking up for resale – at a retail price that is still competitive with comparable products through other sources? (Or are retail prices so high that they must be sold at wholesale to achieve any volume – in order to advance in rank in the scheme?) What evidence do you have to show a high percentage of participants profiting from actual retail sales?

Carried to its logical extreme, how many planets would be required if everyone in this room were to achieve the promised income rewards for their recruitment efforts?

You say that a person can make money doing this part time. Can you furnish the names and telephone numbers or e-mail addresses of part-timers who are earning a good profit at this – AFTER subtracting purchases and other expenses? And have they reported profits on their income taxes from participation in this program?

FINAL CONCLUSIONS FOR THE BOOK

In the introduction of the book, many questions typically asked about MLM were listed. I believe they have been successfully answered – based not only on logical arguments, but on several research studies, worldwide feedback, and extensive evidence we have gathered.

The “easy money” appeal of MLM is often couched in terms such as “time freedom” or “residual income” and “unlimited income potential,” with success of recruits limited only by their efforts. MLMs are often sold as a viable alternative to an unfavorable job market and as a better route to retirement than traditional plans. One also sees a strong sense of belonging, or an “us versus them” cultish mentality.

MLMs (multi-level marketing programs) typically sell “pills, potions, and lotions” or other products that are consumable, that have unique appeal, and that can be claimed to deliver benefits not available elsewhere – to justify their high prices. Products or services sold at competitive prices through an MLM are rare.

With unlimited recruitment of endless chains of participants, all MLMs (multi-level marketing programs) assume an infinite market, which does not exist in the real world. They also assume a virgin market, which does not exist for long. In effect, MLM ignores laws of supply and demand, and unwitting participants are incentivized to recruit their own competition. As a business model, MLM is thus an inherently flawed, unfair, and deceptive practice. Also, with unlimited recruitment, MLMs can be extremely viral and predatory. The villain in any MLM is not the founders or leaders, but a fundamentally flawed system.

In addition to structural flaws in MLM as a business model, MLM is characterized by a litany of deceptions related to questionable and/or over-hyped products, earnings misrepresentations, and a host of related issues. Behavior of participants at “opportunity rallies” is often passionate, if not downright bizarre. Decent people sometimes change in ways that friends may find disturbing. MLM companies often display manic and other unusual behavior as well. A desperate effort to enter new

markets and sometimes with unusual new products reflects a preoccupation with the need to “re-pyramid” elsewhere to replace dwindling product sales in existing markets, since the customer base beyond network participants is often scant. Since position and timing is crucial to success in any pyramid scheme, “pre-launch” campaigns to “get in early to establish your position” are common.

After extensive comparative analysis, I was able to identify four causative and defining characteristics (CDCs, or “red flags”) in all MLMs. They are causative in that they cause the abysmal loss rates, and defining in that they clearly separate what I call “recruitment-driven MLMs,” or “product-based pyramid schemes” from all other forms of business activity. In a total sample of over 600 MLMs, I found these four CDCs in the compensation plans of all of them:

1. Unlimited recruitment of a network of endless chains of participants.
2. Rank advancement by recruitment, rather than by appointment.
3. Ongoing pay-to-play purchases required for commissions and rank advancement.
4. Top-weighted compensation plans, which enrich the founders and a few TOPPs (top-of-the-pyramid promoters) at the expense of a revolving door of new recruits at the bottom levels. These pay plans are upside-down from legitimate direct selling programs in which the bulk of the commissions are paid to the person or retailer doing the selling.
5. In addition, most MLMs have five or more levels in their hierarchy (pyramid) of participants – more than are functionally necessary to manage the sales function. These added levels serve no purpose other than to enrich the earnings of TOPPs. The most highly leveraged compensation plans are breakaway plans, such as is used by Nu Skin. (I use the term “leverage” to refer to the degree to which TOPPs profit from the purchases and recruitment efforts of their downlines.)

In all MLMs for which we were able to obtain data on average (gross) earnings of participants, the loss rates were abysmal – averaging 99.7% (after expenses and

including dropouts) – far worse than for legitimate direct selling or small businesses – and much worse than for no-product pyramid schemes.. And if you eliminate TOPPs (top-of-the-pyramid-promoters) from the calculation, the loss rate is closer to 99.9% for new recruits. In fact, the odds of profiting from a single roll of the dice playing craps or betting on a single number in a game of Roulette is many times the odds of profiting from any MLM. Yet many MLMs encourage participants to write off their expenses on their income taxes – which is not allowed for gambling losses.

In addition to the money lost, reports of harm to MLM participants include countless instances of maxed out credit cards, bankruptcies, foreclosed homes ruined careers, sacrificed educations, divorces, estrangement of extended families, lost friendships, and corruption of humanitarian programs and churches and other affinity groups who get involved. Some have observed addictive behavior in “MLM junkies” who hop from one MLM to another, in the vain hope of finding the “right MLM” that will work for them. Even suicides and murders related to MLM participation have been reported.

The 1979 FTC vs. Amway decision that Amway was not a pyramid scheme, assuming certain “retail rules” were followed (which has not been enforced), has resulted in tragic consequences for consumers in the USA and abroad. Since 1979, hundreds of millions of MLM participants world-wide have been defrauded of hundreds of billions of dollars.

From recent research and from decades of experience, the case can easily be made that MLM as a business model – and therefore all MLMs – are “unfair and deceptive practices” and should be considered per se illegal by the Federal Trade Commission⁶¹⁸ and by several states with statutes against unfair and deceptive practices. It is also common for MLMs to engage in false and misleading advertising in violation of state statutes.

Had the FTC had this information in 1979, and had the administrative judge been impartial and courageous, it is likely that

Amway and its hundreds of MLM clones would not exist to defraud people today. However, since the 1979 Amway decision, law enforcement has been unable or unwilling to stem the tide of MLM abuse. This is due in no small part to carefully placed political donations to political leaders and legislators that have influence on law enforcement at federal and state levels.

Unfortunately, the FTC failed consumers again in 2011 in exempting MLMs from having to comply with its new Business Opportunity Rule, requiring sellers of business opportunities to provide on a one-page disclosure document average earnings, to require a one-week waiting period before investing, and to limit promotion of income projections. Such measures could help prospects make a more informed decision. But the FTC yielded to a powerful \$4 million lobbying effort by the Direct Selling Association in cooperation with member MLM firms. This is an excellent example of what has been labeled “regulatory capture,” where an agency is heavily influenced and even controlled to some degree by the very types of businesses it should be regulating.

Ultimately, much of the inaction of law enforcement against MLM abuse is due to the silence of victims who rarely file complaints against MLM companies. This is due in part to their being taught that if they fail, it is their fault for not properly “working the system.” But I have found in working with victims that fear is also a great deterrent to filing complaints. Because MLM depends on endless chains of recruitment, every major victim has likely recruited friends and family members, and they fear consequences from or to those who are still with the MLM if they file a formal complaint. They also fear self-incrimination, since they have unwittingly defrauded others.

Based on 20 years of research and worldwide feedback, I feel confident asserting that MLMs are merely elaborate pyramid schemes – in fact, the worst by any measure – loss rates, aggregate losses, and number of victims. And whether or not MLM qualifies as a pyramid scheme in a legal system rife with obfuscated definitions, it is clearly an “unfair and deceptive practice” – the very type of activity the FTC was set up to protect against. Because of inaction by the FTC and other

⁶¹⁸ Section 5 of the FTC Act, 15 U.S.C. § 45, prohibits “unfair or deceptive acts or practices.”

regulators, consumers need to do what they can to get informed and protect themselves from MLMs' unfair and deceptive practices.

Considering the FTC's failure to effectively deal with this challenge, state offices of Attorney General and Consumer Protection may need to step up and take the lead in warning and protecting consumers against MLMs' systemic fraud. They could issue warnings on their web sites and use other communications outlets available to them. Non-profit consumer groups can also do much to warn those they serve.

I conclude by repeating the definition of multi-level marketing explained at the end of Chapter 2. Although lengthy, it is the only definition of MLM based on independent research:

Multi-level marketing (MLM) is a purported income opportunity, in which persons in company-sponsored pyramids of participants qualify for commissions and for rank advancement primarily by meeting "pay-to-play" purchase quotas and by recruiting others in endless chains of recruitment, and in which rewards are stacked in favor of participants at the top of the pyramid.

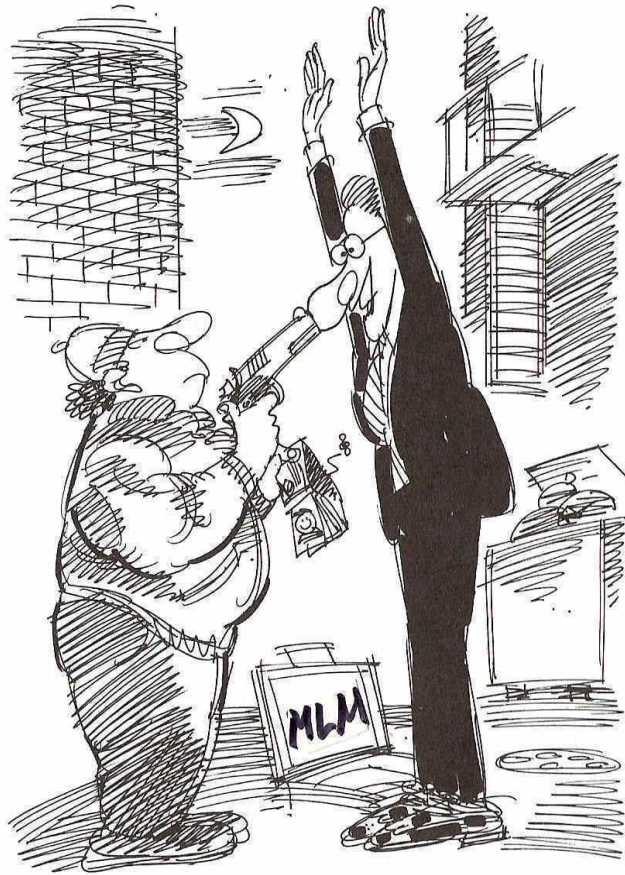
Taken together, the following distinguishing characteristics separate MLM from all other forms of business activity:

- (1) Endless chains of participants are recruited without limit into the bottom level of company-sponsored pyramids of participants.
- (2) Rank advancement up the levels in the pyramid is achieved by recruitment and/or purchases, not by appointment.

- (3) It should also be noted that compared to the incentives for recruiting a large and active downline, rewards for selling to non-participants is insignificant.
- (4) Minimum "pay-to-play" purchases, or quotas, are required to qualify for commissions and/or to attain or maintain ranks or levels in the pyramid.
- (5) The bulk of rewards are paid to those at the top levels of the pyramid, whose positions are usually established early in the formation of the pyramid. Also, most MLMs have five or more levels in their compensation plan, with additional levels exponentially increasing rewards to those at the top of the pyramid at the expense of those at the bottom levels.

This set of four distinct structural characteristics is not found in any other type of business – except pyramid schemes. In fact, the fundamental structure of MLMs (MLM programs) is virtually identical to that of cash-based (no-product) pyramid schemes, except that in lieu of cash exchanged directly between participants, products are purchased and commissions processed through an MLM company sponsor.

The above definition is further clarified by noting (1) the assumptions upon which MLM is based and (2) MLM's powerful effects on participants. These assumptions and effects are spelled out after the definition at the end of Chapter 2.



Cartoon by Cal Grondahl. From the book THE NETWORK MARKETING GAME. © 1997 by Jon M. Taylor.

"What if five robbers were robbing for you and they each recruited five more robbers to rob for you?"